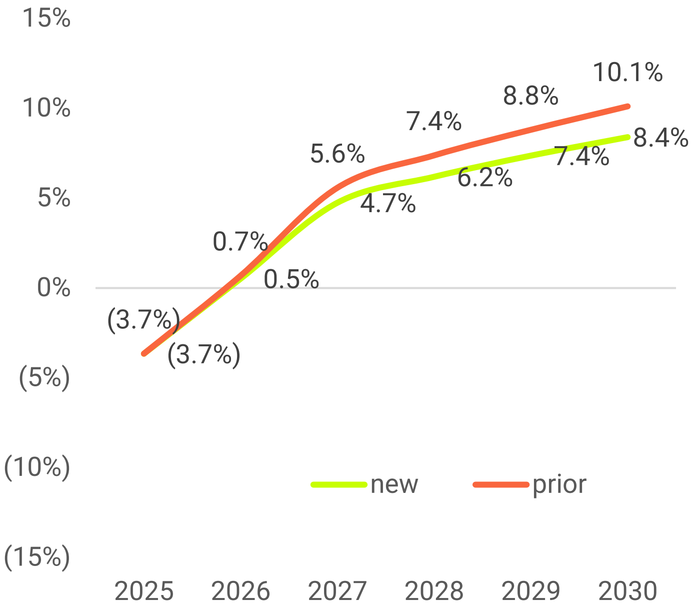
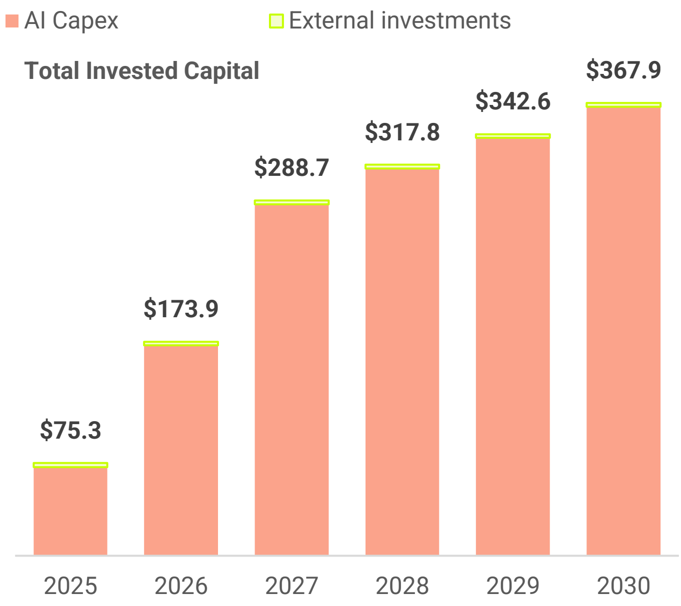
AI ROIC: Lower owing to higher AI capex, partially offset by higher Cloud AI OI & lower GDM expenses

- After our latest AI Capex, Cloud AI revenue and earnings updates, we continue to see GOOGL posting the highest AI ROIC in 2030.
- We believe recent changes at Google DeepMind (GDM) suggest GOOGL is easing away from edge-of-the-frontier development, opening more infrastructure capacity for AI Search inference and other consumer product expansion (including ads and growing Google One subs) and especially Google Cloud Platform, where TPU sales also drive more immediate returns and share gains for the #3 player. **These changes are net positive for near-term ROIC in our view**.
- **With that said, GOOGL's AI ROIC still declines slightly** since our last published update as the increase in AI capex (+$174B in 2030 vs prior) was only partially offset by higher Cloud AI operating income (+$28B in 2030 vs prior) and lower GDM expenses ($7B less in 2030).

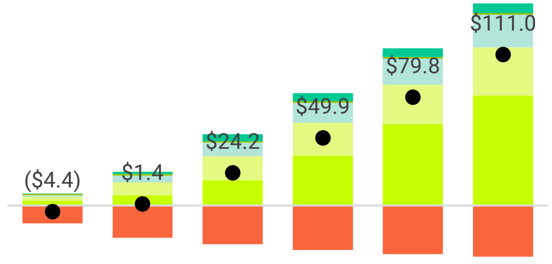
AI ROIC: New vs Prior



AI Invested Capital ($ in B)



AI Operating Income by Type ($ in B)



	2025	2026	2027	2028	2029	2030
SWE AI Coding savings	$0.2	$1.9	$5.2	$5.8	$6.4	$7.0
Google AI Pro & AI Ultra	$0.9	$1.0	$1.1	$1.1	$1.2	$1.2
Gen AI Ad Creative tools	$1.3	$5.1	$9.8	$14.6	$19.0	$24.2
AI Overview/AI Mode	$2.7	$9.3	$18.0	$24.4	$29.1	$35.2
GCP AI	$3.7	$7.7	$18.5	$36.6	$60.0	$81.0
Google DeepMind	($13.1)	($23.6)	($28.3)	($32.6)	($35.8)	($37.6)
AI operatng income	($4.4)	$1.4	$24.2	$49.9	$79.8	$111.0

Source: New Street Research analysis, company reports

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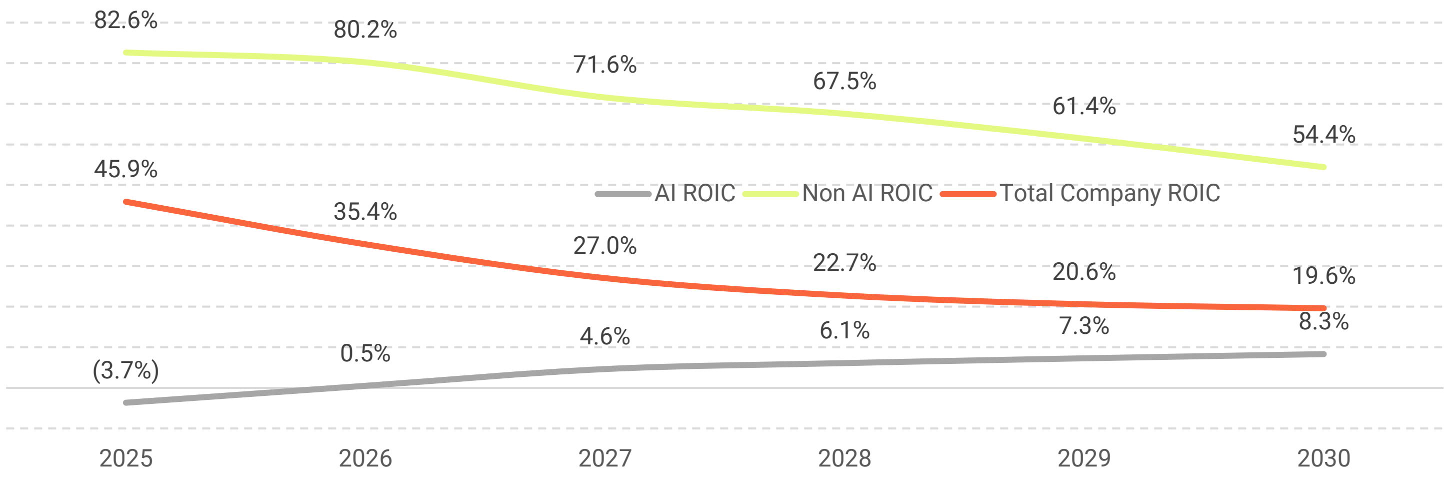
Total Company ROIC: Continues to fall for GOOGL into 2030 but at a slowing rate

- **Our AI ROIC is structurally low**. We have included the biggest initiatives and potential returns, but there are many we haven't explored yet including YouTube's creator tools or AI assistance built into Android, Chrome, the Play Store and other platforms.
- **AI & non-AI are increasingly blurring** relative to our definition of "AI ROIC" which captures investment/returns based on **AI accelerators** (i.e., GPUs & custom ASICs). This is most obvious in the growing use of CPU infrastructure for AI inference. **At a high-level, these distinctions will recede over time *all products/services become AI-enabled or are AI native from the start***.
  - For GOOGL, this blurring in AI Search (e.g., AI Overviews) and Cloud (e.g., AI workloads on Axion CPUs) is acute and contributing to a falling non-AI ROIC in our analysis.
- **All of this is moot however at the total company level**, where GOOGL's ROIC is still falling into 2030, albeit at a slowing rate.
  - **We think ROIC upside (either AI or non-AI) is increasingly most likely in GCP**, where we think the upward estimate revision cycle is sustainable.

AI vs Non-AI vs Total Company ROIC: 2025-2030



Source: New Street Research analysis, company reports

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Quarterly Estimate Changes

$ in M except EPS	3Q26E Prior	New	% ▲	Cons.	vs Cons.	4Q26E Prior	New	% ▲	Cons.	vs Cons.
Adj. EBITDA	**$56,945**	**$57,435**	**0.9%**	**$59,598**	**(3.6%)**	**$64,978**	**$65,900**	**1.4%**	**$66,208**	**(0.5%)**
% margin	*44.4%*	*44.9%*	*43 bps*	*46.9%*	*(206) bps*	*46.0%*	*46.7%*	*70 bps*	*46.9%*	*(15) bps*
EPS	**$2.74**	**$2.73**	**(0.5%)**	**$2.96**	**(8.0%)**	**$3.12**	**$3.11**	**(0.3%)**	**$3.31**	**(6.1%)**
D&A	$7,388	$7,870	6.5%	$8,821		$8,508	$9,420	10.7%		
Cash flow from Operations	$39,061	$39,339	0.7%	$51,619	(23.8%)	$57,784	$58,581	1.4%	$58,807	(0.4%)
CapEx	$56,080	$56,080	0.0%	$56,002	0.1%	$68,151	$68,151	0.0%	$65,261	4.4%
FCF	**($17,019)**	**($16,741)**	**(1.6%)**	**($4,109)**	**307.4%**	**($10,367)**	**($9,570)**	**(7.7%)**	**($5,787)**	**65.4%**
% margin	*(13.3%)*	*(13.1%)*	*20 bps*	*(3.2%)*	*(984) bps*	*(7.3%)*	*(6.8%)*	*56 bps*	*(4.1%)*	*(269) bps*

- Total expenses are unchanged, but our mix of D&A is higher (and cash costs are lower) owing to higher capex flowing through.
- As such, adj. EBITDA is 1-9% higher from 2026-2030, while FCF is 5-8% higher in 2026-2027, and raised in 2028-2030 as well.
- EPS increases slightly on higher cash balance interest income.

Annual Estimate Changes: 2025-2027

$ in M except EPS	2026E Prior	New	% ▲	Cons.	vs Cons.	New Guide	2027E Prior	New	% ▲	Cons.	vs Cons.	New Guide
Adj. EBITDA	**$230,683**	**$232,095**	**0.6%**	**$235,123**	**(1.3%)**		**$302,137**	**$307,059**	**1.6%**	**$305,425**	**0.5%**	
% margin	*46.2%*	*46.5%*	*+31 bps*	*47.2%*	*(69) bps*		*50.1%*	*51.0%*	*+86 bps*	*50.0%*	*+104 bps*	
EPS	**$20.07**	**$20.05**	**(0.1%)**	**$20.51**	**(2.2%)**		**$13.92**	**$13.96**	**0.3%**	**$14.97**	**(6.7%)**	
D&A	$29,482	$30,876	4.7%	$31,832			$50,412	$55,338	9.8%	$52,005		
Cash flow from Operations	$181,704	$182,779	0.6%	$207,182	(11.8%)		$272,893	$278,311	2.0%	$273,163	1.9%	
CapEx	$204,829	$204,829	0.0%	$201,931	1.4%	$195-$205	$338,225	$338,225	0.0%	$302,686	11.7%	"sig. increase"
FCF	**($23,125)**	**($22,050)**	**4.6%**	**$8,095**	**(372.4%)**		**($65,332)**	**($59,914)**	**8.3%**	**($28,023)**	**113.8%**	
% margin	*(4.6%)*	*(4.4%)*	*+21 bps*	*1.6%*	*(605) bps*		*(10.8%)*	*(9.9%)*	*+89 bps*	*(4.6%)*	*(537) bps*	

- **Price target remains $405**: higher 2027–2030 estimates are offset by lower growth in our DCF in 2031+.

Annual Estimate Changes: 2028-2030

$ in M except EPS	2028E Prior	New	% ▲	Cons.	vs Cons.	2029E Prior	New	% ▲	Cons.	vs Cons.	2030E Prior	New	% ▲	Cons.	vs Cons.
Adj. EBITDA	**$382,645**	**$397,503**	**3.9%**	**$387,506**	**2.6%**	**$462,571**	**$491,801**	**6.3%**	**$472,138**	**4.2%**	**$546,046**	**$593,574**	**8.7%**	**$558,793**	**6.2%**
% margin	*54.6%*	*56.7%*	*+216 bps*	*53.3%*	*+345 bps*	*57.8%*	*61.4%*	*+369 bps*	*55.8%*	*+568 bps*	*60.2%*	*65.5%*	*+528 bps*	*57.9%*	*+762 bps*
EPS	**$16.47**	**$16.61**	**0.8%**	**$17.85**	**(7.0%)**	**$19.12**	**$19.38**	**1.3%**	**$20.98**	**(7.6%)**	**$22.04**	**$22.44**	**1.8%**	**$24.42**	**(8.1%)**
D&A	$81,380	$96,263	18.3%	$77,540		$110,719	$139,994	26.4%	$108,835		$139,978	$187,572	34.0%	$138,143	
Cash flow from Operations	$341,401	$357,985	4.9%	$343,029	4.4%	$412,393	$444,868	7.9%	$424,159	4.9%	$486,284	$538,879	10.8%	$503,275	7.1%
CapEx	$376,028	$376,028	0.0%	$340,293	10.5%	$406,665	$409,871	0.8%	$348,890	17.5%	$431,262	$442,661	2.6%	$358,572	23.5%
FCF	**($34,628)**	**($18,043)**	**47.9%**	**$1,644**	**(1,197.5%)**	**$5,728**	**$34,997**	**511.0%**	**$69,158**	**(49.4%)**	**$55,022**	**$96,218**	**74.9%**	**$137,190**	**(29.9%)**
% margin	*(4.9%)*	*(2.6%)*	*+236 bps*	*0.2%*	*(280) bps*	*0.7%*	*4.4%*	*+366 bps*	*8.2%*	*(380) bps*	*6.1%*	*10.6%*	*+455 bps*	*14.2%*	*(359) bps*

Source: FactSet, company reports, New Street Research analysis

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