Scaling the heights

Google's insight into the behavior of Web surfers has led to dominance and a stock near $500.

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November 17, 2006

SAN FRANCISCO — Wall Street thinks who the media juggernaut of the new century will be: Shares of Google Inc. are flirting with the symbolic $500 mark as the search giant solidifies its role as the preeminent broker of information and advertising.

Three days after completing its $1.65-billion acquisition of the video-sharing service YouTube, Google's stock closed Thursday at a record of $495.90. On Wednesday, shares reached $499.85 before settling back to close at $491.93. The stock is up almost 20% year to date.

The highs come as many other media and technology stocks languish — done in, in large part, by the ruthless efficiency of the computer code that runs Google's signature search engine. Google's main competitor in the Internet industry, Yahoo Inc., has lost 32% of its market value this year.

"The last time a single company that makes most of its money with advertising so dominated a market was back when there were three TV networks," said analyst David Hallerman of research firm EMarketer Inc.

Many investors question whether the sixfold rise in Google's stock since it went public in August 2004 can be sustained. Some say Google may be one or two bad quarters away from the sort of spectacular fall common during the dot-com crash of 2000.

But just as many, if not more, expect the Mountain View, Calif.-based company to continue to gain power — and market value — in the next few years. It's already worth more than Time Warner Inc. and Walt Disney Co. combined, and it's more than four times as valuable as Yahoo.

That's because the amount of traffic flowing through its Web services gives Google unparalleled insight into its market. Half of all search queries in the U.S. in September used Google, more than twice the volume of second-place Yahoo, according to research firm Nielsen/Net-Ratings.

Google uses that data as a weapon. Competitors such as Microsoft Corp. say Google has an advantage because it knows so much about the behavior of Web surfers and has relationships with so many advertisers, large and small.

"Google has between 600,000 and 1 million advertisers in its network worldwide — a staggering amount," said RBC Capital Markets analyst Jordan Rohan. "Every time it works with a different partner, Google is able to tap into additional inventory. Its strength begets more deals, which begets more advertisers, which begets more deals."

About 25% of the $15.9 billion that is expected to be spent on online advertising this year will land in Google's coffers, according to projections by EMarketer. Yahoo, once the far-and-away leader in Internet advertising, is second with 18%.

Indeed, the prime casualty of Google's momentum has been Sunnyvale, Calif.-based Yahoo.

Chief Executive Terry Semel, former co-chairman of Warner Bros., helped Yahoo recover from the dot-com bust and turned it into the leading home for online display ads. But investors are skeptical about whether he and his management team can keep pace with Google. Yahoo's stock fell 51 cents to $26.64 on Thursday.

Yahoo stumbled badly in July, when it delayed the launch of Project Panama, the revamped advertising platform billed as the answer to Google's superiority in delivering...
targeted ads.

"Investors recently have grown less patient with Yahoo's performance and have begun to blame management," Rohan said.

As chief executive of the search engine Ask.com, Steve Berkowitz found his company on the wrong side of the inevitable comparison to Google. Now senior vice president of Microsoft's online services group, Berkowitz said Yahoo was facing the same challenge—if Google didn’t exist, Yahoo's stock price would be much higher.

Yahoo isn't standing still. It launched Panama on Oct. 17 and began switching advertisers to the new platform. That same day, the company acquired AdInterax, which makes "rich media" or video advertising technology, for an undisclosed amount, and acquired 20% of Right Media Inc., an online ad exchange.

Google's ubiquity has sparked worry that the company wields too much power. At tech conferences, Chief Executive Eric Schmidt regularly fields questions about whether Google is a monopoly. And several online businesses have filed antitrust claims against Google after the company removed their websites from its search index.

But none of the lawsuits have succeeded, leading instead to rulings that Google has the free-speech right to include or exclude anyone it chooses. For his part, Schmidt counters antitrust questions by noting that consumers can visit competing Web services with a single click. But many stick with Google because it serves their needs and doesn’t lock them in.

"You've got to go to your end users and you've got to say, 'We are a choice, we're not your only choice,'" Schmidt said in a recent interview. "You have to say it, you have to believe it, and you have to behave that way."

Google's path to dominance followed a Silicon Valley tradition. Founders Sergey Brin and Larry Page met as computer science doctoral students at Stanford University in 1996 and began working on a better way to retrieve information from huge piles of data, focusing on the links that interconnect websites.

After raising about $1 million in seed money, they set up shop in a friend's Menlo Park garage and focused on Web search when most Internet entrepreneurs saw it as a low-value commodity. Its speedy search results and simple interface earned Google a huge following, but the company didn't start making real money until it began placing text-based ads next to those results.

Google's top executives declined to cash in during the Internet boom, quietly built a highly profitable business during the dot-com doldrums, then raised $1.7 billion in an initial public offering in August 2004.

It's hard to imagine now, but Google's IPO struggled to get off the ground. Holding an unorthodox auction-style offering during a summer month when many on Wall Street were away, Google was forced to cut the value of its IPO in half during the final hours.

Since then, its profit and revenue have leaped each quarter. The company offers more than 50 online services and employs 9,400 people, and it continues to hire voraciously.

Google's valuation of almost $152 billion makes it the third-largest technology company on that scale, behind Microsoft ($289.7 billion) and Cisco Systems Inc. ($164.8 billion). Brin and Page have benefited handsomely — each founder's stock holdings are worth more than $50 billion.

Google's primary weakness is its reliance on a single form of advertising. Should marketers cool to the targeted text ads that accompany search results, Google would feel the pinch.

But the company is using its pricey stock and the cash generated by its search ads to diversify. Its recent acquisitions and experiments with traditional-media partners demonstrate Google's ambition to become gatekeeper to advertising in all forms, including radio spots, print ads in newspapers and magazines, marketing messages on mobile devices and Internet banner and video ads.

The acquisition of YouTube was Google's most audacious bet on that course. Google agreed to pay $1.65 billion — far more than any of the site's other suitors were willing to pay.

Google is also prepared to take on the dicey legal issues surrounding copyrighted videos that are often uploaded on YouTube without permission. The company said it had reserved 12.5% of the purchase price, or about $200 million, to "secure certain indemnification obligations" — in other words, deal with potential copyright suits.
Credit Suisse, which advised Google on the acquisition, said in a research report Wednesday that it expected YouTube to generate $160 million in revenue next year, adding that the service could eventually generate 10 times that amount as Google got better at delivering video ads.

"No one has been able to match what they've been doing, or even come close," said Standard & Poor's analyst Scott Kessler. "People look at Google as a company that's won in one big category and is poised to do that in a number of other emerging segments."

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