

NEW RISK ALERT: (GOOGL)

Accounting Change to Inflate Google's 2021 Earnings by \$2.1 Billion

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March 30, 2021

This alert compares the language used in the company's latest filing with the period before. [Research](#) suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Google Stretches the Useful Life of Key Assets Over Several Additional Years

Alphabet, Google's parent company, will depreciate some of its key assets slower in 2021 than in the past. In its 2020 [10-K](#), Google revealed it is changing its accounting estimate for the useful lives of its servers and network equipment:

- The estimated useful life of its servers will increase to **four years from three**
- The estimated useful life of certain network equipment to **five years from three**

The change will add approximately \$2.1 billion to Alphabet's operating earnings for 2021, or \$3.07 per diluted share though the impact may vary as the company adjusts its CapEx throughout the year.

Earnings Will Rise, Quality of Earnings Won't

Even without arguing whether Google's assets are truly lasting longer than originally estimated, it's clear the accounting change will positively impact the company's reported earnings. Our analysis reveals the timing of the change to be especially beneficial to reported earnings as Google happens to be spending more on servers—which depreciate slower due to the change—in 2021.

On the Q4 2020 earnings call Alphabet disclosed CapEx would rise significantly in 2021, with much of that increase coming from servers:

*“Looking ahead, we expect a return to a more normalized pace of ground-up construction and fit-out of office facilities, which translates into **a sizable increase in CapEx in 2021. Servers will continue to be the largest driver of spend on technical infrastructure.**”*

If we take Wall Street's consensus estimates— made prior to the accounting change announcement— we estimate Alphabet will report \$68.52 per basic share, or 5% higher than the GAAP consensus forecast of \$65.15 in 2021. Of particular interest to investors is whether Google grows CapEx faster than consensus, 16.8% in 2021. If so— and much of the spend is on servers and network equipment— free cash flow will be negatively impacted to a greater degree than reported earnings.