

Company Name: Alphabet
Company Ticker: GOOGL US
Date: 2018-10-25
Event Description: Q3 2018 Earnings Call

Market Cap: 742,986.71
Current PX: 1071.89
YTD Change(\$): +18.49
YTD Change(%): +1.755

Bloomberg Estimates - EPS
Current Quarter: 13.193
Current Year: 54.712
Bloomberg Estimates - Sales
Current Quarter: 31264.423
Current Year: 110534.000

Q3 2018 Earnings Call

Company Participants

- Ellen West
- Ruth Porat
- Sundar Pichai

Other Participants

- Eric J. Sheridan
- Daniel Salmon
- Anthony DiClemente
- Mark Mahaney
- Brian Nowak
- Douglas T. Anmuth
- Ross Sandler
- Michael Brian Nathanson
- Heather Bellini
- Brent Thill
- Justin Post

MANAGEMENT DISCUSSION SECTION

Ellen West

GAAP and Non-GAAP Financial Measures

During this call, we will present both GAAP and non-GAAP financial measures

A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release

Ruth Porat

Q3 Highlights

Opening Remarks

- Our revenues in Q3 continued to benefit from ongoing strength in mobile search with important contributions from YouTube, cloud and desktop search, resulting in consolidated revenues of \$33.7B, up 21% year-on-year and up 22% in constant currency
- For today's call, I will begin with the results for the quarter on a consolidated basis for Alphabet focusing on y-over-y changes
- I will then review results for Google followed by Other Bets and will conclude with our outlook
- Sundar will then discuss business and product highlights after which we will take your questions

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- Starting with a summary of Alphabet's consolidated financial performance for the quarter, our total revenues of \$33.7B reflect a negative currency impact y-over-y of \$385mm or \$305mm after the impact of our hedging program

International Revenue Growth

- Turning to Alphabet revenues by geography, you can see that our performance was strong again in all regions
- U.S. revenues were \$15.5B, up 20% y-over-y
- EMEA revenues were \$11B, up 20% y-over-y
- In constant currency terms EMEA grew 19%
- APAC revenues were \$5.4B, up 29% vs. last year and up 30% in constant currency
- Other Americas revenues were \$1.8B, up 19% y-over-y and up 28% in constant currency, reflecting weakening of the Brazilian real and the Argentine peso

Cost of Revenue

- On a consolidated basis, total cost of revenues including TAC, which I'll discuss in the Google segment results, was \$14.3B, up 28% year-on-year
- Other cost of revenues on a consolidated basis was \$7.7B, up 36% y-over-y, primarily driven by Google-related expenses
- The key drivers were costs associated with our data centers and other operations including depreciation which continue to be affected by a reallocation of certain operating expenses and content acquisition costs, primarily for YouTube

Operating Expenses

- Operating expenses were \$11.1B, up 26% y-over-y
- Once again the biggest increase was in R&D expenses, reflecting our continued investment in technical talent
- The growth in sales and marketing expenses reflects increases in sales and marketing head count primarily for cloud and ads followed by advertising investments in cloud, Chromebooks for the back-to-school season and the Google Assistant

G&A Expense Trends

- G&A expense trends in Q3 were affected by a number of factors
- In particular, the performance fees accrued in connection with recognition of equity security gains which were again partially offset by the reallocation of certain expenses from G&A primarily to other cost of revenues

Headcount

- Stock-based compensation totaled \$2.2B
- Headcount at the end of the quarter was 94,372, up 5,314 from last quarter

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- Consistent with prior quarters, the majority of new hires were engineers and product managers
- In terms of product areas, the most sizable head count increases were in cloud for both technical and sales roles

Operating Income

- Operating income was \$8.3B, up 7% vs. last year for an operating margin of 25%
- As discussed in the previous two quarters, both operating income and OI&E are affected by the new accounting standard that changes the way companies account for equity security investments
 - This new standard continues to result in greater volatility
- Once again, we've provided a table in our earnings press release to highlight the impact on particular line items
- Other income and expense was \$1.8B which includes \$1.4B of gains in equity security investments
- We provide more detail on the line items within OI&E in our earnings press release

Tax Rate

- Our effective tax rate was 8.8% for Q3, reflecting discrete items, notably an adjustment associated with the U.S. Tax Act
- Net income was \$9.2B and earnings per diluted share were \$13.06

CapEx and Operating Cash Flow

- Turning now to CapEx and operating cash flow
- Cash CapEx for the quarter was \$5.3B which I'll discuss in the Google segment results
- Operating cash flow was \$13.2B with FCF of \$7.9B
 - We ended the quarter with cash and marketable securities of approximately \$106B

Q3 Results

Google Segment

- Let me now turn to our segment financial results, starting with the Google segment
- Revenues were \$33.6B, up 21% y-over-y
- In terms of the revenue detail, Google sites revenues were \$24.1B in the quarter, up 22% y-over-y
- In terms of dollar growth, results were led again by mobile search, with a strong contribution from YouTube followed by desktop search
- Network revenues were \$4.9B, up 13% year-on-year reflecting the ongoing momentum of AdMob and programmatic
- Other revenues for Google were \$4.6B, up 29% y-over-y fueled by cloud and Play
 - We continue to provide monetization metrics in our earnings press release to give you a sense of the price and volume dynamics of our advertising businesses

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Acquisition Costs

- Total traffic acquisition costs were \$6.6B or 23% of total advertising revenues and up 20% y-over-y
- Total TAC as a percentage of total advertising revenues was relatively flat y-over-y, primarily reflecting a favorable revenue mix shift from network to sites, offset by an increase in the sites' TAC rate
- The increase in the sites' TAC rate y-over-y was driven by changes in partner agreements and the ongoing shift to mobile, which carries higher TAC
 - This quarter, we experienced a year-on-year decline in the network TAC rate due to a combination of factors, none of which were individually significant

Google Stock-Based Compensation

- Google stock-based compensation totaled \$2.1B for the quarter, up 23% y-over-y
- Operating income was \$9.5B, up 11% vs. last year
- And the operating margin was 28.2%
- Accrued CapEx for the quarter was \$5.6B, reflecting investments in production equipment, data center construction and facilities

Other Bets

- Let me now turn to Other Bets
- Revenues were \$146mm, primarily generated by Fiber and Verily
- Operating loss was \$727mm
- Other Bets' accrued CapEx was \$55mm
- In terms of Other Bet updates for the quarter, with Waymo in Q3, we built on our early rider program, both expanding the group of participants and beginning to test pricing models

Verily

- At Verily, the team continues to execute on its various partnerships with leading pharmaceutical companies, consistent with its mission to move medicine from reactive to proactive
- Recently launched efforts include a joint venture with ResMed to focus on sleeping disorders and a research collaboration with Gilead

Investment Team GV and CapitalG

- Finally, you can see in our results the benefit and quality of our investment teams GV and CapitalG which are also within Other Bets
- Within the \$1.4B of reported gains in equity securities in OI&E, approximately \$400mm was realized in Q3
 - There will be more detail on these investment activities in the 10-Q.

Revenue

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- Let me close with some observations on the quarter and our longer-term outlook
- First, with respect to revenues
- In Q3, results reflect FX headwinds with U.S. dollar strengthening in contrast to the tailwinds that enhanced reported results in H1
- We continue to be pleased with the underlying momentum in our advertising businesses as we apply our strength in machine learning to improve the experience for users and advertisers
- As we noted, hardware was only a modest contributor in Q3 as we launched a new Made by Google family of products for Q4 holiday season

Profitability

- Second, with respect to profitability, within cost of revenues, the biggest component is TAC.
- We indicated on Q4 2017 call that the pace of year-on-year growth in sites TAC as a percentage of sites revenues would begin to slow after Q1 2018, and you can see that again clearly in our results this quarter
- As frequently discussed, we do expect the sites TAC rate to continue to increase year-on-year reflecting ongoing strength in mobile search
- Looking ahead, we expect seasonal impacts to our other cost of sales from hardware sales which are typically higher in Q4 the year as well as from increased content acquisition costs for YouTube, which have also historically been higher in Q4

OpEx

- Within OpEx, we continue to prioritize our investments to support long-term growth
- In terms of head count, growth was seasonally higher in Q3 because we brought on new graduates
- We are continuing to invest in adding talent to our priority areas, particularly for technical roles in engineering and product management and to support our most sizable growth areas, in particular, cloud

Other Bets

- As I've mentioned previously regarding sales and marketing, expenses are more heavily weighted toward the back half of the year
- As you have seen in prior years, these expenses are particularly elevated in Q4 to support the holiday season
- Other Bets remains a portfolio of earlier stage businesses focused on addressing sizable markets
 - We are moving toward early stages of commercialization, while continuing to calibrate the pace of investment against achievement of key milestones

CapEx

- And finally, with respect to CapEx, you can see our continued investment as we build the infrastructure needed to support the opportunities we see across our businesses
- This includes a number of datacenter construction projects in flight as well as ongoing expansion in our compute capacity

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Sundar Pichai

Q3 Highlights

Opening Remarks

- We had a great quarter, and it was particularly special because last month, we celebrated Google's 20th birthday and the 10th birthday of Chrome
- It's exciting to think that 20 years in, we are still just at the beginning of what's possible
- We get billions of questions from users every day and about 15% of those are queries we have never seen before
- Our mission to make the world's information accessible and useful is as relevant today as when we started
- I want to begin by highlighting our recently launched family of hardware
 - It's a great example of how we bring together Google's strengths to help people through their day
- Then I'll touch on ways AI is helping us approach our mission
- I'll give an update on our video and advertising platforms
- And finally, I'll talk about our growing cloud business

Hardware

- First, hardware
- Every year, we have a new opportunity to push the boundaries of computing
- Those experiences come to life in our Made by Google hardware, which combines the latest advances in software, hardware and AI
- Our third generation is our best yet
 - It includes the Pixel 3, Google Home Hub, the Pixel Slate tablet and more
- We're getting great feedback, and I'm very excited for users to try these devices, especially as the holiday season approaches

Pixel 3

- Our new hardware lineup showcases the best of Google, including the Google Assistant, Android and Chrome
- With the Pixel 3, we've used AI to create a best-in-class camera
- New features like top shot make it so you never miss a shot
- If your timing wasn't perfect, the camera will suggest a better frame and give you the option to save it
- And Night Sight will help you take really good pictures even in bad light

Titan M

- Pixel 3 also has a custom security chip called Titan M

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- It was built to secure Google's own datacenters and now we are bring it to our users
- We also released Google Home Hub, our first smart speaker with a screen
- It shows your morning commute, lets you control your smartphone and gives you hand-free help in the kitchen, and Pixel Slate, Chrome OS reimaged as a tablet with all the great apps from the Play Store

Hardware Efforts

- Our hardware efforts are picking up real momentum
- For example, daily active users of our Google Home devices have grown by over 5x in the last year alone
- I'm incredibly proud of our growing hardware team, including the talented employees who came over from HTC and Nest
- Our investments are paying off as we bring the best of Google to more users and in more countries around the world

Discover

- Even as we build up our hardware business, we continue to advance our mission across our core products and platforms
- Last month, we kicked off 20 years of Google search by introducing some of the biggest updates in many years
- They include a new AI powered ranking approach that delivers more relevant results, a redesigned Google feed called Discover to help you stay informed on topics that matter to you and a new search experience for Google images

U.S. Service Members

- We also continue to tackle the information problem of connecting people to relevant jobs right from search
- This has already helped connect to over 100mm people in 92 countries to job listings that meet their needs and skills
- Now U.S. service members can search for jobs for veterans and enter their military occupational code to see relevant civilian jobs

Google Assistant

- The Google Assistant continues to gain traction, drawing on our strengths in machine learning and helpful Google services like search, YouTube and Maps
- We have expanded the Assistant to 20 languages and 76 countries and it can now understand and speak more than one language at a time
 - We launched our first set of smart displays with Lenovo and JBL as well as our own Google Home Hub

Maps

- Pixel users in the U.S. will be the first to try our new duplex technology which helps you complete real-world tasks over the phone like calling a restaurant to book a table and we introduced a new way to easily book ride

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services with your Google Assistant

- In Maps, we also made several improvements including a commute tab with live traffic and transit information and support for mixed-mode commutes

Project Stream

- Earlier this month, we announced an exciting test called Project Stream
- We are working with video game publisher Ubisoft to stream their latest game, Assassin's Creed Odyssey to Chrome browsers on laptops and desktops
- Streaming graphically rich content for video games represents a great technical advance and we look forward to seeing what's possible here

Flood Prediction Efforts

- I'm particularly proud of our strengths in AI are creating life-changing contributions in other fields
- For example, our recent flood prediction efforts, which use AI to better predict when floods will occur had the potential to help millions of people get out of harm's way
 - We are starting in India, where 20% of flood-related fatalities occur today, and we're looking to expand to more countries soon
- Earlier this month, our research has showed how they've applied deep learning models to improve the accuracy of diagnosis for metastatic breast cancer
- Our research found that pathologists and AI can work together more effectively than either alone

Video and Advertising Platform

- Moving to our video and advertising platforms, which are creating economic opportunities for partners around the world
- First YouTube
- One particular area of focus is educational content
- Every day people from all over the world turn to YouTube to learn something new from career skills to coding to cooking
- Just this week, we announced \$20mm investment to expand our YouTube Learning initiative which will help fund established and emerging educational careers
- We're also partnering with organizations like Goodwill and Year Up to create curated playlists that teach career skills directly in our new learning channel

YouTube's Ask Business

- YouTube's Ask business continues to provide great results for marketers and creators
- At Advertising Week, we announced that we'll be expanding our popular TrueView for actions format
 - This helps users take action directly from video ads

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- They can now do things like sign up for a newsletter and soon they'll be able to find movie show times, download apps or even book a trip right from the app
- For creators, YouTube is continuing to build alternative revenue products like Super Chat, channel memberships and the ability to sell merchandise directly to fans

Revenue

- YouTube gaming creator, [ph] Marquis player (19:55), increased its revenue by 20% using channel memberships
- We continue to see positive traction for our newest subscription experiences too
- YouTube Premium YouTube TV and YouTube Music Premium are continuing to expand to many new countries
- The team is also investing in growing and improving the news experience on YouTube
- More prominently surfacing credible news sources on the platform is a big priority for us

Advertising Platform

- Next, our advertising platforms
- Advertisers love that we are bringing our machine learning strengths to offerings like responsive search ads and universal App Campaigns to create more effective ads
- One new example is Smart Shopping Campaigns which use signals like seasonality and price to optimize where ads are shown
- Tens of thousands of advertisers are using this and seeing an average of 20% more sales for the same budget
- Just last week we announced that Nike, Best Buy and Sephora are joining our Shopping Actions program
 - This allows people to move seamlessly from browsing to buying with a universal card that works across Google search and our system
- In apps, we announced a partnership with Unity Technologies, which gives our advertisers access to one of the largest global networks of mobile gaming titles across 1.5B devices
- Unity's developers can monetize their apps with Google ads without any additional development work

Cloud Business

- And lastly, our growing cloud business
- At Google Cloud Next, we made over 100 announcements including the Titan security key, which features Google designed firmware to help verify that nothing on a customer's key has been tampered with
- And we expanded our breakthrough Cloud AutoML portfolio, which now includes vision, natural language and translation

Google Cloud Platform

- And all over the world we are seeing great customer adoption of our Cloud Platform

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- With help of SAP, Metro, one of the largest B2B wholesalers globally, is centralizing their finance system on Google Cloud Platform
 - They're using BigQuery to generate data-driven insights to help create more personalized marketing campaigns
- In the U.S., we partnered with the National Institutes of Health to provide access to cloud services that help researchers access large datasets to accelerate biomedical advances
- We also added new customers like ING and Broadcom, joining existing customers like PayPal, ANZ Bank and Kroger

G Suite Business

- Our G Suite business continues to fuel transformation in companies large and small and we crossed two important milestones in the quarter
- Google Drive became the eight Google product with 1B monthly active users
- And Gmail now has more than 1.5B monthly active users
- One of our big wins in the quarter was Fast Retailing, the Japanese retailer best known for its popular brand UNIQLO, which is migrating its employees globally to G Suite, while also pursuing AI solutions like on-demand forecasting on Google Cloud Platform
- Our cloud business is benefiting from our investments in technical infrastructure including a U.S.-Europe cable that will improve speeds for millions of people

Revenue Growth

- Before I wrap up, I want to quickly call out our continued momentum in Asia as well as the investments that we are making in the U.S
- As you can see from our results, revenue growth in APAC remains strong
 - This is a reflection of our very focused efforts to build great experiences for the billions of people across the region
- We have adapted many of our core products like search, Maps and YouTube to work well for the next generation of users coming online

Tez

- We're also building products to meet the specific needs of users in the region like Tez, a digital payments app for India, to help people easily pay their electrician or split it in a bill with just a few taps
- Just one year since it launched, over 30mm people in businesses across India now use the app every month and they've collectively made more than 1B transactions
- We have recently rebranded the app to Google Pay as we look to bring many of the app's features to others around the world

CapEx

- We are also investing closer to home

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- In Q3, more than 80% of Alphabet's total CapExs was within the U.S
- Not only do these investments in datacenters, machines and offices allow us to provide great services to users, they have a strong positive impact on the communities around them, supporting thousands of jobs and countless local businesses
 - This YTD we have added over 9,000 new employees in the U.S. and we continue to grow faster outside the Bay Area than in it
- As you can see, there's exciting momentum across many different areas
- I'm constantly struck by the number of incredible opportunities ahead of us as a company and how far we have come over the last 20 years
- I want to say a big thank you to all of Googlers around the world who help us deliver on that mission every day

QUESTION AND ANSWER SECTION

<Q - Eric J. Sheridan>: Maybe two for Sundar if I can. Referencing the blog post and some of the changes about how you see the future of search, I wanted to know what some of the key investments you think the company needs to make so that search becomes more visual or relevant and what that might mean tying it back to the business for engagement with your products relevant to that medium to long term.

And then with respect to your comments on YouTube, we're starting to hear from advertisers that there is some blurring between brand and direct response ad budgets as they look at products maybe more across blended lines. It sounds like the YouTube announcements coming out of Adweek were about making YouTube more responsive or more direct response. How are you thinking about the blurring of those lines and what it means for product development long term? Thanks so much.

<A - Sundar Pichai>: Thanks, Eric. I'll take the two. The first on search. You're right that search, we are always trying to anticipate what the user experience expectations are and trying to meet them there. And increasingly in mobile, people do want immersive engaging experiences. They want their experiences to be more visual and that's partly what you saw us announce in our 20th birthday event. And we are excited to move in that direction.

And I do think we have a lot of important assets to bring here. YouTube is a big part of what we do. We are investing in image search and we do have products like Google Maps and Photos which all add to the visual experience. And as part of doing that, we are investing in our advertising offerings as well. And so over time, we'll adapt that so they go hand-in-hand. But I think it's an important evolution for us.

In terms of YouTube, I think part of what makes YouTube great is I think we can offer different opportunities for advertisers. We've always felt direct response is something that can work well on YouTube. And our instinct is bearing out. And I look at my personal use cases that are many times now sometimes instead of search, actually find something I want to do in YouTube, maybe thinking about going to a place. And I research it on YouTube. So I think it offers the same opportunity over time. And from our standpoint, we want to make sure that we are evolving the product to bring those opportunities to advertisers. So I'm very excited by it.

<Q - Daniel Salmon>: Sundar, two questions for you. First, earlier this month or it might have been late last month, Sridhar Ramaswamy, your Head of Ads and Commerce left to go to a VC firm. I'm betting that wasn't a surprise to you, but I'm just hoping you could shed a little light on sort of succession planning for that important role and whether or not you expect any sort of broad changes to ad product strategy.

And then second, just amongst those announcements on the anniversary were the evolution of Feed to Discover. And I recognize that's an evolution of a product, but it does look like you're taking advantage of that long unused white space on google.com. And so, just love to hear a little bit more, just sort of a follow-up on Eric's question on the evolution of search, but how you see that surface in particular evolving and particularly the potential for ad monetization over time.

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Thanks.

<A - Sundar Pichai>: Good. On the first one, look I mean we, one of the things I'm really proud about Google is we have a deep bench of talent and for example in the ads team almost all of our senior ads leadership has been here for well over a decade. And so for us, we are fortunate to be able to tap into it.

Our ads leadership comes – Prabhakar who has taken over our ads product and engineering efforts, someone I worked with for many, many years, and most recently has led our G Suite business, but has done many roles before, is a deep computer scientist. And I expect to, for him to continue our tradition of technical excellence with the – approach our advertising work. Also want to mention Philip and his team, his extraordinary team, who definitely lead many of our initiatives here. And Philip and Prabhakar, with them I think it's in great hands. And I expect a lot of continuity there.

On your question on search and Discover, it's in addition to making search more visual, one of the things we are very, very focused on is not always do users turn to us and actually ask a question. So we feel our job is to be there when users need us, anticipate what they want and sometimes proactively meet them. That's where services like Discover really play a role. Right? And I think we are thinking hard about how we can surface relevant information for our users, stuff they are really looking for, can act on, in a way in which it's delightful for them and is showing up for them when they need it.

So I see that as an important evolution of search as well. And so you're going to see us investing more. Mobile offers us a great opportunity. And if you use it in Pixel 3, that's the latest product in which we bring our vision of how to bring all these products together and we'll give you a good sense of how we plan to do that over time.

<Q - Anthony DiClemente>: First for Sundar, you spent some time on hardware. You spent time discussing your suite of hardware devices, the Google Assistant, the Pixel. How are you measuring the returns on those investments in hardware, both in the products and on the marketing side here in a pretty competitive marketplace? What are the milestones for success that we should be looking for on hardware?

And then for Ruth, as we start to look ahead to 2019, as you plan for 2019, how are you thinking about the relationship between revenue growth and dollars of operating income growth for next year, particularly if the macroeconomic environment were to become, let's say, less of a tailwind to the broader ads environment as it was this year and in prior years? Thank you.

<A - Sundar Pichai>: On hardware, we always want to be at the forefront of computing. And so, and a lot of times that involves thinking across the whole stack, bringing together the entire experience in an integrated way for our users. And we genuinely see a very differentiated way to do this. We think of our approach of bringing together AI software and hardware is unique and we think we can deliver the best-in-class experience and we are committed to doing it. At the same time, we want to build a great business here as well. So we are investing in the long run because we see it clearly as an important business opportunity for us as well, so both go hand-in-hand.

We closely look at metrics, and the metrics we have been very focused on for the last couple of years. This is our third generation of hardware. It's the first time we actually are doing our products end-to-end, and we've expanded to newer categories. We look at user feedback and reception. We measure NPS scores. And our scores are now reflecting best-in-class in the category. And beyond that, we're looking at how the market adoption is and we are thoughtfully building a business but we are committed to building and investing for the long run.

<A - Ruth Porat>: And in terms of how we're thinking about planning, we're in the middle of it now. And many of the questions sort of been already asked sort of point to the direction that we feel really good about the underlying strength in the ads business as we've talked about on numerous calls. We continue to invest here because we see ongoing opportunities in particular as we leverage machine learning to provide better experience for users and for advertisers. And some of the comments that Sundar made about the opportunities that open up with visual search again continue to point the direction direct response, continue to point to some of the underlying areas in which we're focused.

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But as we've talked about on prior calls, that's one element of it, and we continue to invest for opportunities that are sizable over the long term. Sundar has already commented on both hardware and cloud as really important examples, and we think the steps that we're taking, the investments we're making, provide the foundational support for ongoing long-term sustained growth. And so then we marry that with the second part of your question, which is in how do we think about the pace of investment. As we've said repeatedly, we're very focused on investing for the long term. We're trying to make sure that we prioritize crisply across the opportunity set that we have and we make the right types of trade-offs but we do remain focused on long-term investing given the scale of the opportunities that we see.

<Q - Mark Mahaney>: Two questions please. One, Sundar, could you just update us with your thinking on China and the China market and the extent. I know Google is already in that market, but the extent to which you want to expand, re-expand your presence there with search.

And then in terms of Waymo, just a quick question. Commercialization of Waymo, do you know when, do you have a sense of when you'll have pricing established and you'll have a roughly well-defined and acted on go-to-market strategy with Waymo? Is that the end of this year, beginning of next year, whenever? Thank you.

<A - Sundar Pichai>: And, Mark, on China, we obviously, we deeply care about serving Chinese users. We've been investing for many years and especially from developing Android. But more recently, we have launched mobile apps such as Google Translate and Files Go and improved our developer tools there. So we are constantly looking for ways by which we can better serve Chinese users. And that's where we are today.

<A - Ruth Porat>: And then in terms of Waymo, in Q3, as I think you know, we extended our Early Rider Program to a larger group and we moved into very early days of commercialization. So we do now have people paying for rides and we're also testing pricing models.

I think the main point, we've said this repeatedly is that, we are intently focused on safety first and ensuring a great user experience. And so what that means is, we're really expanding the program methodically. We're taking an iterative approach as we continue to broaden the geographic footprint.

And then on top of that, as we've talked about on prior calls, we've been developing the B2B opportunity. So in Phoenix, as an example, we've been piloting with several partners who are sponsoring a service on behalf of their employees and customers. And again it's early days. So small revenues, but we're pleased to be testing this out as well, and then on top of that continuing to explore applying our technology for logistics and deliveries and for personal use vehicles and for last mile solutions for cities. So you can see a move in Q3. But as we said repeatedly, it's very early days and we are taking a very deliberate iterative approach to broadening it out.

<Q - Brian Nowak>: I have two. The first one on map monetization and putting some more ads in the map. Can you just talk about sort of early learnings there? I know you talked about local mobile searches growing quite rapidly in the past. But any early learnings from the monetization and the return that advertisers are getting on that front?

And the second one on video games and Project Stream. Could you just talk a little about how you think about the gaming opportunity for Alphabet, and what you think are the key factors you need to tackle to really build and scale direct-to-consumer facing cloud gaming product.

<A - Sundar Pichai>: Look, on the ad stuff, we've had ad formats in Maps for some time and we are constantly working to make it more useful and relevant. But I wouldn't underestimate the focus we have on local. Just to give you a sense, local mobile searches are growing faster than just mobile searches overall, and have increased by almost 50% in the last year.

So for us, that's an important focus area and Maps plays a big role there. So we recently announced Local campaigns, which is a new campaign type specifically designed to drive foot traffic to local businesses, right. And it's going to roll out in the coming months. And so that is a big focus.

And as you pointed out, we are definitely launching and experimenting with newer ad formats on Maps itself. We have promoted places which appears on the map itself. We have place page ads which appear on Google listings in Maps and search. But we are definitely in the phase of putting those, testing it out, making sure the user experience works and

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making sure we can deliver value for advertisers. We are being patient here because the opportunity in local search, it's a big opportunity and we are focused there.

On your second question, look, we today serve our users on gaming across Google ads but in many ways, right. Obviously, Google Play does this a lot. It's a big important vertical on YouTube. And so we touch with gaming developers across many areas already. And so we are thoughtfully thinking about what more we can do there.

And Project Stream, having spent my life on computing. I was blown away by seeing our ability to stream a game which needs real-time interactions and to be able to do that from the cloud. And it's one of the most important technological advances I've seen in a while. And so we are going to focus on that and make sure we are making progress there and bring newer experiences for gamers.

<Q - Douglas T. Anmuth>: One for Sundar, one for Ruth. Sundar, can you help us better understand how the remedy in Europe will work in terms of licenses and TAC going forward? And what impact do see that having on financials? And then Ruth, can you just talk about where you are in the hardware replacement cycle in your datacenters? Pretty major step up this year just given that large ramp. How are you thinking about the trajectory into 2019? Thank you.

<A - Sundar Pichai>: Thanks, Doug. On Europe, I mean it's early to say. We'll begin only implementing the remedy in the next few weeks. But in all these cases, we always, we're focused on complying with the commission's directive and we want to make sure that the transition for both our users and our OEM partners is as smooth as possible.

In this case you're dealing with life cycles for mobile phones. So changes is going to take some time to reach users. And it's difficult to predict how the licensing model will be adopted. But our products are very popular with users across platforms. And so it's early to say but we're focused on doing the right thing there.

<A - Ruth Porat>: And then in terms of technical infrastructure and our CapEx as we talked about last quarter, CapEx reflects our view of the growing opportunity set in our core ads and search businesses as well as the longer-term opportunities in newer businesses in particular to support cloud. And then very importantly, as we've talked about machine learning across Alphabet.

And we're particularly excited about the opportunity with machine learning, because it opens up more services and products for users and for advertisers and for enterprise customers. And so given our view about the long-term potential with these opportunities, we're very focused on ensuring that we have the needed compute capacity to support growth. And that's what you're really seeing with the uptick in investment.

To give you a bit of a breakdown, the largest component continues to be machines. But relative to last year, it's important to note that datacenter construction is an increasing percentage of our CapEx investment. And so we're now in various stages of developing more than 20 datacenter sites globally. We're also investing in network infrastructure such as undersea cables so we can deliver speed and quality. So again this really goes to our view of the opportunity set.

That being said, we do remain very focused on optimizing the use of CapEx and also on compute efficiency. We're very mindful of the fact that our decisions here on CapEx don't just result in CapEx spend but also translate into higher depreciation expenses and that goes both to cost of sales and OpEx. So very careful about how we're using it, but I want to make sure that we've built for the requirements that we have.

And as much as you asked about technical infrastructure, just a quick note that our facility spend, namely real estate, was more muted this quarter and it was primarily just the ongoing work on our ground up development. So you're primarily seeing what's going on, on technical infrastructure here.

<Q - Ross Sandler>: Great. Two questions. Ruth, so you guys posted pretty solid growth all around. But if we look at some of the international markets, each geography had a tougher comp and decelerated a little bit on a currency-neutral basis. So, I guess, stepping that high level, the growth rates are solid. But can you give us any color on the overall macro picture here? I think we're getting mixed feedback from different companies across different sectors. So any high-level comments would be helpful on just the ad market given that you're close to 20% of global advertising ex-China.

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And then, Sundar, question on I guess Pixel and just the overall advance that you're seeing in smartphone devices. So as you guys roll out more products like Lens and Gboard and some of these other utilities on top of your 1 billion-plus apps like search and YouTube, is there any way to parse out what the overall engagement looks like in markets like the U.S. and Western Europe when the phones are improving their functionality and can you keep adding these additional utilities? Is query volume going up on a per user basis? Any color there will be helpful.

<A - Ruth Porat>: So in terms of your first question, we actually felt pretty good about the strength globally, which as I noted in opening comments, across the board, 20% growth in the U.S. on \$15B base. As Sundar noted, what's going on in APAC, 30% year-on-year growth. It's now over \$5B revenue business and we've had sustained quarter after quarter growth at this kind of 30%-ish area, feel really good about that.

And by country, it really does reflect broad-based strength. As he said, we're very focused on the region. And I think we're delivering terrific products and experiences in rapidly growing markets. You see the same thing in other Americas, neutralizing for currency movements, 28% year-on-year growth. So we're really proud of what the teams are doing around the globe.

<A - Sundar Pichai>: And on your second question, one of the things we clearly see when we make a hardware product like Pixel, in which all the tools and the utilities we build are conveniently there integrated and the experience is great. We definitely see users engaging more. And so, we see an opportunity. And that's one of the bigger reasons why we do hardware as well, to show that into an experience, both for our ecosystem as well as for us. It helps us give users a much deeper engaged experience as well. And when you look at all our products, we see that. And so, we do see that as an opportunity.

<Q - Michael Brian Nathanson>: I have two for Sundar, kind of the same theme. One is on the Pixel 3. The marketing message is clear. The product looks great. But I wonder, when you look at to date the success ramping the product, what's been the gating factor? Has it been the carriers? Has it been the price? And we look at the factors for why it hasn't scaled as much as the product should have a scaled, what are the factors?

And then on Verily, you called out some deals you've had with big pharmaceutical companies this quarter. But again there I wonder, who's your most natural partnership? Is it hospitals, insurance, governments? So we think about the big opportunity, where is the most natural fit to drive Verily going forward?

<A - Sundar Pichai>: On Pixel, look, first of all, part of the big thing is this is our third generation of hardware. Each generation, first of all, we've been scaling up the product in terms of even the number of units we can make and so on. So if you remember the first couple generations were struggling to meet the early demand we saw. This is the first year we have done it end-to-end and we are ramping up from there. And so each year when I look at all the metrics, be it NPS or be it our sales, be it our reviews, etcetera, everything is progressing well.

But there are, you're right, the gating factors to ramp this up, first of all is to be able to build the supply we need. And second is go-to-market, getting ourselves in as many locations in retail as possible, in as many countries as possible with as many carrier certifications as possible. So in each of those dimensions, we are making progress as well.

<A - Ruth Porat>: In terms of Verily, what we've talked about there is, they have partnered with a whole host of leading pharmaceutical companies focusing on specific diseases, whether it's diabetic retinopathy or across the board for neurological diseases. I announced a couple of new partnerships, the ResMed arrangement as well as Gilead. And that's what they tend to do. They partner with best-in-class to focus on specific areas where working with the pharmaceutical companies they can, and the technology we have, and benefiting from machine learning, we can really move from reactive to proactive care. That's the Verily focus.

<Q - Heather Bellini>: I just wanted to focus on cloud a little bit more. Sundar, you gave some good color in your prepared remarks. But I'm wondering if you could share with us an update maybe on the partner momentum and direct sales momentum you're seeing in the market, how you've seen that change?

And also if you could highlight, if you've noticed if there's been noticeable changes in win rates over the last year as the product continues to mature. And you, also in the beginning of the year and exiting Q4, you would give us some

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high-level growth commentary about GCP. and I'm just wondering if you have anything else you could share? Thank you.

<A - Sundar Pichai>: Thanks, Heather. Look, overall I mean it's now we've been doing this seriously at the next level for three years. And we are definitely seeing strong indicators that are the investment in product is clearly beginning to work. Our value proposition does come through in many competitive situations. I've seen many important wins in what seemed like very, very competitive situations.

I also don't, from the way we see it, it doesn't look like a zero-sum game as you know. We're addressing a large market opportunity here. It seems like very early days. And more importantly, the general sense I get is, we're very aligned with where the market is headed in the long run. And this notion of supporting open architecture so that enterprises don't feel locked in and allowing for a multi-cloud environment to develop. That's the direction we are betting on and our indications are that the market is headed in that direction as well. So that gives us a lot of comfort. That gives us a lot of comfort as well.

And on-the-go to market side, we have really ramped up both in terms of our investments, our direct investments, but also our partnership strategy is beginning to work. And when I look at the pipeline ahead that's we are clearly seeing momentum there as well. In this business, obviously the enterprise business plays in a way in which you do have wins, but those accounts turn into larger revenue deals over time. And so it's very clear to us that we are laying the foundation and we are getting the strong early momentum. And that's the big reason why we are investing in a strong way in the area. And over time, we'll obviously share more here as well.

<Q - Heather Bellini>: And could I just ask one follow-up if possible? I was just wondering if you look at Microsoft, they have a on-premise and cloud strategy. If you look at Amazon, what they're doing with AWS and VMware, they're kind of doing a similar strategy. Do you think there's a requirement for you to also have an on-premise strategy to solve this hybrid world as long as it's hybrid for? Thank you.

<A - Sundar Pichai>: We are thoughtfully looking at it. I mean we are increasingly working with partners like, for example our partnership from SAP or Pivotal, VMware, these are all on hybrid cloud solutions. And so we are thinking about how to do that better. and our overall approach to cloud hybrid modernization I think is the right long-term direction and so we are doing that. And there are many, many situations we are in where on-prem is a big, big, big requirement for customers, but with our partnership approach, we've been able to address the needs well. So, I don't see that as a gating issue for us.

<Q - Brent Thill>: Thanks. Ruth, I just wanted to see if you could quantify the FX headwind. I think it was a negative 1% for Q3 and in Q4, do you anticipate it to be similar or a little worse?

<A - Ruth Porat>: I will let you forecast the dollar. As you noted, it was 1 point here. We went from a tailwind in Q2 to a 1 point drag here going forward. But we called out that and we'll have more in the Q, but noted the impact, for example, a pretty big delta between our reported and fixed and other Americas, 19% to 28% growth and that was really what was going on with the Brazilian real and the Argentine peso. We saw some movements in other currencies around the globe, but you can see that, which is why we broke out the geography the way we've done it a number of quarters ago to try and give you, help give a better sense of the types of headwinds and I'll let you forecast the dollar.

<Q - Brent Thill>: Okay, we look forward to that. Real quick just on EMEA, you were flat on your constant currency growth, 19%, 19% the last two quarters despite with GDPR. So, I would believe that would suggest that you're probably not seeing as big a headwind perhaps as maybe some expect. Could you just talk to the European business and what you're seeing there?

<A - Sundar Pichai>: Look, I mean specifically, I think if your question is around GDPR and so on, first of all, I mean we've always been as a company very, very focused on user privacy and security. And so in some ways we were very early on, engaged on GDPR and we worked very hard to make sure our products are ready in in compliance. We've generally always approached our products with a strong privacy lens for our users. So, and I think that helps us work through these changes, because I don't think they are at odds with what we are trying to accomplish. I think GDPR is a very good and comprehensive set of regulations. And so I think it's been good to see a smooth transition on our

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products and for our users.

<A - Ruth Porat>: We're continuing to invest significantly in Europe, because we see the opportunity across Europe and are investing in the communities in which we're working.

<Q - Justin Post>: Great, thank you. One quick one for Ruth. People are really asking about Amazon. Just wondering if your e-commerce vertical was any difference vs. your other verticals in the quarter. Anything to call out there?

And then secondly, Sundar, a lot of interesting things going on with YouTube and Waymo and cloud and other areas. As you look out two or three years, do you think any of these businesses could really make a financial positive difference on the bottom line for overall Google? Thank you.

<A - Sundar Pichai>: Look, I mean, I think on the first thing on e-commerce, maybe really in people, we do see a lot of activity in the vertical on our products, and we see strong growth there as well. We see is an important use case and that's why we are investing a lot. And if you look at our recent work with Shopping Actions, that's an example of the kind of work we are doing there.

And when we do those things, we clearly see users respond. Like for example, on Shopping Actions I think we just recently had partnerships with Best Buy and Nike and Sephora, I mentioned it earlier. So we are continuing to invest there and we are also driving strong partnerships with the retail sector, both in terms of our shopping experiences as well as through cloud. And I think that continues to be a big opportunity.

And on your broader question, look, the reason we are investing across Google and Alphabet in a set of areas is because as a company over the past 20 years, we have developed deep capabilities in technology, in computer science and especially with machine learning and AI. And we see an opportunity to apply that across a set of important areas. There are a lot of opportunities ahead of us. We are pretty disciplined about where we focus on and we're focused on real large opportunities. And when you mention areas like YouTube and Waymo and cloud and hardware, they all fit the category. But we take a very long-term view. And we want to investigate the user experience right. And we're pretty confident that when we do that, the value will follow.

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