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Headlines versus reality

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Alphabet's latest quarterly results this week provide a timely reminder of why investors should look beyond the headline earnings figures when assessing a company's true performance.

At first glance, the numbers appeared exceptional. Revenue reached $119.8 billion, while reported net income rose to more than $112 billion, producing earnings per share (EPS) of $9.11. On the surface, these figures suggest an extraordinarily profitable quarter.

However, a closer examination reveals that a substantial portion of these earnings did not originate from Alphabet's core businesses- namely Google Search, YouTube, Google Cloud or its advertising operations. Instead, approximately $98–99 billion of reported profit came from gains on Alphabet's portfolio of minority equity investments in private companies. These gains largely reflect increases in the estimated value of holdings in businesses such as SpaceX, Anthropic and Databricks, rather than cash generated through day-to-day operations.

Under current U.S. accounting standards, companies are required to recognise changes in the fair value of certain equity investments within their income statement, even if those investments have not been sold. As a result, reported earnings can fluctuate significantly due to changes in the valuation of investment holdings, despite there being little or no impact on the underlying operating business or cash flow.

This distinction is important because it highlights the difference between reported (GAAP) earnings and underlying operating performance. When analysts adjusted for these investment gains, Alphabet's underlying earnings per share were estimated to be closer to $2.85, compared with the reported $9.11. While the company's operating performance remained healthy, the difference demonstrates just how much the headline figure was influenced by accounting gains rather than recurring business activity.

For this reason, professional investors rarely rely solely on headline earnings. Instead, they focus on measures that provide a clearer picture of the health of the business, including revenue growth, operating income, cash generation, margins and the performance of key divisions such as Google Cloud. These metrics are generally considered more reliable indicators of a company's long-term earnings power than one-off gains arising from investment revaluations. Tracking cashflow reduces the risk of misunderstanding a company's operating performance.

Alphabet's results also illustrate a broader trend among large technology companies, many of which now hold sizeable stakes in rapidly growing private businesses. As valuations of these investments rise or fall, reported earnings may become increasingly volatile, even though the performance of the core operating business remains relatively stable.

Alphabet's latest results serve as a timely reminder that headline numbers do not always tell the full story. While the reported earnings were impressive, much of the increase reflected accounting gains on investment holdings rather than improvements in the company's underlying operations. For long-term investors such as us, understanding the quality and sustainability of earnings is far more important than reacting to headline figures alone.

As this example demonstrates, headlines can be highly misleading when analysing companies, reinforcing the importance of looking beneath the surface before drawing investment conclusions.