CP&E Partners, LP
1983 Lakeport Way
Reston, VA 20191
JPAMCO@YAHOO.COM
(703) 476-0416

November 9, 2024

Dear Friends,

Alphabet (GOOG) is currently our largest position at 9%. The company currently faces two issues: generative artificial intelligence (gen AI) and antitrust. There is currently a perceived threat of AI replacing the search market. The nature of search is starting to change with large language models. It is unclear if there is an advertising model with verbal search (voice command on phones or Alexia). GOOG has all the tools to lead in gen AI and search. Back when GOOG began in the late 90s/early 2000s, its search was a little faster and a little better than competitors, even though competitors had a head start in browser and search. This led to GOOG's dominant market share in both search and browsers. Today, GOOG has all the tools to be a little better than any of the competitors. GOOG can develop customized chips for its servers to speed up response time (Microsoft, Amazon, and Meta Platforms can do that as well, but Perplexity and Open AI are much smaller and at a disadvantage). GOOG still has a superior web crawler to get results for the most obscure searches. Microsoft's Bing is the closest to Google search but has had only 10% share in search for years. Though the speed advantage may be measured in nano seconds and obscure/rare search results may be infrequent, it is the tail end on a bell curve of performance that helps Google succeed. We continue to closely monitor the situation.

The second risk is antitrust. There is short term headline risk because of all the antitrust cases. Based on past antitrust cases, litigation is likely to take 6-10 years to play out.[1] In the meantime, GOOG will pile up a lot of cash earnings. Any forced breakup of Google could bring higher overall stock value. Based on 2025 estimates, if we assume the government doesn't allow payments to Apple and others and adjusts for over-staffing, we think Google Search (just Search, before Network, YouTube and Cloud) can make over $8 per share with margins similar to Meta's family of apps. If GOOG was forced to divest Android, it could make $10 profit per phone.[2] Or about $0.90 per share. YouTube should have $60bn in revenue next year, using Netflix EBITA margins of mid-20%, that is another $0.90 per share. Cloud should also make about $1 per share if it ran at 30% EBITA margin. In sum, hypothetically, if the breakup happened next year, you would have $10ish in earnings power in 2025. Since the breakup probably would take at least 5 years, you would have cash build and EPS power growing before a potential break up.

---

[1] Unlike historic antitrust actions (e.g., Standard Oil, ATT, IBM, Microsoft), the DOJ will be taking on two giants. Not just Alphabet---Apple gets around $20bn a year profit from Google Search that could disappear. That is a lot of interests working against the DOJ over a long period of time, where the personnel and objectives of the DOJ may change.

[2] 1.3bn Android phones are sold per year. Microsoft Windows makes an incremental $18 to $40 per PC. We think Android could charge at least $20 per phone and thus get $10 after tax per phone.

Waymo robotaxi is another Alphabet business with huge potential. An Uber ride currently costs around $3 per mile including tip. If Waymo can get 100bn miles a year at $1.00 per mile (5 trillion miles are driven between US and Europe annually) at unit costs around $0.50 per mile, every 100bn miles driven is $50bn in additional EBIT, which translates to $600bn of added value or $50 per share. And the number of miles overall may increase as travel becomes cheaper and easier.

If you monetize non-search assets, AlphaFold 3 (AI drug discovery), Waymo, Google Play, Pixel, Nest, Fitbit and the net cash build up, Search, YouTube and Cloud are trading around 14x 2025 projected cash earnings before stock-based compensation. The two founders of AlphaFold just won a Nobel Prize. AlphaFold will use AI for drug discovery. While it is unclear how Alphabet will monetize the value of AlphaFold, having more effective and efficient targeted therapeutic discovery is important to humanity and should be worth something to shareholders.

GOOG Segment Earnings Power	**Margin**	**Rev**	**EBITA**	**Multiple**	**Value**	**Comments**
Search	60%	$ 215	$ 129	15x	$ 1,935	Meta Family of Apps margins.
YouTube	25%	$ 59	$ 15	20x	$ 295	NFLX EBITA Margin in mid-20s
Cloud	30%	$ 51	$ 15	20x	$ 306	AWS EBIT margin in 40s
AlphaFold	??				$ 20	Guess
Waymo					$ 40	Recent Valuation
Cash					$ 110	Recent 10Q
Google Play, Nest and Pixel					$ 55	Guess
		Tax	$ 37		$ 2,761	
		NI	$ 122		$ 224	
		# of Shares	12.3bn			
		EPS	$ 10			

We have 7% of our assets in Steel Partners, LP (SPLP). SPLP is a conglomerate (industrial, banking and energy) run by Warren Lichtenstein and Jack Howard. Since SPLP is a public limited partnership, it has a k1, which precludes many funds from owning shares. Warren and Jack also receive a private equity-like incentive fee. As of the last proxy, the insiders own 79% of the outstanding units (CPE owns 4% of the minority shares traded). SPLP has no net debt and trades at less than 6x earnings. SPLP has shrunk its share count from 27.3MM (2015) to 20.5MM (July 2024). In 2015, EBITDA was around $146 MM. EBITDA is now $245MM for the last twelve months. Pension obligation went from $276MM to $42MM. Management is very good at operations and world class at pension liability and cash tax management.

26 Year Benchmark Review

Asset	3 Years	5 Years	10 Years	26 Years
Money Market Fund	3.20%	2.07%	1.49%	1.87%
Consumer Price Index	4.64%	3.87%	3.00%	2.44%
Average Price of Single-Family Home	1.54%	4.64%	3.77%	3.89%
Big Mac Index	7.36%	3.35%	4.80%	4.97%
500 Stock Fund	11.80%	15.87%	13.25%	8.76%
Oil	-1.65%	3.66%	-3.08%	5.99%
Gold	14.38%	12.32%	8.13%	8.91%
Berkshire Hathaway	18.87%	17.25%	12.80%	9.88%
CP&E Partners, L.P. Net Returns	7.82%	11.20%	7.88%	13.38%

The returns of the last decade have not kept up with 500 stock index funds or Berkshire Hathaway, but have kept up with homes, oil, Big Macs and CPI. While I would like to keep up with the index, I am not going to increase my valuation parameters to buy the 500-stock index vs keep what we own (21x vs 8.5x earnings).

Other Goodies

I wanted to share some of the movies, podcasts and books that have shaped my thinking. Some are economic and investing related, while others are part of what Charlie Munger called building a mental lattice. Where possible I provide links for your reference and convenience. These are just my opinions and observations, and I could be completely wrong.

Chimp Empire (Netflix documentary) or any chimp documentary:

Since the first cell organism showed up 3.8bn years ago, we have shared the same evolutionary line with chimps for 99.8% of time. We also share 99.8% of DNA with chimps. When we study them, we study us. When you watch *Chimp Empire*, you will notice that conflict is ingrained in both intra-clan (tribe) and between clans. Also cooperation and grooming (sharing food among allies within a clan) keeps the alpha chimp on top and the clan together. This reminds me of political fractions (intra-clan) and between clans (other nations). As a society, we need conflict because it's a part of our evolutionary response to compete. That is why in high school you hated your cross-town high school rival even though they basically had

the same upbringing. Yankee fans hate Red Sox fans; Dems hate GOPers. For centuries, the UK and France had conflict. These are examples of cross clan conflicts. Within the clan, we see in same party politics how individuals can go from groomers to backstabbers quickly (e.g., what happens in the switch between Joe and Kamela). In short, there is a part of humans that is ruthless and vicious. That is an essential part of homo sapiens existence.

The Godfather: The scene near the end when the Godfather explains to Michael his life choice of being a criminal. Watch this scene, particularly at 2:35 minute mark, on YouTube https://www.youtube.com/watch?v=Z9DHU1toJcU or search "Godfather Vito and Michael garden scene."

The Godfather said he didn't want to be a puppet at the end of the string. He didn't want to dance for somebody else. I see my own life choices in that statement. This is why I went my own way in 1998 and became a family only office in 2012. My freedom from dancing on somebody else's string was my driving force.

Atlas Shrugged: I was introduced to John Galt's speech in 2008---it is timeless. If you are interested, here is a link on YouTube to John Gault Speech---it's 3 hours long…
https://www.youtube.com/watch?v=LDOfOu2_hkI&t=4520s

The other speech that influenced my thinking from *Atlas Shrugged* was the speech:

WHAT IS MONEY?

https://www.youtube.com/watch?v=u-T0ey0IKDA&t=4s

The Lessons of History by Will Durant: The patterns we see today have happened many times before. Here are some quick bullet points.

History is cyclical in every geography and time period:
- Redistribution of wealth and war is part of the cycle
- Human nature is biological and persistence
- Morals, religion, and faith provide social cohesion and ethical behavior

For a fatter version of the summary, you can Gemini AI the terms "Lessons of History Will Durant" or YouTube the same term or you can listen to his book on YouTube.

https://www.youtube.com/watch?v=h0B9prAPUus

I am currently digesting *The Great Depression* by Benjamin Roth. The book is a daily journal of an individual's daily observation during the depression. There is a good chance we or our kids will face hardship again, so understanding the daily dimensions of the last depression could be useful. Here is the link to Amazon for the book.

https://www.amazon.com/Great-Depression-Diary-Benjamin-Roth/dp/1586489011

Free favorite podcasts I find interesting/helpful:

Paul Johnson on valuations: Paul changed the trajectory of my vocation. I would not have the process I developed if I did not sneak into his lecture back in the mid-90s. He taught me why P/E expands and shrink. It was that P/E expansion theory that became the key to my process. His series of lectures is a must listen to any value investor.

https://www.youtube.com/watch?v=ZLSS_RqJHkc&list=PL_Mx9Q1Wge6L-5ZHLAOhc4H1wmGQoRlsB

Prof G Markets Podcast (Scott Galloway): Great storyteller with very good quick takes on business and life.

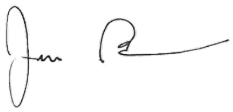
https://www.youtube.com/watch?v=GU70qI5WDFQ

All-In Podcast: Very good short takes on tech, business, and current events

https://www.youtube.com/watch?v=xH76q6yYVlk

I am very grateful for the last 26 years. Every day I look forward to learning or relearning something new, and hopefully pick up pennies (or with inflation---nickels) off the floor.

Sincerely,



James Pan