What Google should do with its $10 billion war chest

The search engine is mum about how it plans to use its cash, but analysts have some ideas for how Google could spend it.

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April 11, 2006: 2:41 PM EDT

NEW YORK (CNNMoney.com) – Saving for a rainy day is common practice for many businesses. But what kind of downpour are you expecting if you need $10 billion?

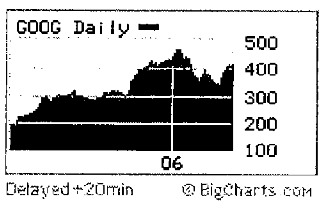
That's what search engine Google has on its balance sheet following last month's secondary offering of 5.3 million shares. Google raised about $2.065 billion from the sale.

The company didn't sell the stock because it needed cash. Google (Research) said in a regulatory filing that one of the main reasons for the sale was to meet demand from index funds that needed to buy the stock after Google was added to the benchmark S&P 500 on March 31.

With $10 billion in cash and a hot stock, Google could clearly throw its weight around and make some acquisitions.

But Google's growing cash hoard (analysts predict that Google could have more than $12 billion by year's end) has Wall Street speculating about what the company might be planning to do next.

A Google spokesperson would not comment. According to the company's filing, proceeds from the stock offering would be used for "general corporate purposes, including working capital and capital expenditures, and possible acquisitions of complementary businesses, technologies or other assets."



Don't call it a comeback: Shares of Google took a brief hit earlier this year but have rallied lately on hopes of strong 1Q earnings.

Thus far, the company has avoided large purchases, instead preferring to buy smaller private firms. Analysts don't expect that to change.

"They will focus on smaller companies with unique interesting technologies," said Scott Kessler, an equity analyst with Standard & Poor's.

Searching beyond search

With that in mind, what could Google go after?

Michael Cohen, director of research with Pacific American Securities, thinks Google should stick to do what it does best: search.

"Here's a company that has the ability to raise cash and do anything they want. But I think they'd be ill-served if they didn't stick to their core strategy," Cohen said.

To that end, Google is said to have recently bought the rights to new search technology that allows users to view answers to search queries without having to leave for another Web site.

Still, Google is clearly broadening its scope beyond search. Google once noted on a corporate Web page about its philosophy that it did not "do horoscopes, financial advice or chat." Yet, Google now does two of those three things. (We're still waiting for the Google horoscope beta.)

As such, Bill Tancer, general manager of global research with Hitwise, an Internet research firm, thinks Google needs to make more deals in social networking. He said Google's biggest threat will not come from search engines like Yahoo! (Research), Microsoft's (Research) MSN or IAC/Interactive's (Research) Ask.com but from MySpace, the social networking site owned by News Corp (Research).

"Google's core business is helping people consume information on the Web. As we see Google grow out its content offerings such as finance and maps, I think they'd have to make a serious play into more social and user-generated content," he said.

Google already has some presence in this area - web log tool Blogger, photo sharing software service Picasa and social networking site, Orkut, for example. But Tancer thinks Google needs to make an even bigger splash.

Tancer said that Facebook, an online community site that competes with MySpace, could be a good deal for Google. Facebook is rumored to have turned down a $750 million buyout offer from another firm, and could be seeking closer to $2 billion, he said. YouTube, the popular online video service, could also make sense as a purchase, he said.

He added that online travel search is another area Google should target, with sites such as privately held SideStep, Kayak and Mobissimo being possible buyout candidates.

International expansion should be another priority for Google, especially in Asia. Scott Devitt, an analyst with Stifel Nicolaus, thinks Google's preference is to launch its own sites abroad and hope they wind up on top. But a fallback position is to follow eBay's lead and buy into new markets.

"If eBay couldn't win a market on its own, they'd acquire the leader. I think it would be logical for Google to follow a similar strategy," Devitt said, adding that Google could buy China's Baidu or South Korea's NHN, which owns the portal Naver.

More strategic investments on the way?

But Chris Sherman, executive editor of SearchEngineWatch.com, an influential Web site covering the search industry, points out that Google simply may be stockpiling cash in order to hire more engineers both abroad and in the U.S.

Sherman said if Google's ultimate goal is to be more competitive with Microsoft on several fronts, the company has a long way to go. Google had nearly 5,700 employees at the end of last year, up from about 3,000 at the end of 2004. Microsoft has about 61,000 workers worldwide.

"Google is still small compared to Microsoft in terms of employees and facilities, and expanding is not cheap," he said.

There are also Google's capital expenditures to consider. Analysts point out that Google is constantly rolling out new features. Also, Google's partnership with EarthLink to build a wireless broadband network for the city of San Francisco should have some high start-up costs.

Kessler adds that as Google rolls out even more features, it might make sense for the company to start promoting its brand more aggressively. The company has so far eschewed major marketing campaigns.

Google may also look to do more investments in strategic partners, moves like its $1 billion purchase of a 5 percent stake in AOL, the portal owned by Time Warner (Research). (Time Warner also owns CNNMoney.com.)

Sherman said Google might want to invest in a cable or telecom firm in order to ensure that it would not have to pay these Internet service providers fees to get its services delivered to broadband users at optimum speeds.

Google and other Web firms are arguing for so-called "Net neutrality," a promise from phone companies and cable firms that they won't give preferential treatment to their own online offerings or to others who pay for faster delivery. Sherman said Google could help make "Net neutrality" a reality if it owned a piece of the ISPs.

Finally, Sasa Zorovic, an analyst with Oppenheimer, argues that Google should pay a dividend, even though momentum investors might balk at the idea. (Dividend payments are often viewed as a sign of a mature company.) But with $10 billion, Zorovic thinks Google could afford to pay a dividend while continuing to spend on research and development.

"For sure, if Google said they are going to pay a dividend, the stock would get whacked. But I wish they would give some money back to investors," he said.

A new way to Google? Click here.

For more about the issue of "Net neutrality," read about the Broadband War of 2006.

Are Google and Yahoo! eyeing India's Net leaders? Click here.

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The reporter of this story owns shares of Time Warner through his company's 401(k) plan. ■

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