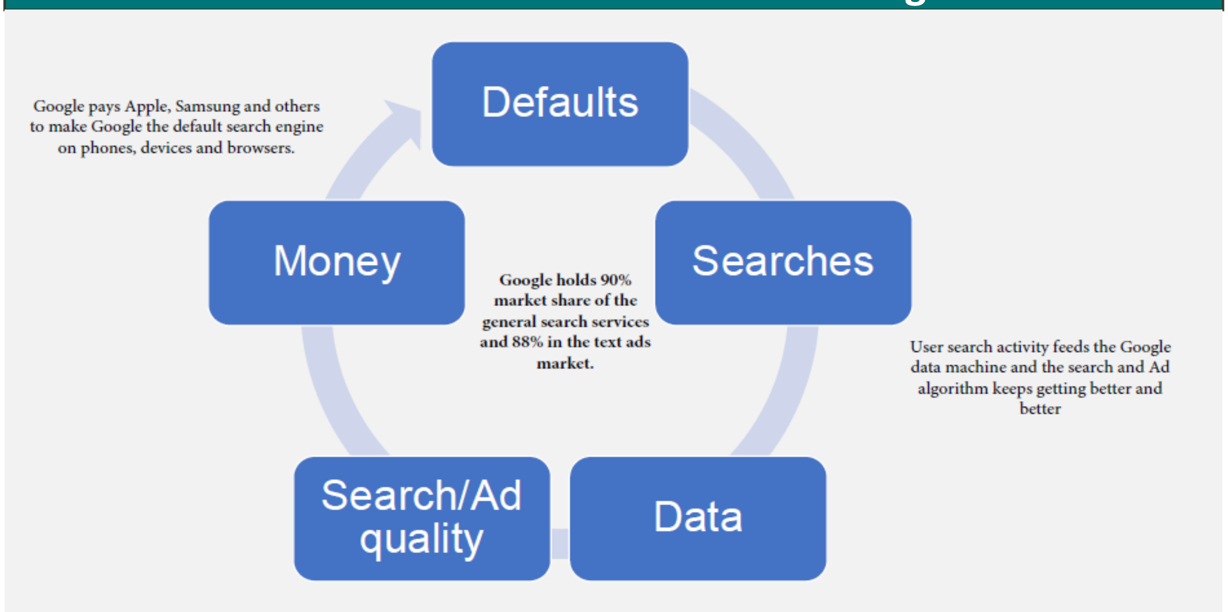
In August 2024, Judge Amit Mehta of the DC Federal Court ruled in favor of the Department of Justice (DOJ) and coalition of states led by Colorado that Google illegally monopolized the search market (general and text advertising) through exclusive deals with Apple and Samsung. This is a monumental ruling and the first of its kind since the Microsoft antitrust decision in 1998.

The current litigations involving Alphabet's misuse of monopoly power also underscore why NorthStar has continued to advocate for stronger governance at Alphabet by filing shareholder resolutions asking for equal voting rights since 2015. Improved corporate governance ensures effective independent oversight and management accountability.

Google's Virtuous Business Cycle – Chrome as a gateway and distribution channel for its search engine



Following its legal win, the DOJ has proposed a set of seven behavioral and structural remedies to address the identified harms and restore competition. These include severe restrictions on Google's ability to strike preferential agreements and exclusive partnerships at various points in the cycle above. The most punitive of recommendations involves the divestiture or unbundling of the Chrome browser—Google's gateway and distribution channel for its search engine.

Next Steps

Google is expected to respond to the DOJ's proposed remedies including alternative proposals in the coming months. Judge Mehta will review both the DOJ's proposed remedies and Google's responses and determine the most appropriate actions to address the antitrust violations. A final decision will be issued by August 2025. Both parties have the right to further appeal the decision at the Circuit Court and then to the Supreme Court. During this time, both parties can also reach a settlement. The overall duration of this process can be anywhere from a few months to a few years.

Implications for Alphabet shareholders

Historical Precedents

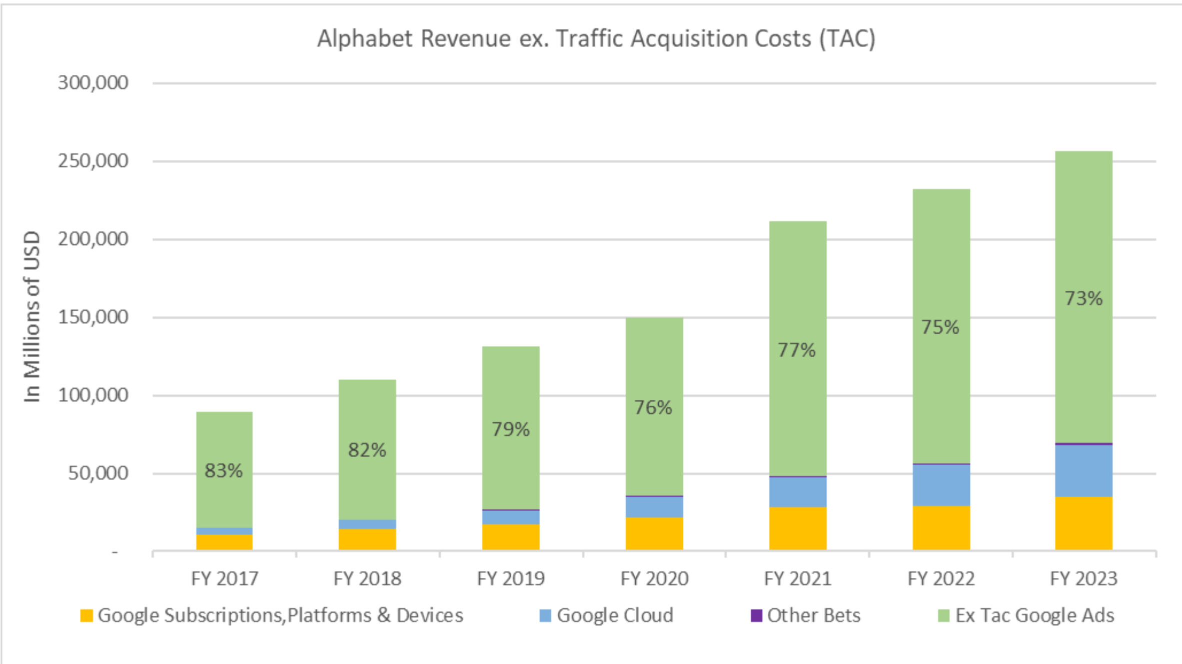
The finality of these recommendations is far from clear at this point with only two major historical precedents to rely on. In the *United States v. Microsoft Corp* case in 1998, the U.S. Court of Appeals vacated the District Court's remedial order to break up Microsoft. The Justic Department and Microsoft reached a settlement in 2001 with wide ranging behavioral remedies aimed at curbing Microsoft's anti-competitive practices. In 1974, the DOJ filed a major antitrust lawsuit against AT&T alleging that the company had used its monopoly power to stifle competition. After years of litigation, AT&T agreed to settle in 1982, requiring the break-up of "Ma Bell" into seven independent Regional Bell Operating Companies or "Baby Bells." After both instances, long-term shareholder returns outpaced the performance of the S&P 500 index, although it did take several years and in the case of Microsoft, also included dismal returns following the bursting of the technology bubble in 2000.

Evolution of Alphabet's Business Model

We believe that Alphabet is likely to suffer a decline in revenues and profits in its advertising and search business due to increased regulatory guardrails and competition. However, the company has been proactively reducing its dependence on advertising revenue. For example, the proportion of advertising revenue has declined from 83% in FY 2017 to 73% in FY2023 on an ex-TAC (Traffic Acquisition Costs or costs incurred for favorable agreements/default placements) basis. This shift is being driven by the growing traction Alphabet is seeing with its cloud offering, growing from 5% to 14% of sales within the same period. Alphabet is also concentrating on further monetizing YouTube as it has entered the Shorts and TV market. The company is also one of the early leaders in the nascent generative AI market with the development of its AI model, Gemini. Gemini is on par with all other comparable products on the market such as ChatGPT, Perplexity, and Claude. Cumulatively, these changes in Google's business model are happening within the backdrop of a rapidly evolving search and digital advertising market. Five years from now, search as we know it may look completely different as more consumers migrate to large language models and social media. Additionally, reliance on

Google's search engine is strongly habitual and effective hence market share loss may not be as dramatic.

Figure 2: Alphabet Revenue ex. Traffic Acquisition Costs (TAC)



Valuation

Given all the regulatory, competitive and technological disruption challenges, a standalone valuation for each of Alphabet's business segments is appropriate. The analysis indicates that the market is ascribing no value to the search engine and is assuming ~30% reduction in revenues and profits from the advertising business. Value is instead being shifted to the other offerings such as Google Cloud whose growth is being accelerated by the move to the cloud and increasing deployment of generative AI, depicted by the growing capex allocations to and demand for servers and data centers. Value is also growing in the subscription offerings, led by YouTube with YouTube Premium and YouTube TV. Other sources of recurring revenue growth can be attributed to Google One which has over 100 million subscribers paying for Google suite storage, Google Workspace which is an alternative to Microsoft 365, and Gemini, the generative AI offering. Although Gemini subscriptions make up a smaller portion of the segment, Alphabet can leverage and better monetize this offering in a post-Chrome divestiture world. The company has already begun to integrate Gemini into its major product verticals – YouTube, Advertising, Cloud, Workspace, Maps, Assistant, and of course, Search. Within Other Bets, Waymo, the autonomous vehicle project has been launching its rideshare service in more cities as it is now in L.A and will soon expand to Miami, Austin, and Atlanta.

Bottom line

The broad range of remedies recommended by the DOJ suggests Google's competitive advantage and grasp on the advertising and search ecosystem will most likely be eroded over the next years. The extent and the pace of this erosion is far from clear and may take years to fully actualize. However, the valuation reflects an almost 30% decline in advertising profits and no incremental value from the investments in Generative AI or various other businesses. Hence, the risk reward is positively skewed for long-term shareholders willing to stomach short term volatility for preserving long term option value. We have reduced the target weight of Alphabet to 3.5% and may reduce it further to 3% in 2025 but remain committed to the long-term investment and social/governance case in the stock.

Appendix

Subsidiary	**Business**
Admob	Mobile advertising subsidiary.
Calico	Focuses on health, aging, and well-being.
CapitalG	An independent growth equity investment fund.
Chronicle	A cybersecurity company.
DoubleClick	Digital marketing company.
DeepMind	An AI research and development company.
Fiber	Provides high-speed internet and television service.
Fitbit	Develops wearable technology devices.
Google	This encompasses the core businesses, including Search, Android, YouTube, Ads, Cloud, and Hardware.
GV	A venture capital investment arm.
Intrinsic	Develops software for industrial robots.
Isomorphic Labs	Uses AI for drug discovery.
Looker	A business intelligence and data analytics platform.
Mandiant	A cybersecurity company specializing in threat intelligence and incident response.
Mineral	Develops AI and robotics technologies for agriculture.
Nest Labs	Develops smart home products.
Verily	A life sciences research organization.
Waymo	Develops autonomous driving technology.
Wing	Develops drone delivery technology.
X Development	(Also known as "the Moonshot Factory") A research and development facility that explores new technologies.