Dear Sundar,

TCI has been a significant shareholder of Alphabet since 2017. We currently own shares valued at more than $6 billion, reflecting our strong conviction in Alphabet’s future.

We are writing to express our view that the cost base of Alphabet is too high and that management needs to take aggressive action. The company has too many employees and the cost per employee is too high. Management should publicly disclose an EBIT margin target, substantially reduce losses in Other Bets and increase share buybacks.

Google’s Search business has high operating leverage and is not labour intensive. Despite strong revenue growth, operating leverage has been minimal over the last five years. In Q3 2022, total expenses grew 18% year-over-year while revenues grew only 6%. The EBIT margin of the Google Services segment contracted from 39% in 2021 to 32% in Q3 as a result.

During a period of high growth between 2017 and 2021, revenues increased at an annual rate of 23%, cost discipline was not a priority. However, cost discipline is now required as revenue growth is slowing. Cost growth above revenue growth is a sign of poor financial discipline.

**Headcount is too high**

Our conversations with former executives of Alphabet suggest that the business could be operated more effectively with significantly fewer employees. We agree with Altimeter Capital’s Brad Gerstner, who wrote: “It is a poorly kept secret in Silicon Valley that companies ranging from Google to Meta to Twitter to Uber could achieve similar levels of revenue with far fewer people.”
You have publicly stated that Google should be 20% more efficient. We could not agree more. Nearly all technology companies are reducing costs. Meta reduced headcount by 13% last week. Amazon is reducing headcount by 10,000. Microsoft, Salesforce, Stripe and Twitter are also reducing headcount.

Alphabet’s headcount has increased at an annual rate of 20% since 2017. It has more than doubled since 2017. This growth is excessive, both in relation to historic headcount growth and what the business requires.

![Number of Full-Time Employees](image)

**Compensation per employee is too high**

Alphabet pays some of the highest salaries in Silicon Valley. As detailed in Alphabet’s Schedule 14A filing, median compensation totaled $295,884 in 2021. An analysis by S&P Global illustrates that median compensation at Alphabet was 67% higher than at Microsoft and 153% higher than the 20 largest listed technology companies in the US. There is no justification for this enormous disparity.

We acknowledge that Alphabet employs some of the most talented and brightest computer scientists and engineers, but these represent only a fraction of the employee base. Many employees are performing general sales, marketing and administrative jobs, who should be compensated in-line with other technology companies.
Median compensation at largest US technology companies

Top-20 Median  Microsoft  Alphabet

$117,055  $176,858  +67%  $295,884

Source: S&P Global Market Intelligence. Analysis includes largest 20 information technology or internet companies by market capitalisation as of Dec. 31, 2021. Excludes companies that do not disclose CEO pay ratio.

Establish an EBIT margin target

As part of basic financial management, Alphabet should establish and publicly disclose an EBIT margin target for the Google Services segment. We believe an EBIT margin target of at least 40% is reasonable. Almost two-thirds of revenues come from Search, a very strong business with high underlying margins. The Google Services EBIT margin was 39% in 2021 and therefore 40% should be easily achievable through operating leverage and cost cutting. Management compensation should be linked to this target to ensure accountability.
Reduce losses in Other Bets

Over the last five years, Other Bets has generated only $3 billion of cumulative revenues but incurred a massive $20 billion of cumulative operating losses. Alphabet’s investments in Other Bets have been unsuccessful. Alphabet should reduce annual operating losses in Other Bets (which we expect to amount to $6 billion this year) by at least 50%.

The biggest component of Other Bets is Waymo. Unfortunately, enthusiasm for self-driving cars has collapsed and competitors have exited the market. Ford and Volkswagen recently decided to shut down their self-driving car venture, saying: "We have looked at this every way you can and we just see the profitability a long way out." Waymo has not justified its excessive investment and its losses should be reduced dramatically.

Share buybacks should be increased

We welcome Alphabet’s increased share repurchases, which are now at a run-rate of $60 billion per year. Nevertheless, Alphabet still has over $116 billion of cash on the balance sheet. Alphabet’s large cash balance is serving neither shareholders nor the company.

Alphabet’s ability to pursue large scale M&A is very limited due to regulatory scrutiny. Alphabet should follow Apple’s capital allocation strategy and become “cash neutral” over time through increased share repurchases.

Alphabet’s share price is down 34% year-to-date and the stock is trading on only 16x 2023 EPS. This is based on our estimates adjusted for losses in Cloud, Other Bets and net cash. The stock is very cheap. Alphabet should take advantage of the current low valuation and significantly accelerate share repurchases.

The stock price matters to your employees, who receive significant stock-based compensation and want the stock to perform for morale and income reasons.

Summary

In a new era of slower revenue growth, aggressive cost management is essential. We look forward to your announcement of a clear action plan as a matter of urgency.

Yours sincerely,

Christopher Hohn
Managing Director