Google’s Cash Road to Nowhere

Let me be the millionth investor to express frustration at Alphabet Inc’s approach to capital allocation. When the Google parent reported earnings recently, its cash balance totalled a whopping US$102bn. What in the world does the company need with all that cash? There are fewer than 100 companies in the world with a market cap greater than US$100bn, yet Alphabet has as much stuffed in a mattress somewhere.

This was all supposed to end with the recent change in US tax law involving the taxation of foreign profits. For many years, US-based multinationals avoided taxes on overseas earnings by keeping those cash balances offshore. Many companies including Alphabet took advantage of this quirk in the tax code.

Everyone understood the dynamic, but nobody liked it. Investors acquiesced fearing the tax burden that could be triggered if funds were repatriated, and the US government bemoaned the tax revenue leakage.

The new tax system has been designed, in part, to correct this inefficiency. It will force everyone to pay taxes on accumulated foreign earnings, thus removing any incentive for keeping them offshore. In fact, US companies are required to bring those funds back to the US. Though in opting for leniency, the US government has given companies an eight-year grace period.

Bringing home the bacon

So while I had grown used to Google’s mounting cash pile, I was optimistic things might improve, even if only marginally. Given the aforementioned changes, I hoped management would adopt a shareholder-friendly capital policy. By retrieving the cash held offshore, it could institute a larger buyback program. It could even choose to pay a special one-time dividend. At the very least, I expected management to address the issue on its recent earnings call. But at the moment of truth, they opted for no comment.

Currently, Alphabet’s cash comprises 14% of its market capitalisation, a significant amount. The company’s search business is one of the strongest businesses in the world. Each quarter, its cash flow comfortably exceeds its spending needs. Google simply doesn’t need the cash.

Contrast Alphabet’s capital inaction with that of rival Apple. Apple too has cash stockpiled overseas, but over the last several years it has aggressively engaged in a shareholder friendly campaign of buybacks and dividends funded with debt. During its most recent earnings call, it highlighted a number of spending initiatives it was pursuing in the US, presumably because it was now free to bring home its cash.

So why has Apple seen the light and not Google? Activist heavyweights including Carl Icahn and David Einhorn agitated for Apple’s approach. Sadly for Alphabet shareholders like us, management’s voting control over the company effectively eliminates that possibility. Count this quarter a dud.