Thoughts Heading into 3Q Earnings Season; Good News On the Horizon?

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Expect Amazon, Microsoft, and Alphabet to Lead the Way This Week on Tech Earnings

Overall we are expecting a strong 3Q tech earnings season over the next few weeks based on our recent field checks across both enterprise and consumer technology names. Looking at this week’s upcoming major tech earnings, while names such as Twitter continue to face headwinds around advertising growth and longer-term MAU trends, we believe tech stalwarts such as Amazon, Microsoft, and Alphabet should lead the way with better than expected results across the board. On the enterprise front, we continue to believe the shift to cloud is a major secular trend that is significantly benefiting both Microsoft (Azure, Office 365) and Amazon (AWS) disproportionally in the field as a major tailwind in 3Q and should continue its momentum heading into year-end/2018 in our opinion. Our survey work at GBH around cloud spending indicate an acceleration of spending among enterprises into 2018 around public and hybrid cloud, which should create a healthy environment for pure play cloud vendors as well as other larger tech players (e.g. Oracle) over the next 12 to 18 months.

- **Alphabet looking to prove naysayers wrong in 3Q.** On the consumer tech names, we believe Alphabet/Google in particular saw strong mobile search growth trends this quarter based on our analysis, led by healthy ad click and impressions activity combined with pronounced YouTube strength. While sentiment has been mixed on Google over the past few months, we view 3Q results/guidance as a positive catalyst to move shares higher given healthy search trends/ad growth we are forecasting heading into year-end.

- **Amazon—all eyes on Whole Foods impact.** Overall, while many tech investors later this week (Thursday, Oct. 26) will be laser focused on better understanding the near-term margin story at Amazon now with Whole Foods in its back pocket, (acquisition closed late August), we continue to believe that the Amazon story is still in the middle innings of a major consumer_enterprise transformation that should translate into significant earnings power over the coming years and lead to further multiple expansion.
Amazon (AMZN, Highly Attractive, $1,185 Valuation Target)

- **Summary thoughts heading into earnings:** We expect strength from Amazon across the board this quarter as our analysis indicates a better than performance on the North America retail channel as well on the AWS front, which should translate into a top-line upside in our opinion. While near-term there is a major focus on significant investments around fulfillment, Prime, Echo/Alexa, AWS, and integrating the Whole Foods acquisition into the fold which could depress margins over the next few quarters, we believe this is “near term pain for long-term gain” as Amazon has a unique window of opportunity to double down on its consumer and enterprise initiatives heading into 2018 and drive significant growth/cash flow for the coming years as Bezos & Co. further diversifies the Amazon franchise globally. More details around the Whole Foods acquisition, AWS strength, and margin guidance will be focus areas for investors heading into earnings and could be a swing factor on the stock in the near-term. In a nutshell, Amazon remains one of our favorite secular tech growth stories into FY18 as our GBH Consumer surveys/analysis support the Amazon consumer growth thesis, coupled by cloud strength on the AWS segment which is still in the early innings of playing out among enterprises globally.

Microsoft (MSFT, Highly Attractive, $92 Valuation Target)

- **Summary thoughts heading into earnings:** Microsoft continues to be in the midst of shifting its business from traditional, slow growing PCs into a leader in the fast-growing cloud market on the shoulders of its core Azure platform, which our checks indicate will yet again show strength this quarter
(FY1Q18-Sept.) and result in better than expected top-line growth and margin upside. Nadella’s focus and strategic vision has put Microsoft in the “catbird seat” on the move to public/hybrid cloud which should be a growth tailwind for FY18/FY19. We believe a better than feared PC environment, healthy Office 365 migrations (better annuity visibility), and improving OPEX performance will be music to the ears of investors digesting September quarter results/guidance and should put lingering margin concerns to rest. Microsoft continues to be one of GBH’s top tech picks given its Azure cloud momentum, Office 365 transition on consumer/enterprise, and newer integrated product initiatives around consumers (LinkedIn), that are still in the early days of playing out within Redmond’s ubiquitous installed base of consumers and enterprises worldwide.

Alphabet (GOOG, Attractive, $1,060 Valuation Target)

- **Summary thoughts heading into earnings:** Our mobile search analysis/tracker this quarter continue to show strength from Google around its “bread and butter” search business, which should be a catalyst for at least in line to modestly better than expected earnings in 3Q. We are also seeing accelerating ad momentum from search and YouTube again this quarter and heading into year-end. TAC trends will be a focus this quarter, as mobile advertising impression success remains a key going forward for Google in this very competitive land grab market opportunity. Overall, while shares have been range-bound over the past few months (since 2Q earnings), we believe solid 3Q earnings and guidance could be a positive catalyst for shares into year-end and holiday season.
Twitter (TWTR, In Line, $19 Valuation Target)

- **Summary thoughts heading into earnings:** With Twitter still facing major headwinds around MAU metrics, declining revenue, and ad pricing erosion there is clear uncertainty around the story in the near-term. While there are a number of organic initiatives to potentially grow its mobile advertising trajectory the jury is still out on the timing/success of the potential Twitter turnaround story. Given the secular growth in the industry vs. Twitter’s advertising decline, there are clear concerns around the company with the Street looking for any signs of a turnaround this quarter. That said, we believe improvement on the MAU and ad front are still a few quarters further out and speaks to our “wait and see” thesis on the name.