

Ensemble Capital's Updated Investment Thesis on Alphabet

This article features MOI Global instructor Sean Stannard-Stockton, president and chief investment officer of Ensemble Capital Management, based in Burlingame, California. Visit Ensemble's [Intrinsic Investing](#) website for additional insights.

Ensemble Capital recently hosted a quarterly client conference call. You can read a full transcript [here](#). Below is an excerpt from the call discussing the firm's investment in Alphabet, Inc (GOOGL)

Excerpt (Sean Stannard-Stockton speaking):

The decline of Google's share price in the quarter was due to news that the department of justice is investigating whether to launch an investigation of the company on anti-trust grounds. It isn't just Google being targeted, the DOJ has said they are considering investigations of Google and Apple, while the Federal Trade Commission is considering investigations of Facebook and Amazon. It is important to note that no suits have been filed and no investigations have been launched. Instead the agencies are investigating whether to launch formal investigations.

On the surface, this certainly seems like bad news. However, we would note that the last similar antitrust investigation was of Microsoft and today they are the most valuable company in the world. That doesn't mean an anti-trust investigation is irrelevant, but it is important to note that even if the DOJ were to launch a formal investigation, and file charges and win in court, that still doesn't mean Google's stock price will perform poorly or that their business will suffer.

From our perspective as investors, our primary focus is on whether Google's profits are a function of illegal or anti-competitive behavior and if so, how any remedy to stop these behaviors would change future profits. So I'll say at the outset, that we believe unequivocally that the vast majority of Google's profits are a function of the company offering one of the single most important services ever invented. A service that brings information to the 7 billion internet connected devices around the world to people of every walk of life. As an American working in an office job, I simply cannot imagine navigating personal and works tasks without Google. And democratizing access to information across national boundaries has hugely positive social benefits. In fact, a hundred years ago the primary focus of philanthropists was to build libraries for just this reason. Viewed in this light, Google's opening up of the collective knowledge of humanity to anyone with an internet connected device at no cost to the user can easily be seen as one of the most important social benefits ever created by any nonprofit or for-profit organization.

That being said, might there be changes to some of Google's practices if they are subject to an in-depth investigation? Sure. But we do not think that these changes, should they happen, will strike at the core value that Google provides to the world and it is this value, not any particular business practice of their advertising offering, that is the root cause of the company's profit stream.

I will also say that at Ensemble Capital, we do agree that it is well past time for antitrust regulators globally to create a more modern approach to monopoly analysis. There is nothing inconsistent between being a supporter of free markets and a supporter of robust antitrust enforcement. Antitrust enforcement done right is designed to preserve free market competition and prevent companies from curtailing free market forces.

Two antitrust remedies that we think might be legitimate outcomes of these investigations is a more robust understanding of when the government can and should block acquisitions. Today, that analysis

is primarily a function of the market share, based on revenue, of the two companies in question. But when companies sell intangible assets with little to no incremental cost of production, it often makes sense for them to defer building revenue and instead focus on user acquisition. Viewed in this light, both Facebook's acquisition of Instagram and Google's acquisition of Waze (at the time, the only meaningful competitor to Google Maps) may well should have been blocked. It is plausible that these investigations will lead to the retroactive blocking of the acquisitions of Waze and Instagram. In the case of Google and Waze, we do not think this outcome would have a material impact on the value of Google. But in the case of Facebook, a company we do not own in our portfolio, we think a retroactive blocking of the Instagram merger would trigger an existential crisis at the company.

Clients, employees, and/or principals of Ensemble Capital own shares of Alphabet, Inc (GOOGL).