Company Deep Dive

Alphabet

The company that was supposed to be disrupted by AI has become one of its biggest winners. Search is still growing, Google Cloud is growing 82 per cent and the antitrust cases ended without a break-up. The price is $200 billion of capital spending a year and the first negative cash flow quarter in two decades.

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Coverage summary. Eighteen months ago the consensus view was that generative AI would erode Google's search monopoly, that the US government would force it to sell Chrome or its advertising technology business, and that Alphabet was a cheap stock for good reasons. None of those fears has materialised. Search revenue grew 17 per cent in the second quarter, AI Mode in search has passed one billion monthly users, Google Cloud revenue rose 82 per cent with a backlog of $514 billion, and courts rejected structural break-ups in both antitrust cases. The market has noticed: Alphabet is now worth about $4.2 trillion. The new debate is about cost and quality. Capital spending is guided at $195 to $205 billion this year, more than operating cash flow, free cash flow turned negative last quarter, and reported profits are swollen by paper gains on stakes in SpaceX and Anthropic. This note separates the operating business from those effects and asks what the valuation assumes.

Share price / mkt cap	Q2 revenue	Google Cloud	2026 capex guide
$344 / $4.2tn	**$119.8bn**	**+82%**	**$195-205bn**
GOOGL, 2 October close	*+24% year on year*	*backlog $514bn*	*Q2 free cash flow -$5.9bn*

Exhibit A. Key figures, second quarter 2026

Metric	Figure	Note
Total revenue	$119.8bn	+24% y/y
Search & other	$63.3bn	+17% y/y
YouTube ads / subscriptions, platforms and devices	$11.1bn / $12.9bn	+13% / +15% y/y
Google Cloud revenue / operating margin	$24.8bn / 35.6%	+82% y/y; margin 20.7% a year earlier
Operating income / margin	$40.8bn / 34.0%	+30% y/y
Reported net income	$112.2bn	includes ~$98bn of other income, mainly equity gains
Capital expenditure / free cash flow	$44.9bn / -$5.9bn	first negative quarter in about two decades
Cash and securities / debt	$242bn / $121bn	net cash ~$122bn
Valuation	~25.6x forward P/E	reported trailing P/E ~17x is distorted by gains

Figures from company results, press reports and market data; underlying earnings and multiples are Andra Markets estimates and are approximate. Colour convention (charts only): green marks growth, red marks cash outflow or non-operating effects. All body and table text is set in black.

1.0 Executive Summary

Key takeaways

The AI threat to search has not materialised, at least not yet. Google integrated AI answers directly into search through AI Overviews and AI Mode rather than waiting to be displaced, and the results so far are better than almost anyone expected. Search revenue grew 17 per cent in the second quarter, faster than a year earlier, AI Mode has more

than one billion monthly users, and new AI-driven ad formats are lifting advertisers' conversion rates. Search remains the profit engine of the group, and it is growing.

Cloud is the new growth engine, and it is now very profitable. Google Cloud revenue grew 82 per cent to $24.8 billion in the quarter, operating income nearly tripled to $8.8 billion and the operating margin reached 35.6 per cent, up from 20.7 per cent a year earlier. The backlog of contracted revenue rose by more than $50 billion in three months to $514 billion. Alphabet's advantage here is vertical integration: it designs its own AI chips, the TPUs, builds its own models with Gemini and sells both, which lets it offer compute at lower cost than rivals that depend entirely on Nvidia.

The cost of winning is the cash flow, and the earnings need adjusting. Capital spending is guided at $195 to $205 billion this year, roughly double 2025, and management has said 2027 will be "significantly" higher. Free cash flow was negative in the second quarter. Reported net income of $112 billion included about $98 billion of other income, mainly unrealised gains on Alphabet's stakes in SpaceX, which listed in June, and in Anthropic. Excluding those, underlying earnings grew about 20 per cent. At around 26 times forward earnings and with negative free cash flow, the stock is priced for the AI investment to earn a good return; the operating evidence so far supports that, but the margin for error has narrowed.

2.0 Business Overview

Four engines and a portfolio

Alphabet is the holding company for Google and a set of smaller businesses known as Other Bets. Google itself has four main revenue streams. Search and related advertising, at $63.3 billion in the quarter, generates the majority of profit. YouTube advertising contributed $11.1 billion. Subscriptions, platforms and devices, which includes YouTube Premium and TV, Google One storage, the Play app store and Pixel phones, contributed $12.9 billion. Google Cloud, at $24.8 billion, sells computing infrastructure, AI models and workplace software to businesses. Other Bets include Waymo, the autonomous-driving company that now operates commercial robotaxi services in several US cities, and the life sciences unit Verily.

Alongside these, Alphabet has accumulated a valuable portfolio of investments in private companies, most importantly SpaceX, in which Google invested $900 million in 2015, and Anthropic, the AI lab whose models compete with Gemini but which is also a large customer of Google Cloud and its TPUs. These stakes are now worth well over $100 billion and are marked to market through the income statement, which matters for interpreting reported profits. The group is led by chief executive Sundar Pichai and chief financial officer Anat Ashkenazi, with founders Larry Page and Sergey Brin retaining voting control through super-voting shares.

3.0 Search in the AI Era

Disruption absorbed

The bear case on Alphabet in 2024 and 2025 was simple: if people asked chatbots instead of searching, the most profitable advertising business in history would shrink. The data so far point the other way. Google responded by building AI answers into search itself, first with AI Overviews at the top of results and then with AI Mode, a conversational search experience that has passed one billion monthly users. Rather than reducing queries, these features appear to have increased engagement, particularly for longer and more complex searches, and Google has found ways to place ads within them. Its AI Max campaign tools, used by more than half a million advertisers, report conversion rates about 15 per cent higher than traditional campaigns.

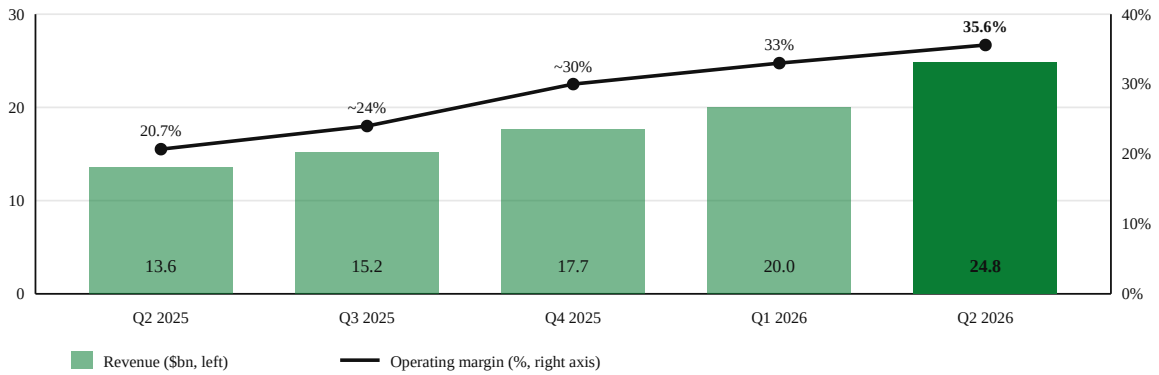
That does not mean the threat has disappeared. ChatGPT and other assistants have hundreds of millions of users, some commercial queries, such as product research and travel, are migrating to them, and the economics of AI answers, which are more expensive to generate than a list of links, put pressure on margins. But Google's distribution, through Android, Chrome and default search agreements, its data, and its ability to monetise intent have so far proved more durable than feared. Search revenue growth of 17 per cent in the second quarter, after 19 per cent in the first, is the strongest evidence that the core franchise is adapting rather than eroding.

4.0 Google Cloud and TPUs

From laggard to profit engine

Google Cloud was for years the distant third in cloud computing behind Amazon Web Services and Microsoft Azure, and it only became profitable in 2023. AI has transformed its position. Revenue has nearly doubled in a year, and profitability has risen even faster as scale has been reached: the operating margin has climbed from about 21 per cent a year ago to almost 36 per cent, comparable to the most profitable cloud businesses in the industry.

Exhibit 1. Google Cloud: quarterly revenue ($bn) and operating margin (%)



Source: Andra Markets; Alphabet quarterly results and press reports. Q3 and Q4 2025 margins are approximate. Green marks revenue growth.

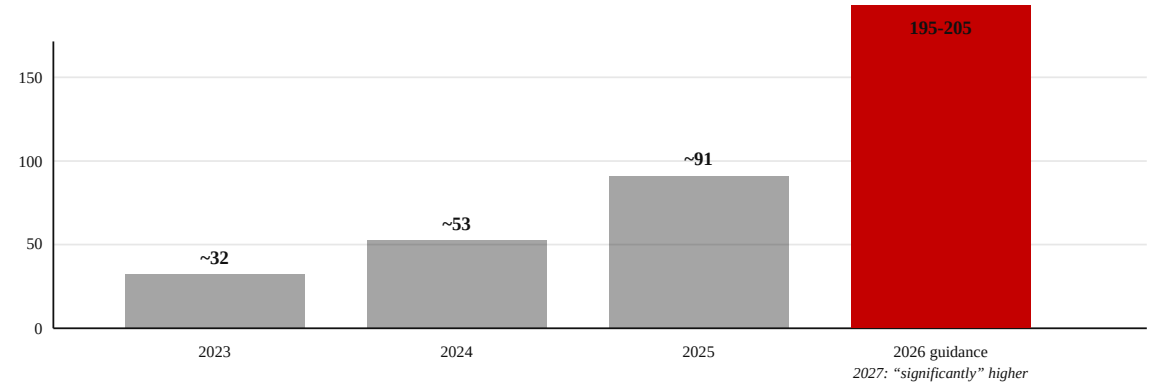
Three things drive the business. Demand for AI computing from companies and AI labs, including Anthropic, which has committed to use large volumes of Google's TPUs; Gemini, Google's family of AI models, sold to developers and enterprises; and the TPUs themselves, which Google has begun to sell as capacity to external customers and, through a venture backed by Blackstone launching in 2027, to lease more broadly. TPUs give Google a cost advantage over clouds that rely mainly on Nvidia GPUs, and make it the only large provider with a credible alternative chip at scale. The $514 billion backlog gives visibility for years. The constraint is capacity: management said it will temporarily rent third-party capacity, which will put some pressure on Cloud margins in the third quarter.

5.0 Capital Expenditure and Cash Flow

The price of the build-out

Alphabet's investment programme has grown at an extraordinary rate. Capital spending was about $32 billion in 2023, $53 billion in 2024 and around $91 billion in 2025. For 2026 the guidance has been raised twice, most recently to $195 to $205 billion, and management has said 2027 will be significantly higher still. In the second quarter alone it spent $44.9 billion, more than double a year earlier, of which about 60 per cent went on servers and the rest on data centers and networking.

Exhibit 2. Alphabet capital expenditure by year ($bn)



Source: Andra Markets; Alphabet annual results and guidance. The 2026 bar is truncated at the top of the scale. Red marks the step-change in spending.

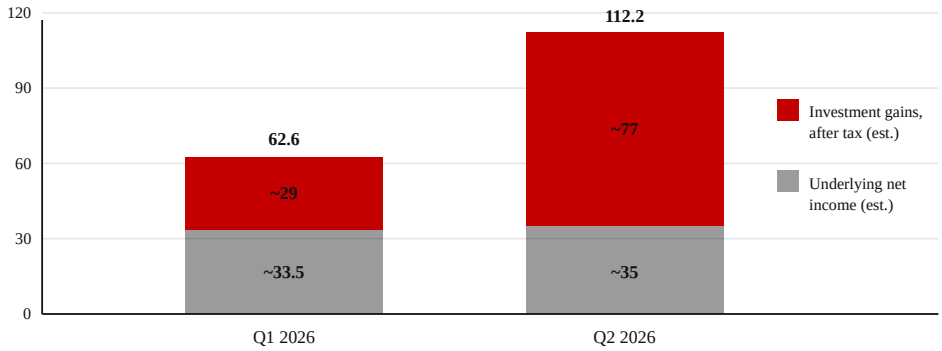
The effect on cash flow is now visible. Free cash flow was minus $5.9 billion in the second quarter, against plus $10.4 billion a year earlier, reportedly the first negative quarter in about two decades, and trailing twelve-month free cash flow has fallen to about $53 billion against operating cash flow of about $186 billion. Depreciation, which follows capital spending with a lag, will rise sharply over the next few years and weigh on operating margins. Alphabet can afford this: it holds about $242 billion of cash and securities and about $121 billion of debt, and it has started to issue bonds on a larger scale. But a business that historically returned most of its free cash flow through buybacks is now spending all of it, and more, on infrastructure.

6.0 Earnings Quality

Operating profit versus paper gains

Alphabet's reported profits in 2026 overstate the earnings of the business. Under US accounting rules, equity stakes in private companies are revalued when there is an observable price, such as a funding round or a listing, and the change goes through the income statement. In the first quarter, gains on equity securities added $36.9 billion before tax; in the second, other income reached about $98 billion, mainly from SpaceX's listing in June at a valuation of around $2 trillion and from a revaluation of Anthropic. Reported net income was $62.6 billion and $112.2 billion respectively, and reported earnings per share of $9.11 in the second quarter was nearly four times the year-earlier figure.

Exhibit 3. Reported net income: underlying operations versus investment gains ($bn, approximate)



Source: Andra Markets estimates based on reported net income, operating income and disclosed gains, assuming a 21% tax rate on gains. Illustrative. Red marks non-operating, mark-to-market gains.

Stripping out these gains, Andra Markets estimates underlying net income of around $35 billion in the second quarter, or roughly $2.85 per share, up about 20 per cent on the year. That is a strong result, consistent with operating income growth of 30 per cent, but it is a long way from the reported figure. The distinction matters for valuation: the trailing price-to-earnings ratio shown by most data providers, about 17 times, is flattered by gains that will not recur, while the forward multiple of about 26 times, based on analysts' operating forecasts, is the more meaningful measure. The stakes themselves are real value, worth well over $100 billion, but they behave like an investment fund attached to the company, and they can fall as quickly as they rose.

7.0 Regulatory Position

Two cases, no break-up

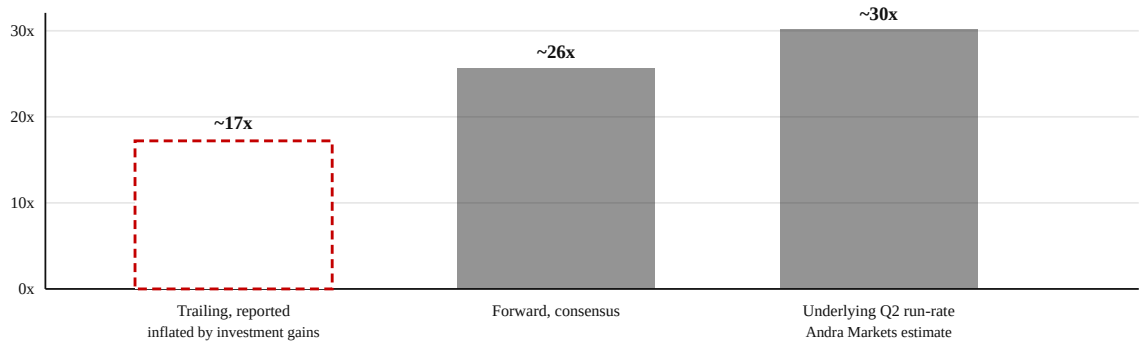
Alphabet has lost two major US antitrust cases but avoided the most severe remedies in both. In the search case, the court found in 2024 that Google had illegally maintained a monopoly in search, but the remedies decided in September 2025 rejected the government's request to force a sale of Chrome or Android, opting instead for restrictions on exclusive default-search contracts and requirements to share certain data with competitors. In the advertising technology case, Judge Leonie Brinkema ruled on 2 September 2026 against the Justice Department's request to force the sale of the AdX exchange and parts of Google's publisher tools, ordering behavioural remedies instead, with a court-appointed monitor reported to oversee compliance for six years. Both cases are subject to appeal, and Google still faces regulatory pressure in Europe under the Digital Markets Act. But the risk that most worried investors, a forced break-up of the core business, has receded substantially.

8.0 Valuation

No longer cheap, still not extreme

At $343.50 per Class A share, Alphabet is valued at about $4.2 trillion, with net cash of about $122 billion. Its multiple has risen sharply as the AI narrative has turned in its favour: a year ago it traded at a discount to the other large technology companies, and it now trades at about 26 times forward earnings. On our estimate of underlying earnings, annualising the second quarter gives a multiple of about 30 times, and the free cash flow yield is only about 1.3 per cent while the build-out continues. The average analyst price target, about $429, implies further upside, and the consensus rating is a strong buy, which indicates how much optimism is already embedded.

Exhibit 4. Alphabet price-to-earnings on different earnings measures (x)



Source: Andra Markets; market data as of 2 October 2026 and Andra Markets estimates. Red outline marks the distorted reported measure.

The valuation is reasonable if the investment earns a good return. If Cloud keeps growing at 50 per cent or more with margins above 30 per cent, if search continues to grow in the mid-teens and if capital spending eventually stabilises, earnings could rise fast enough to bring the multiple down quickly, and today's price would look modest in hindsight. The risk is the reverse: that spending keeps rising faster than revenue, that depreciation compresses margins from 2027 onwards, and that the AI cycle slows before the investment pays off. In that case, a multiple in the high twenties on earnings that are temporarily depressed by depreciation would offer little protection.

9.0 Risk Considerations

Where the case could break

The first risk is capital intensity. Alphabet is committing amounts that exceed its operating cash flow on the assumption that demand for AI computing will remain strong for years; if it does not, the company will be left with excess capacity, rising depreciation and lower returns on capital. The second is competition in search from AI assistants, which may erode the most valuable commercial queries more gradually than a single quarter's data can show, and in cloud from Microsoft, Amazon and specialised providers. The third is regulatory: appeals in both US antitrust cases, enforcement of the remedies, and continued scrutiny in Europe could still constrain the business, particularly default-search agreements with Apple and others that bring a large share of traffic.

There are also risks around earnings quality and concentration. Reported profits will remain volatile as long as the SpaceX and Anthropic stakes are revalued, and a fall in their value would show up as losses in the income statement. Anthropic is simultaneously an investee, a cloud customer and a competitor to Gemini, a relationship that creates both opportunity and potential conflict. Finally, the dual-class share structure gives the founders control, which has allowed long-term bets such as Waymo and TPUs but limits shareholders' influence over capital allocation.

10.0 Outlook and Monitoring Points

What to watch

Third-quarter results, due in late October, will be watched for four things: whether search growth holds in the mid-teens, whether Cloud sustains its growth rate and how much its margin dips as third-party capacity is rented, whether free cash flow stays negative, and any first indication of 2027 capital spending. Beyond the results, the trajectory of the Cloud backlog, external TPU sales and the Blackstone venture will show how far Alphabet can monetise its infrastructure

beyond its own needs. The appeals in the antitrust cases and the valuation of the SpaceX and Anthropic stakes will continue to move reported numbers. Alphabet has turned the biggest threat to its business into a source of growth; the next phase will test whether it can do so without permanently lowering the returns that made it one of the most profitable companies in the world.

Methodology and Source Notes

Method. This note is a fundamental review of Alphabet based on company results for the first and second quarters of 2026, earnings call coverage, court rulings as reported, and market data as of the 2 October 2026 close. Underlying net income is an Andra Markets estimate that removes reported investment gains using an assumed 21% tax rate and is approximate; Q3 and Q4 2025 Cloud margins are approximate. Historical capital expenditure figures are rounded. This note is analysis, not investment advice.

Principal sources. Alphabet Q1 and Q2 2026 results and earnings call coverage (Yahoo Finance, BigGo Finance, July 2026); ValueAdd VC, on capital expenditure and TPU strategy; The Motley Fool and Fortune, on investment gains (July to August 2026); Courthouse News, on the ad tech remedies ruling (September 2026); StockAnalysis, for valuation and market data.

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