

Q2 2021 Earnings Call

Company Participants

- Jim Friedland, Director, Investor Relations
- Philipp Schindler, Senior Vice President & Chief Business Officer, Google
- Ruth M. Porat, Senior Vice President & Chief Financial Officer
- Sundar Pichai, Chief Executive Officer & Director

Other Participants

- Brent Thill, Analyst
- Brian Nowak, Analyst
- Colin Sebastian, Analyst
- Doug Anmuth, Analyst
- Jason Bazinet, Analyst
- Justin Post, Analyst
- Mark Mahaney, Analyst
- Michael Nathanson, Analyst

Presentation

Operator

Welcome, everyone. Thank you for standing by for the Alphabet's Second Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there'll be a question-and-answer session. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Jim Friedland, Director of Investor Relations. Please go ahead.

Jim Friedland {BIO 22019382 <GO>}

Thank you.

Good afternoon, everyone, and welcome to Alphabet's second quarter earnings conference call. With us today are Sundar Pichai, Philipp Schindler, and Ruth Porat.

Now I'll quickly cover the safe harbor. Some of the statements that we make today regarding our business, operations and financial performance, including the effect of the COVID-19 pandemic on those areas may be considered forward-looking and such statements involve a number of risks and uncertainties that could cause actual results to

differ materially. For more information, please refer to the risk factors discussed in our most recent Form 10-K filed with the SEC.

During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of non-GAAP to GAAP measures is included in today's earnings press release, which is distributed and available to the public through our Investor Relations website located at abc.xyz/investor.

And now I'll turn the call over to Sundar.

Sundar Pichai {BIO 15004624 <GO>}

Thank you, Jim, and good afternoon, everyone.

It's good to be with you. Today, I'll give an overview of the quarter, going through some of our product momentum, then touching on Cloud and YouTube. First, I want to acknowledge that the new COVID-19 variance have been challenging for so many communities across the world. As the pandemic evolves, we want to help people get the information they need to keep themselves and their family safe. I really encourage everyone to get the vaccine when it's available to you.

Turning to the quarter. We saw a rising tide of online consumer and business activity. We are proud that our services helped so many businesses and partners. In fact, we set a number of records this quarter. This quarter, publisher partners earned more than they ever have from our network. We also paid more to YouTube creators and partners than in any quarter in our history. And on top of that, over the past year, we've seen more traffic to third party websites than any year prior. In addition to generating billions of data connections, like phone calls, directions, ordering food and making reservations that drove customers and revenue to businesses around the world that are working to get back on their feet.

A few years ago, we placed a bet on AI, believing that it would be a fundamental technology that would underpin and dramatically improve all our products. That vision was on full display at our I/O event in May, where we announced new advancements that will be helpful to people and businesses everywhere. As one example, we introduced Multitask Unified Models or MUM. MUM is a big advancement in search at 1,000 times more powerful than our current systems. It has the ability to learn and transfer knowledge across 75 languages, which means that it can learn from sources in one language and help bring that information to you in another.

We also announced a new AI system called Lambda that achieves a new level of natural conversation capabilities. We think Lambda will help make information and computing more accessible, and we are excited about this early stage research. And last week, DeepMind had its new AlphaFold protein structure database, which double the number of high accuracy human protein structures available to researchers. In the coming months, it will include almost every sequence protein known to science.

FINAL

Bloomberg Transcript

Turning to Android. We previewed Android 12 at Google I/O. The latest version will include new ways to personalize devices and significantly improve speed and power efficiency. We've built new privacy protections directly into the OS, such as the new privacy dashboard to help people keep information safe and private. Android 12 will, of course, be central to Google's own devices. I'm very excited by our fall lineup, which will showcase Android 12 and some of the deep technology investments that are helping us push boundaries.

Pixel remains at the heart of that long-term strategy. And I'm proud of how the team continues to deliver the best of Google through our family of helpful devices, including Nest and Fitbit. You can see all of these devices at our First retail store in New York City, and I'm looking forward to seeing some new ones there soon. We're also seeing developers getting tremendous benefit from Google Play. Through the end of Q2, over \$120 billion has been earned cumulatively by developers around the world from Google Play.

Let me talk a bit more about Cloud. Q2 revenue grew 54% year-over-year. Our innovative products, focused go-to-market strategy and growing ecosystem are driving our momentum. Organizations across industries are choosing Google Cloud as their platform for digital transformation, including SAP customers like PayPal, Johnson Controls and Whirlpool, who have deployed SAP environments on Google Cloud.

This quarter, we saw three distinct trends. First, the increase in cyber and ransomware attacks is a wakeup call for the industry. Over two decades, Google has built some of the more secure computing systems in the world, and we are proud that our Google Cloud customers can benefit from our experience here. Customers like Major League Baseball are partnering with Google Cloud to further enhance their security program. We pioneered the zero-trust approach, an architecture that builds in multiple layers of defense against unauthorized access. This approach and other security solutions help customers minimize the impact of cyber attacks and prevent them completely. At our Cloud Security Summit last week, we announced new solutions across our portfolio of products. BT is bringing our new security operation solutions based on Chronicle to the managed security services market. And Adobe in the State of Wisconsin are helping product users with our fraud detection product.

Second, our expertise in real-time data and analytics continues to differentiate us in the data cloud, one of the fastest growing segments of the market. BigQuery is not only a data warehouse, it's a platform for customer innovation. And it's helping drive our strong year-over-year growth with customers like HCA Healthcare, who will be using BigQuery to analyze data to improve clinical care. Additionally, our deep expertise in AI and machine learning remains a key differentiator, winning customers like Group Casino and leading to partnerships with the industrial automation leaders like Siemens. Our focus on delivering industry-specific solutions, coupled with our secure open cloud infrastructure, enable us to support leading telecommunications companies such as Reliance Jio, Telecom Italia TIM and Ericsson to work together on applications and new solutions for 5G networks and mobile edge computing. These join existing customers, Vodafone, Telus and many others.

FINAL

Third, Google Workspace continues to show strong growth, particularly in the enterprise space because we've designed the product to meet the challenges of hybrid work. This includes the announcements we made at I/O about smart canvas, as well as expanding our advanced security and compliance capabilities and solutions for frontline workers. These innovations are landing wins with companies like Carvana, the online auto retailer and software company, Red Hat.

Turning next to YouTube. YouTube Shorts continues to gain momentum. We've been rolling it out everywhere YouTube is available in more than 100 countries worldwide. I'm proud to announce that YouTube Shorts has just surpassed 15 billion daily views. Also pleased with the progress we're making with YouTube subscription products across Music, Premium and YouTube TV, each delivering a fantastic experience and content for viewers.

And finally, Waymo continues to build and commercialize the Waymo Driver and grow the team. People love the fully autonomous ride-hailing service in Phoenix. Since first launching its services to the public in October 2020, Waymo is safely served tens of thousands of rides without a human driver in the vehicle, and we look forward to many more.

Before I close, let me call out our continued work on sustainability, which has been a core value for us since our founding. As you'll recall, we were the first to announce an ambitious goal that will be transformative for the industry. We aim to operate on 24-7 carbon free energy by 2030. In Q2, we announced that five of our data centers are already operating at or near 90% carbon-free energy. To help us reach our target everywhere, we implemented a system to shift flexible computing tasks to different times and places with greater availability of carbon-free energy. And we are working to enable geothermal power in more places starting in Nevada next year.

I want to thank all our employees around the world for their contributions to a great quarter. I know it's been a challenging 18 months, through it all taking care of everyone in our workforce has remained a top priority. Now we are reimagining the future of work with flexibility as a guiding principle. I was excited to see so many people in person, as we started a voluntary return to our California offices recently. As we make our way back, we are giving employees more flexibility in how and where they work, and we'll continue to invest in our sites in the US and elsewhere.

Over to Philipp.

Philipp Schindler {BIO 21014597 <GO>}

Thanks, Sundar, and hello, everyone. It's great to be with you today.

We're pleased with the growth in Google Services revenues in the second quarter. Year-on-year performance reflects elevated consumer online activity, broad-based strength in advertiser spend and the lapping of the first ever revenue decline in our Ads business last year due to COVID. In the second quarter, retail, again, was by far the largest contributor to the year-on-year growth of our Ads business. Travel, financial services and media and entertainment were also strong contributors.

FINAL

Let's now take a few minutes to talk about the trends we've seen across our business. Over the last 18 months, we've been deeply focused on helping businesses, big and small, navigate profound change. First is a lifeline during the pandemic and now as a partner to reaccelerate growth as the world begins to reopen. The road to global recovery is likely to be uneven and unpredictable. That's why the real-time insights we put in the hands of businesses going into the pandemic will be just as important coming out of it.

New tools like Travel Insights, which launched in the US this month after rolling out to select countries in APAC and EMEA in December are helping our partners get a clearer picture of where demand is coming from. Wyndham Hotels & Resorts, for example, is leaning into insights and automation across search, display and YouTube to meet travelers wherever and whenever they need a hotel. They drove nearly 2 times more direct bookings from media deployed on Google in the first half of 2021 versus the year prior.

Or take Amtrak. COVID hit ridership plummeted budgets were cut. Uncertainty ensued and how to efficiently reach essential travelers. So we stepped in with insights and automation. Bookings for the last quarter, which was Q2, increased 3 times year-over-year with cost-per-acquisition down 52%. These examples also underscore the value of AI and automation in a world that's changing fast. We know today that more than 80% of our advertisers use automated bidding.

Using ML, our Ads products are more efficiently connecting businesses with our customers, taking the guesswork out of getting the right message at the right time to the right customer, all in a privacy first way. And Performance Max, our newest AI part campaign is now in beta. It lets brands by ads from a single campaign across all Google properties, helping drive more online sales, more leads and/or more store visits. Early results for participating advertisers are great.

Moving on to retail, where momentum remains strong. We're continuing to build an open ecosystem that benefits both users and merchants. Last year, we removed financial barriers with three product listings and zero commission fees. This year, we're removing integration barriers with Shopify, WooCommerce, GoDaddy and Square, merchants can now onboard and show their products across Google for free. And our Shopping Graph is using AI to connect these products to the people who want them with over 24 billion listings from millions of merchants across the web.

Let's talk omnichannel. Last quarter, I said it was here to stay and it is. Retailers continue to build their digital presence to drive both online and offline sales, and we're helping them to do it. Take Bed Bath & Beyond, who quickly pivoted to curbside pickup, pickup in store and same-day delivery when people were stuck at home. They've continued these offerings across Google with impressive success. Omnia digital shoppers now make up to 50% of customers in Q1, a third of total digital sales were fulfilled by stores, plus they stepped YouTube to build awareness for the new customer inspired owned brands. We'll continue to invest in new ways to help retailers through what is likely to be a long and uncertain recovery around the world.

FINAL

Let's move to YouTube, which had a great quarter with strong growth in both brand and direct response. We've seen three key trends. First, brand. YouTube is helping advertisers reach audiences they can't find anywhere else. According to Nielsen's total ad ratings reach reporting, from Q4 2018 to Q4 2020, on average, 70% of YouTube's reach was delivered to an audience, not reached by the advertiser's TV media. In other words, YouTube's reach is becoming increasingly incremental to TV, and this audience dynamic is a huge win for brands. In fact, Nielsen found that US advertisers who shifted just 20% of spend from TV to YouTube generated a 25% increase to the total campaign reach within their target audience, while lowering the cost per reach point by almost 20%. These combined effects of approved reach and efficiency are helping advertisers get the most out of their brand investments.

Second, direct response. Advertisers are turning to the platform to generate demand and drive transactions. Like Malaysian ed-tech platform Mindvalley, which focuses on personal growth and learning, increased their investment in TrueView for Action and no video action as people turn to YouTube in record numbers to learn. In Q2, this generated 600,000 plus needs with 20% coming from the US.

Third, YouTube is uniquely positioned to drive both massive reach and action. We're seeing more advertisers adopt a full funnel approach to scale their businesses with increased efficiency. Compara, a financial services market leader in Chile, combined a reach and direct response campaign to capitalize on leads. Over 10 weeks, they reached 5 million users with incremental conversions up 70%. This trend is widely embraced by the largest advertisers with business are breaking down silos between online and offline.

Since our founding, we've always believed that the future of Google and the future of our partners are intrinsically linked, from individual YouTube creators and major music labels to global and local online publishers to play developers, big and small. Our business is built on revenue share models that succeed only when our partners succeed. One excellent example of how we're helping our partners innovate is our work with the telecom industry. Sundar talked about efforts in Cloud to help them build more efficient networks and transition to 5G. We're also working across Google to help carriers including AT&T, Telstra, T-Mobile and Verizon launch new devices and services, add new subscribers. Recent customer engagement via business messaging partnerships and support enterprise growth.

I want to close with two huge thank yous. First to our customers and partners for their collaboration. Second to our product, partnership, sales and many support teams for their extraordinary work this quarter and dedication to our customers and partner success.

Now over to Ruth.

Ruth M. Porat {BIO 2536317 <GO>}

Thank you, Philipp.

Our strong revenue performance in the second quarter reflects lapping the impact of COVID on our business, elevated consumer online activity, broad-based strength in

FINAL

advertiser spend, as well as the benefit of excellent ongoing execution by our teams. My comments will be on year-over-year comparisons for the second quarter, unless I state otherwise. We'll start with results at the Alphabet level, followed by segment results and conclude with our outlook.

For the second quarter, our consolidated revenues were \$61.9 billion, up 62% or up 57% in constant currency. Our total cost of revenues was \$26.2 billion, up 41%, primarily driven by growth in TAC, which was \$10.9 billion, up 63%, followed by growth in other cost of revenues, which was \$15.3 billion, up 29%. The largest driver of which was content acquisition costs.

Operating expenses were \$16.3 billion, up 22%. In terms of the three component parts of OpEx, first, the increase in R&D expenses was driven primarily by headcount growth. Second, the growth in sales and marketing expenses was due primarily to the ramp up of spending on ads and promo in contrast to the pullback in the second quarter last year. Finally, the increase in G&A reflects the impact of charges relating to legal matters. Headcount was up 4,061 from the first quarter. Operating income was \$19.4 billion, up 203% and our operating margin in the quarter was 31%. Other income and expense was \$2.6 billion, which primarily reflects unrealized gains in the value of investments in equity securities. Net income was \$18.5 billion.

Let me now turn to our segment financial results. Starting with our Google Services segment. Total Google Services revenues were \$57.1 billion, up 63%. Google search and other advertising revenues of \$35.8 billion in the quarter were up 68% with broad-based strength across our business, led again by strong growth in retail. YouTube advertising revenues of \$7 billion or up 84% driven by brand, followed by direct response. Network advertising revenues of \$7.6 billion or up 60% driven by Ad Manager and AdMob.

Other revenues were \$6.6 billion, up 29% primarily driven by growth in YouTube non-advertising revenues, followed by hardware, which benefited from the addition of Fitbit revenues and finally, Google Play, which lapped the increased level of user engagement that started in Q1 last year due to the pandemic. Google Services operating income was \$22.3 billion, up 134% and the operating margin was 39%.

Turning to the Google Cloud segment. Revenues were \$4.6 billion for the second quarter, up 54%. GCP's revenue growth was again above Cloud overall, reflecting significant growth in both infrastructure and platform services. Once again, strong growth in Google Workspace revenues was driven by robust growth in both seats and average revenue per seat. Google Cloud had an operating loss of \$591 million. As to our Other Bets in the first quarter, revenues were \$192 million, the operating loss was \$1.4 billion.

Let me close with some comments on our outlook. In the second quarter, revenues benefited from an FX tailwind of more than 4% at the consolidated level. Based on FX spot rates against the dollar relative to the third quarter of last year, we expect a more muted tailwind to revenues in the third quarter. In terms of outlook by segment, for Google Services, the benefit to revenue growth in Q2 from lapping the effect of COVID

FINAL

last year will diminish through the balance of the year as we begin to lap stronger performance in the second half of 2020.

In the second quarter, we continue to benefit from elevated consumer online activity and broad-based strength in advertiser spend. We believe it is still too early to forecast the longer-term trends as markets reopen, especially given the recent increase in COVID cases globally. Within Other revenues, Play revenue growth for the balance of the year will face headwinds due to the impact of lapping elevated engagement in the pandemic, as well as the change in fee structure, which was implemented as of July 1. We continue to invest across Google Services to support the extraordinary opportunities we see.

A couple of reminders consistent with prior years. We expect that headcount additions will be seasonally higher in Q3, as we bring on new graduates. In addition, we expect sales and marketing expenses to be more heavily weighted to the back half of the year, in part to support product launches and the holiday season. As for Google Cloud, we remain focused on revenue growth and are pleased with the trends we are seeing. Across Cloud, we will continue to invest aggressively given the opportunity we see.

Turning to CapEx. The results in the second quarter primarily reflect ongoing investment in our technical infrastructure, most notably in servers to support ongoing growth across Google. We also began to increase the pace of investment in ground-up construction and fit-outs of office facilities, which were slowed due to COVID and are focused now on advancements.

Turning to cash and capital allocation. We continue to generate strong free cash flow of \$16.4 billion in the quarter and \$58.5 billion for the trailing 12 months. We ended the second quarter with \$136 billion in cash and marketable securities. As we indicated in our press release today, our board has approved an amendment to the existing \$50 billion stock repurchase program, permitting us to repurchase both Class A and Class C shares in a manner that's in the best interest of the company and its stockholders.

Thank you. And now Sundar, Philipp, and I will take your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions) And our first question comes from Brian Nowak with Morgan Stanley. Your line is open.

Q - Brian Nowak {BIO 16819013 <GO>}

Thanks for taking my question. I have two. One for Sundar, one for Philipp. Sundar, the first one is you've had so much innovation over the years using AI to improve search and improve the overall business. Can you just give us some examples of where you still see more hanging fruit or areas for further improvement in the company's overall products using AI, et cetera over the next couple of years?

Bloomberg Transcript

And then Philipp, your comments on omnichannel were pretty loud and clear. Give us some examples of where you're most focused to continue to enable more retailers to move in the omnichannel and sort of that side of the business? Thanks.

A - Sundar Pichai {BIO 15004624 <GO>}

Brian, thanks. A couple -- we see so much headroom, given our bet on AI, going to our most important product of all, search, when you see the launch of BERT, which was a significant improvement, and we are following that up with MUM, which is another extraordinary advance. So the rate information is growing pretty rapidly. And so constantly developing better models to improve our search quality ranking, et cetera, is one of the most important ways we invest. Beyond that, I would say, all the work we are doing into making sure computers can understand in a multi-modal way, be it images, audio, text, video and then bringing it up across our products, I think it's an important way we'll approach it.

Philipp?

A - Philipp Schindler {BIO 21014597 <GO>}

Yes. And to my part of the question. Look, we want to make sure that when people come to Google, they're able to basically find the best products and prices available from frankly the widest possible range of merchants. And we're making strong progress on the build leadership. And as I said earlier, 2020 was about removing financial barriers. We made listings free, removed commission fees. And it's worth pointing out the upside of combining free listings with shopping ads, actually merchants that use both in Q1 saw a 50% lift in clicks once they started, I think that's pretty impressive.

2021, as I said, has been about removing integration barriers. We have the partnerships with Shopify, Square, BigCommerce, GoDaddy, WooCommerce and so on. And they're making it easier for businesses to get started with us, whether it's across search and shopping and image search and YouTube. And then once merchants are onboarded, I mean there is so much more value we can offer them. We launched a new measurement tool to help retailers better understand performance and pricing, you asked a specific question about focus areas. And then we're making the product and user experience better, not only with our UI, UX research feedback with our tech and AI capabilities.

And maybe, for example is how we're using AR to bring in store experiences online like with auto dealerships and then letting users really try before they buy, and we do this in a cosmetics and in apparel categories, and we have the Shopping Graph, which I mentioned earlier. And we think it will open up completely new product experiences across Google shopping with lenses, one example you can shop your screenshots or use your phone camera to find the dress or pair of sneakers that caught your eye or whatever. And we're working hard to build and open retail ecosystem. And that really levels the playing field for all merchants, and we think there is a lot of opportunity ahead. And I think those are biggest areas of focus.

Q - Brian Nowak {BIO 16819013 <GO>}

Great. Thank you, both.

Operator

Thank you. Our next question comes from Doug Anmuth with JPMorgan. Your line is open.

Q - Doug Anmuth

Great. Thanks for taking the question. I've two. First, just I think the key initiative over the last couple of years has been to bring the full breadth of Google services to customers. So I was hoping you could talk more just about when you think about the search and overall ads recovery and also growth in Google Cloud, how those efforts are going as you work across businesses with corporate customers and what their reception has been? And then, Ruth, just on cost kind of in the back half and going forward, as you think about bringing some of these costs back. Just curious if you can comment more around some of the puts and takes as you think about the overall cost structure pre-COVID versus post-COVID? Thanks.

A - Sundar Pichai {BIO 15004624 <GO>}

Yeah. Thanks, Doug. I would say, overall as you realize, it's a broad digital shift. Customers are looking for digital transformation. And depending on the sector they are in, they look to Alphabet as a digital partner, and we try to bring the broader solution set, that's possible across our capabilities and that's been working well.

You mentioned cloud, most of our cloud customers are either in conversations with us. It could be because they're concerned about security on their supply chain or they're trying to understand the shift to digital and invest more in data analytics or the shift to hybrid workforce is what's probably getting them to think about workspace and so on.

And if they are retailers, we can bring in our expertise across ads. The work we're doing on commerce to be with the partnerships we have and so we can bring those additional expertise to bear. And so that's a trend we're seeing across, Philipp gave examples of our telco partnerships and so across our priority verticals, we are able to engage in a broad way and maybe the recent Google-wide partnership with Univision was another example of multi-product partnership with the company.

A - Ruth M. Porat {BIO 2536317 <GO>}

And with respect to the second question, how we think about investments in the back half. If really the driving focus is how do we support near-term, long-term quality growth, and I think it's important to note that some of our costs are less variable in the short term, such as depreciation and the operations cost of our data centers. So when you look at Q2 performance, in part, the meaningful year-on-year improvement in the operating margin in the second quarter, clearly reflects the strong revenue growth, but also the fact that some of these costs are less variable in the short term.

However, to support long-term growth and very much to your questions through across both Google Services and Google Cloud, we will continue to increase the pace of investment, and that's true in headcount. It's true with compute, sales and marketing really

across the board. And you also heard that and so my comments about CapEx, we're continuing to pick up the pace of investment in office facilities, both fit-outs and ground up construction have been slowed as a result of COVID, and we're pleased that the pace has picked up, and that really relates to our comments about continuing to build out across the US and around the globe in line with continuing to invest in headcount growth.

I'd make one other point which is, I think you're aware of this, but in this quarter, the results also reflect the benefit from the change in useful lives that we talked about earlier in the year that reduced depreciation expense. It's a benefit of about \$721 million in the quarter and the benefit from this change will be lower in the second half, as you're looking ahead.

Q - Doug Anmuth

Great. Thank you, Sundar and Ruth.

Operator

Thank you. Our next question comes from Justin Post with Bank of America. Your line is open.

Q - Justin Post {BIO 3469195 <GO>}

Great. Thanks for taking my questions. A couple, when you look at search in the quarter, it really accelerated beyond the comp and if you look at it quarter-over-quarter, it was really good. So wondering if there's any products or verticals that really surprised you or things to call out? And how do you think about the sustainability here, specifically in search and the product pipeline from here? And then secondly on Cloud, really saw a nice margin improvement there. How do you feel about where you are in an infrastructure side and ability to really continue to show kind of that improvement in margins over time? Thank you.

A - Sundar Pichai {BIO 15004624 <GO>}

Two questions, maybe I'll take the second first. On the cloud side, first of all, we do in the investments in our infrastructure. First of all, we are doing it across the set of cloud services we're building for Google and it's the same that we bring the cloud and so there is tremendous synergies we have there. And maybe to give you an example of it, I earlier mentioned data analytics and processing. It's the same infrastructure, be it BigQuery, et cetera, which we've invested and built over time. And people are looking to use data analytics alongside with machine learning and AI. They want to do this across structured and unstructured data, do it across any platform and so that's the kind of capability we are able to bring.

And overall, I'll let Ruth comment on maybe the margin side of this a bit more. Ruth?

A - Ruth M. Porat {BIO 2536317 <GO>}

Yeah. I would just to build on Sundar's comment. There is really no change in our approach to building the cloud business. We do intend to continue to invest meaningfully.

FINAL

We are very pleased with the business as we both said. As an example, we're continuing to build out the global footprint, continuing to invest in our compute capacity globally. As an example, we most recently announced a second cloud region in India. This is our 26th cloud data center region globally. And so continuing to invest across the board, given the opportunity that we see and as I said last quarter, I would not extrapolate from quarter to quarter, given we still are in the early stages of building the business, and we do intend to continue to invest aggressively, including expanding our go-to-market organization, our channel expansion, our product offerings and our compute capacity, excited about what we're seeing the team executing upon here.

A - Philipp Schindler {BIO 21014597 <GO>}

On search, that's the first part of your question. Yeah. Can you hear me?

Q - Justin Post {BIO 3469195 <GO>}

Yes.

A - Philipp Schindler {BIO 21014597 <GO>}

And to the first part of the question, similar to what I said in my remarks at the beginning, retail was again by far the largest contributor to the year-on-year growth of our Ads business, travel, financial services, media, entertainment were also very, very strong contributors.

Q - Justin Post {BIO 3469195 <GO>}

Thank you.

Operator

Thank you. Our next question comes from Colin Sebastian with Baird. Your line is open.

Q - Colin Sebastian {BIO 6373379 <GO>}

Great. Thanks for taking my questions. First, Sundar, as a follow-up on Cloud, you talked about the tailwinds from advanced AI and data analytics in terms of growth. Is it fair to say as well based on your initial comments that security also represents a competitive differentiation that's contributing incrementally to business development?

And then for Philipp, on the momentum in YouTube and capturing the shift in viewership and advertising away from linear TV, how does the different Google Services fit together in that, not just core YouTube, but Android TV, Google TV, YouTube TV? Is this something that's been increasingly connected or linked in the back end and as well in the front end for consumers? Thanks.

A - Sundar Pichai {BIO 15004624 <GO>}

On security and cloud, we've definitely see it as a strong differentiation. Obviously, Google for a long time we are cloud native. We pioneered approaches like zero-trust, build architecture out from a security-first perspective. And so, particularly over the course

FINAL

of the last couple of years, as companies have really with the recent ad packs, they really started thinking deeply about the vulnerabilities. Supply chain security has been a major source of concern, just particularly over the past few quarters. Cyber threats increasingly is in the mind of not just CIOs, but CEOs across our partners. And so, it's definitely an area where we are seeing a lot of conversations, a lot of interest. It's our strongest product portfolio, and we are continuing to enhance our solutions, be it integrating Chronicle, BeyondCorp and all the product components we have there. So a definite source of strength and you'll continue to see us invest here.

A - Philipp Schindler {BIO 21014597 <GO>}

And on the second part of your question, look, momentum is really strong across both our brand and direct response business on YouTube, maybe let me start on the brand side. The global shift to online video and streaming continues with over like 2 billion monthly active users now, a billion plus hours of video watched every day. I think, we're at the forefront of the shift. And advertisers have increasingly needed to look beyond linear TV alternatives to achieve their reach and awareness goals. And as I said earlier, Nielsen total ad ratings reach reporting found on average 70%, of YouTube's reach was delivered to an audience not reached by the advertisers TV media. So not only are we driving improved reach, but we're also helping brands do it more efficiently. And as a result of this, you see many advertisers reevaluating the media mix and increasing the investments in our platforms.

And as far as the direct response part goes, we're helping advertisers convert intent into action, we try to drive performance at an incredible scale, take an example like with video action campaigns, which is our next generation TrueView for Action format. Advertisers were getting access to even more inventory across YouTube and our partners all in a single automated campaign. And as I said before, we're working really hard to make YouTube not only more actionable, but also more shoppable. So YouTube is proving to be meaningful for not just brand building and reaching a massive audience, but also for converting viewers into buyers. And what's nice is that we're seeing more advertisers leveraging brand to create demand and direct response to convert it. So they're basically using the full funnel very, very smartly.

And then to the second part of your second question, YouTube TV ads for example, this part, we're really trying to bring the well, connected TV is -- let me phrase it from connected TV part, I think, that's easier. It is really the fastest growing consumer surface that we have. And that growth started before the pandemic and has frankly solidified since and in the US, we have over 120 million people watch YouTube on TVs every month and that's up from like 100 million last year. We're number one in reach and watch time along ad supported streaming services. So we're very, very happy with the development that we're seeing here.

Operator

Thank you. Our next question comes from Brent Thill with Jefferies. Your line is open.

Q - Brent Thill {BIO 1556691 <GO>}

Bloomberg Transcript

Thanks. Just a follow-up on YouTube. Can you maybe talk to the e-commerce opportunity that you're seeing evolve? Where are you right now and eventually, where would you like to be? Thank you.

A - Sundar Pichai {BIO 15004624 <GO>}

On YouTube, look, I mean, if you look at the engagement across the platform, we definitely see a lot of headroom for e-commerce. Over the past year, you've seen us really focus on accelerating a shift to in terms of onboarding merchants across Google. So we've definitely invested both in terms of bringing merchants on board, removing barriers there, providing better integrations by partnering with players, platform providers across the industry. And now we are investing in our consumer experience speed on Google search or on YouTube. And so you will see us roll out features over time.

Philipp, do you want to add more here?

A - Philipp Schindler {BIO 21014597 <GO>}

Yeah. Look, there is a ton of commercial intent across YouTube, and it was a shopping destination before COVID. I mean think unboxing videos, product reviews, makeup tutorials and so on. And throughout the pandemic, we've really seen more shoppers turn to the platform for ideas, inspiration and really help them decide what to buy. And number of shopping capabilities already underway, and we're working really hard to make it easier for users to discover and buy directly on YouTube. And I mentioned home merchants can globally add their product feeds now right into video action campaigns and brands and shoppers alike are loving it and we've also begun beta testing this for example with Discovery Ads. And last quarter, I mentioned, hope you guys can make purchases from the favorite creators via early experiments with Brand Connect, and shop with product shelves and early adopters are seeing a lot of success here. So stay tuned for more updates later this year.

Q - Brent Thill {BIO 1556691 <GO>}

Great. Thank you.

Operator

Thank you. Our next question comes from Mark Mahaney with Evercore ISI. Your line is open.

Q - Mark Mahaney {BIO 3027058 <GO>}

Thanks. We've had record new business formation in the US, I think globally in the wake of COVID. And my guess is that, that's also been a major driver of growth for you. Could you just talk about that a little bit to the extent to which you think some of these especially the advertising trends come from these new businesses that are form whether they're digital hybrid or whatever? And then secondly, how do you go from tens of thousands of Waymo rides to millions of rides? Like, what are the biggest obstacles to that? Any clue at all as to how long that takes? Are the issues more regulatory more technical? Thank you.

A - Philipp Schindler {BIO 21014597 <GO>}

New businesses, small businesses are the backbone of our economy here. But obviously, local communities are in varying stages of recovery, some are reopening, while others are unfortunately returning to lockdown. And we're focused on continuing to, I would say, level the playing field for SMBs here. And from getting them online and frankly set up for success to giving them all the digital tools they need to get discovered and be ready for what is ahead. This includes the ability to like seamlessly transition between online and offline, and reach customers nearby far beyond the local neighborhoods as well.

So over the past few months, I mean, literally just the past few months, we've made it easier for SMBs to show their product across Google for free, and we had new ways for them to highlight in store inventories, for local inventory ads, and we've also made it easier for them to leverage the power of YouTube. They now can create video ad campaigns, literally within minutes via their smartphone. And these are just a few examples of the ways we're helping, plus also interesting trend, people are more eager than ever to support their local small businesses. Searches for support local business are up like 20x last year in the US alone. And this is creating a lot of opportunity for SMBs overall, and I don't know, take an example like Ayla Beauty, for example, it's a San Francisco beauty brand, let me 100% pivot to online during the pandemic, and with insight into popular wellness and beauty searches in Google Ads has been really able to grow their business significantly over the last year.

A - Sundar Pichai {BIO 15004624 <GO>}

On Waymo, as you mentioned, in Phoenix, we've had very good experience by scaling up rides. These are driverless rides and no one else in the car other than the passengers and people have had a very positive experience overall. We are obviously with a strong focus on safety. We're looking to scale it up. Through it all, we're building newer capabilities as well, investing in next generation of hardware and software. So it's a native process and at each step, it's very clear to us that we are ahead, and we are making progress. And you'll see us continue to invest here with the focus on safety first, and I expect us to scale up more through the course of 2022.

Q - Mark Mahaney {BIO 3027058 <GO>}

Thank you, Sundar. Thank you, Philipp.

Operator

Thank you. Our next question comes from Michael Nathanson with MoffettNathanson. Your line is open.

Q - Michael Nathanson {BIO 2009061 <GO>}

Great. Thanks. I have one for you, Sundar, and one for Philipp. Just a minute ago, Philipp spoke to the acceleration in streaming in smart TVs worldwide, and the importance that YouTube has on the TV glass. I wanted to hear from you about your interest in supporting the smart TV ecosystem. And what do you see the opportunity for Google in terms of your product offerings to maybe improve consumer adoption of connected TVs?

And maybe for you, Philipp, people have been asking about search. But if you look at search on a 2-year stack, the growth is high as it's been in years. And I wonder if you can disaggregate for us the growth between maybe new search customers coming on the platform versus increased spending on our existing per customer basis or anything help us on how to what drove it on a client by client basis on search?

A - Sundar Pichai {BIO 15004624 <GO>}

On the first question, on the smart TV ecosystem, look, there is a shift to these becoming computing devices over time. They're going to be connected computing experiences. People, both consume content passively, actively, including gaming over-the-top video and so on. So we view this is part of our platform shift. Android TV has made tremendous strides. It's a very customizable platform. We are working not only with TV providers globally, we are doing it with cable box manufacturers, as well as we supplement it with Google TV with Chromecast as well. So it's a significant investment from our side, making sure we can drive that shift. And obviously, there's a lot of synergies for us in terms of being able to bring our services to our users, as well as give more opportunities for our Play developers to reach more users as well. But definite strong integration points with YouTube and YouTube TV as well.

Philipp?

A - Philipp Schindler {BIO 21014597 <GO>}

Look, maybe rather than go into the deep disaggregation that you're talking about, let me maybe talk a little about how we think about the overall market for search and the addressable market in the last call -- last quarter, I gave you a little bit of a breakdown here. But what is really important is we're not just addressing above the line marketing budgets, which is different metrics around the globe, let's say \$0.5 trillion, which is traditional advertising, TV advertising and so on. And there is also significant upside and below the line budgets overall like promotional pricing, product within sponsorships and so on.

And sure we've seen COVID accelerate the shift to e-commerce at an astounding rate, but keep also in mind 80% of commerce still remains offline. So there is a lot of room for digital to play a bigger role, and we think we can tap into other budgets that were traditionally used for, let's say, local advertising to drive sales. And as we think about our long runway for growth, we also think obviously about improving user and advertiser experience for years to come here. And we're constantly asking ourselves, how do we drive better answers to queries, including those with commercial intent and how do we use our ML to deliver even more relevant and higher quality experiences for users? And our primary focus is really on delivering great experience for users and driving incremental value for our partners and making them successful. And I think as long as we do this, we should continue to see budgets move our way.

Q - Michael Nathanson {BIO 2009061 <GO>}

Okay. Thank you, both.

Operator

Thank you. Our last question comes from Jason Bazinet with Citi. Your line is open.

Q - Jason Bazinet {BIO 4013756 <GO>}

I just had one question, Maybe it dovetails off of what you just said. But if I take your ad dollars this quarter, \$50 billion in annualized, it's like \$200 billion a year. Are you with the board focused at all on trying to diversify away from the ad market? Or do you just feel like there's so much runway that there is no real reason to stay focused on non-ad-based growth?

A - Sundar Pichai {BIO 15004624 <GO>}

Look, at a high level, we -- multiple parts to your question. Obviously, we're very focused on. We have a mission. We have an approach of being helpful across certain important attributes, and we do deep investments in computer science and AI to build services. And out of that, naturally, there is diversification over time when you look at YouTubers contributing to that. You look at cloud, and within cloud, via both GCP and Workspace contributing to that and longer term, we have efforts like Waymo as well. Beyond that as both Philipp and Ruth have spoken about, with this digital shift, we see a lot of headroom in terms of where market for either advertising or e-commerce and so we see a lot of headroom there as well.

So we take a long-term view. We start from first principles towards focusing on both investing in deep technology and solving user problems. And out of that, I think you have a set of diversified models that emerge, both different types of businesses. And also within a business, for example in YouTube, via, both ads and subscription over time. And so I think we'll continue approaching it that way with an eye for the long term.

Q - Jason Bazinet {BIO 4013756 <GO>}

Thank you.

Operator

Thank you. And that concludes our question-and-answer session for today. I'd like to turn the conference back over to Jim Friedland for any further remarks.

A - Jim Friedland {BIO 22019382 <GO>}

Thanks, everyone, for joining us today. We look forward to speaking with you, again, on our third quarter 2021 call. Thank you, and have a good evening.

Operator

Thank you, everyone. This concludes today's conference call. Thank you for participating. You may now disconnect.

FINAL

Bloomberg Transcript

FINAL

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2023, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

Bloomberg Transcript