

Company Name: Alphabet
Company Ticker: GOOGL US
Date: 2018-04-23
Event Description: Q1 2018 Earnings Call

Market Cap: 744,243.10
Current PX: 1073.81
YTD Change(\$): +20.41
YTD Change(%): +1.938

Bloomberg Estimates - EPS
Current Quarter: 12.507
Current Year: 50.653
Bloomberg Estimates - Sales
Current Quarter: 25188.519
Current Year: 107024.667

Q1 2018 Earnings Call

Company Participants

- Ellen West
- Ruth Porat
- Sundar Pichai

Other Participants

- Douglas T. Anmuth
- Heather Bellini
- Eric J. Sheridan
- Mark Mahaney
- Brian Nowak
- Ross Sandler
- Anthony DiClemente
- Daniel Salmon
- Colin Alan Sebastian
- Michael B. Nathanson
- Brent Thill
- Stephen Ju

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

Financial Highlights

Opening Remarks

- We delivered ongoing strong revenue growth, up 26% year-on-year, and up 23% in constant currency
- The sustained outstanding performance in sites revenues, in particular, reflects the combined benefits of innovation and secular growth with mobile search again leading the way
 - Robust growth in network revenues was again led by our programmatic business
- Ongoing substantial growth in other revenues, namely cloud, hardware and Play, continues to highlight the growing contribution of our non-ads opportunities

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- Our outline for today's call is, first, I'll review the quarter on a consolidated basis for Alphabet, focusing on y-over-y changes
- Second, I will review results for Google, and then Other Bets
- As we highlighted in our earnings press release, our results this quarter were affected by a new accounting standard that changes the way companies account for equity security investments
- I'll highlight the impact on particular line items as I review the quarter
- I will then conclude with our outlook
 - Sundar will then discuss business and product highlights, after which, we will take your questions

Revenues and Currency

- Starting with the summary of Alphabet's consolidated financial performance for the quarter, our total revenues of \$31.1B were up 26% y-over-y
- We realized a positive currency impact on our revenues y-over-y of \$1.3B, or \$1.1B after the impact of our hedging program

Revenues by Geography

- Turning to Alphabet's revenue by geography, you can see that our performance was strong again in all regions
- U.S. revenues were \$14.1B, up 20% y-over-y
- EMEA revenues were \$10.5B, up 29% y-over-y
- In constant currency terms, EMEA grew 21%, reflecting strengthening of both the euro and the British pound
- APAC revenues were \$4.8B, up 33% vs. last year and up 30% in constant currency, reflecting strengthening of the Japanese yen and Australian dollar
- Other America (sic) [Other Americas] revenues were \$1.7B, up 36% y-over-y and up 35% in constant currency

Cost of Revenues

- On a consolidated basis, total cost of revenues, including TAC, which I'll discuss in the Google segment results, was \$13.5B, up 37% year-on-year
- Other cost of revenues on a consolidated basis was \$7.2B, up 39% y-over-y, primarily driven by Google-related expenses
- The key drivers were, first, costs associated with our data centers and other operations, including depreciation, which was affected by a reallocation of certain operating expenses primarily from G&A; second, content acquisition costs primarily for YouTube; and finally, hardware related costs

Operating Expenses and G&A Expenses

- Operating expenses were \$10.7B, up 27% y-over-y with the biggest increase in R&D expenses, reflecting our continued investment in technical talent

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- The growth in sales and marketing expenses reflects advertising investments in cloud and hardware as well as the Assistant
- G&A expense trends were affected this quarter by a number of factors, in particular, performance fees accrued in connection with the recognition of equity security gains, which were partially offset by the reallocation of certain expenses from G&A, primarily the other cost of revenues, and the benefit of the Uber litigation settlement

Stock-Based Compensation and Headcount

- Stock-based compensation totaled \$2.5B.
- The quarter-on-quarter step-up reflects the full year equity refresh grant to employees at the beginning of the quarter and the biannual grant to SVPs
- Headcount at the end of the quarter was 85,050, up 4,940 people from last quarter, including just over 2,000 people who joined at the end of January when we closed our previously announced deal with HTC.
- As in prior quarters, the majority of new hires were engineers and product managers
 - In terms of product areas, the most sizable head count increases were the additions from HTC, followed by hiring in cloud for both technical and sales roles

Operating Income, Other Income and Expenses

- Operating income was \$7B, up 7% vs. last year, and the operating margin was 22%
- Other income and expense was \$3.5B, which includes \$3B of primarily unrealized gains in equity security investments recognized under the new accounting standard
- We provide more detail on the line items within OI&E in our earnings press release

Tax Rate

- Our effective tax rate was 11% for Q1
- As outlined in our earnings press release, this includes a 5 percentage point reduction from the release of a deferred tax asset valuation allowance, which offset the income tax expense on the equity security gains

Net Income

- Net income was \$9.4B, and earnings per diluted share were \$13.33
- As indicated in the table in our earnings press release, these results reflect an increase in net income of \$2.4B and \$3.40 in earnings per diluted share, due to the impact from the gains on equity security investments we've already discussed

CapEx, Cash Flow and FCF

- Turning now to CapEx and operating cash flow
- Cash CapEx for the quarter was \$7.3B, which I'll discuss in the Google segment results
- Operating cash flow was \$11.6B with FCF of \$4.3B.
- We ended the quarter with cash and marketable securities of approximately \$103B.

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Google Segment

Revenues

- Let me now turn to our segment financial results
- Starting with the Google segment, revenues were \$31B, up 26% y-over-y
- In terms of the revenue detail, Google Sites revenues were \$22B in the quarter, up 26% y-over-y, led again by mobile search, complemented by solid growth from desktop search and strong performance from YouTube
- Network revenues were \$4.6B, up 16% year-on-year, reflecting the ongoing momentum of programmatic and AdMob
- Other revenues for Google were \$4.4B, up 36% y-over-y fueled by cloud, hardware, and Play
- As a reminder, the hardware revenues in this line now include our Nest business, and prior periods were restated

Advertising Businesses

- 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
- As we previously announced, we made a change this quarter to impression-based monetization metrics for our network business, given the ongoing growth of programmatic

Traffic Acquisition Costs

- Total traffic acquisition costs were \$6.3B or 24% of total advertising revenues, and up 36% y-over-y
 - This year-on-year increase in sites TAC, as a percentage of sites revenues, as well as network TAC, as a percentage of network revenues, continues to reflect the fact that our strongest growth areas, namely mobile search and programmatic, carry higher TAC.
- Total TAC, as a percentage of total advertising revenues, was up y-over-y, reflecting primarily an increase in the sites TAC rate, which was modestly offset by a favorable revenue mix shift from network to sites
 - 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.
- The underlying trend affecting the network TAC rate y-over-y continues to be the shift to programmatic, which carries higher TAC.

Stock-Based Compensation, Operating Income and CapEx

- Google's stock-based compensation totaled \$2.3B for the quarter, up 22% y-over-y
- Operating income was \$8.4B, up 12% vs. last year and the operating margin was 27%
- Accrued CapEx for the quarter was \$7.7B, reflecting investments in facilities, production equipment, and data center construction

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- Facilities was the largest component of CapEx this quarter due primarily to the \$2.4B purchase of Chelsea Market that we announced in March

Other Bets

Revenues, Operating Loss and CapEx

- Let me now turn and talk about Other Bets
- For Q1, Other Bets revenues were \$150mm, primarily generated by Fiber and Verily
- As a reminder, Nest results are now reported as part of the Google segment with revenues reflected in the Google other revenues line
- Operating loss was \$571mm for Q1
- Other Bets' accrued CapEx was \$55mm

Waymo, Partnership and Diabetes Management Platform

- We're pleased with our progress across Other Bets
- A couple of updates
- At Waymo, we have achieved five million miles of driving on city streets, adding the latest million in just three months
- We also announced the long-term partnership with Jaguar Land Rover for their fully-electric I-PACE vehicles
- Verily is seeing good progress with Onduo, its joint venture with Sanofi
- The company has made its diabetes management platform commercially available in three states with Blue Cross Blue Shield of Arkansas and South Carolina, and Anthem's health plan in Georgia

Outlook

Revenues

- Let me close with some observations on the quarter and our longer term outlook
- First, with respect to revenues, the opportunity set ahead of us is quite extraordinary, and we remain focused on investment to support long-term revenue and profit growth
- We have both the business confidence to invest appropriately in the next phase of innovation as well as clarity about some very compelling opportunities that, in our judgment, will enable us to create shareholder value
- We're pleased with the continued momentum of our revenue growth again this quarter, reflecting strong underlying trends across our business, which are amplified by our relentless focus on innovation, not only in our newer businesses, like cloud and hardware, but in our sites business
- Specifically, we're excited by the still sizable opportunity in search advertising led by mobile
- At 26% year-on-year revenue growth in our sites business, we continue to benefit from our investments to enhance the user and advertiser experience

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Profitability and TAC

- Second, with respect to profitability
- Within cost of revenues, the biggest component is TAC.
- While we expect sites TAC to continue to increase as a percentage of sites revenues, reflecting ongoing strength in mobile search, we continue to anticipate that the pace of y-over-y growth in sites TAC, as a percentage of sites revenues, will slow beginning in this second quarter

OpEx, R&D, Sales & Marketing and Expenses

- Within OpEx, as I said last quarter, we are continuing to support our priority investment areas
- Within R&D, this is reflected in increased head count, particularly for technical roles
- Sales and marketing is similarly elevated to support these areas, both in the quarter and for the full year
- And we expect expenses to remain more heavily weighted toward the back half of the year to support the holiday season

G&A and Other Bets

- As you've seen in prior quarters, G&A can be a more difficult line to forecast
- In particular, this quarter, we had the impact of the accrual for performance fees related to the equity gains previously discussed, partially offset by the reallocation of some expenses to other cost of revenues and the Uber legal settlement
- We appreciate the importance of prioritization and are keenly focused on the steps we can take to make the right investments with the proper intensity, while being diligent about long-term plans and returns
- For our Other Bets, we remain focused on moving toward commercial applications in a number of areas with a continued focus on calibrating investment to metrics for success

CapEx

- Third, with respect to CapEx, our commitment to growth is evident in the trend in CapEx investment, almost equally split this quarter between compute capacity and facilities
- Our facility spent in Google dominated by the Chelsea Market acquisition reflects that we favor owning rather than leasing real estate when we see good opportunities
 - With respect to compute capacity, the largest component of CapEx is for machines that incorporate the latest technologies
- We are also investing in data center growth and increased network capacity through undersea cables
 - These combined investments will expand our compute capacity to support our growth outlook across Google, including machine learning, the Assistant and cloud

Investments

- In many respects, these investments underscore my opening comment about both our confidence and clarity about future opportunities with our focus on proprietary solutions that enable us to deliver the secure, reliable,

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high-performing compute infrastructure to support new and emerging products and services for our users, advertisers and enterprise customers

Sundar Pichai

Q1 Highlights

Google News Initiative

- The end of Q1 is always an exciting time as we prepare for our annual developer conference, Google I/O.
- Computing is evolving at a rapid rate, and we can't wait to share what's next and how we are tackling important issues
- I want to call out an important highlight from Q1, the Google News Initiative that we unveiled in March
 - Over the years, we have worked closely with the news industry to address key challenges through projects like Accelerated Mobile Pages
- We're building on that partnership with \$300mm investment to elevate and strengthen quality journalism

New Products

- As part of this effort, we announced more than a dozen new products, including Subscribe with Google developed in close collaboration with publishers, which lets you use your Google account to buy a subscription on participating news sites
- We've had overwhelming interest
- Since the launch, we have heard from more than 300 news publishers who are interested in Subscribe with Google
 - We also introduced new tools for journalists and improvements to our platforms to ensure that we are surfacing accurate quality content where it matters most

Machine Learning

- Today, I'll quickly talk about how machine learning is helping us advance that mission
- Then, I'll highlight progress in our three big areas, cloud, YouTube and hardware; and share updates on our computing and advertising platforms
- First, machine learning and making information accessible to everyone
- Our own ML-powered products like Google Photos and Google Lens gets better every day
 - The Google Assistant is a great example of this

New Device Partners

- In the Home, we have added over 200 new device partners that work with Assistant just in the last four months alone
- We now partner with all major manufacturers of connected devices for the Home in the U.S.

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- All told, the Google Assistant can now help you with over one million actions, including new things like reminding you to buy a bread when you get to the store or sending money to friends, or if you want to get a rideshare home

ML Techniques

- For a concept we unveiled at I/O less than two years ago, this is great progress
- AI is also unlocking new opportunities for everyone
- Just in the last few months, we have seen some amazing applications from dairy farmers in Georgia using TensorFlow to improve the health their herds, to our own Google researchers who figured out how to use ML techniques to assist as a person's risk of a heart attack
- The possibilities of AI in healthcare are truly exciting

TensorFlow Hub

- At our recent TensorFlow Summit, we introduced TensorFlow Hub, making it easier for developers to share and reuse models, so that we can work together to tackle even more problems and get to better ideas faster
- Our investments in this area are held because of our specialized Tensor Processing Units, which are specifically designed to be highly efficient for machine learning applications

Google Go App

- Of course, we continue to advance Google's core mission in other ways, too
- We recently launched our Google Go app in 26 African countries
 - This app reduces the amount of data needed to display search results by 40%
- And we continue to invest in ways to give people granular and easy controls over their information across all our products
- Every single day, nearly 20mm people visit My Account, which gives them options to review their Google security, privacy and ad settings
 - Additional, tools like Security Checkup and Privacy Checkup prompt people to keep their account secure and control their data settings

Cloud

- Now, turning to our three big areas: cloud, YouTube and hardware
- Last quarter, we shared some exciting metrics about the progress of Google Cloud, including that we passed \$1B per quarter in 2017
- In Q1, we saw increasing momentum
- We're growing across the board and are also signing significantly larger, more strategic deals for cloud
- Our security capabilities, the easy-to-use advanced data analytics and machine learning solutions and the secure and industry leading collaboration platform, G Suite, are winning customers over
- Google Cloud is growing well

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New Technologies AND New Subsea Cables

- Some examples of new technologies announced in the quarter include Cloud AutoML, which makes it easier for companies without machine learning expertise to build complex neural nets and more than 20 new security products
- Our global infrastructure continues to expand to support demand
- We commissioned three new subsea cables and announced new regions in Canada, Japan, Netherlands and Saudi Arabia, bringing our total of recently launched and upcoming regions to 20

G Suite

- G Suite has reached a point where it can serve all the needs of a large enterprise, and as a result, growth is at an inflection point
- The Suite is growing from strength to strength
- We believe our secure environment is an important factor in driving enterprise customer wins
 - G Suite customers like Colgate-Palmolive Company tell us that no one offers a better combination of hardware, network and data security
- In Q1, we also signed agreements with customers like Airbus and Thailand's Krung Thai Bank
 - As a result, G Suite revenue growth accelerated in Q1

YouTube

- Next, YouTube
- The platform continues to grow as millions of creators build communities and find opportunity on YouTube
- Over the last year, channels earnings six figures annually grew more than 40%
 - This quarter, Dua Lipa's video for New Rules became the 100th video on YouTube to reach 1B views
- We're also investing in new experiences like live content, where we see tremendous momentum
- One recent example was our exclusive Coachella live stream, which had more than 41mm live views from all over the world
- Coachella was YouTube's most viewed live music festival ever
 - And no surprise, Beyoncé was the most viewed Coachella performance ever on YouTube

Investments

- Even as we invest in new experiences, we stay very focused on making sure that YouTube remains a safe platform with great content
- We are aggressively combating content that violates our strict policies through a combination of user and machine flags
- Over six million videos removed in Q4 were first flagged by our machine systems, and over 75% of those videos were removed before receiving a single view

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- We also changed our monetization requirements to better identify creators who contribute positively to the community and drive more ad revenue to them

Hardware

Nest

- Moving to hardware
- This quarter, we welcomed Nest of the Google hardware team to supercharge our efforts
- Nest is building industry-leading products for the home, including new additions like the Nest Hello doorbell and Nest Temperature Sensor
- In 2017, they sold more devices than the previous two years combined
 - They are an incredibly talented team with fantastic momentum

Google Home

- Google Home continues to be super popular, and we are making it available in many more countries
 - Just recently, we launched Google Home and Mini in India and Singapore, and the response has been terrific

Net Promoter Scores

- Our early 2018 Net Promoter Scores rank among the highest in the industry across all product categories
 - This shows how much love people have for Made by Google consumer hardware devices and makes us even more excited for what's ahead

Mobile World Congress

- There's great momentum across our computing platforms like Android and Chrome
- At Mobile World Congress, a new generation of Android partner devices was introduced, including Android One phones like the Nokia 7 plus
- Android One pairs high-quality hardware with secured and streamlined software experience from Google
- This quarter, we launched the Acer Chromebook Tab 10, the first Chrome OS tablet designed specifically for education
 - It is a secure and easily shareable tablet equipped with all the Chromebook features that educators and students love

Advertising Platforms

- And finally, our advertising platforms
- We continue to make Google Search and Shopping the best places for people to find and buy products from a range of merchants

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- We recently announced Shopping Actions, allowing customers to easily buy from their choice of participating retailers on the Google Assistant and Search with the universal cart across mobile, desktop and even Google Home
 - This is also really helping retailers
- Early testing showed that participating retailers see an average increase in basket size of about 30%

YouTube

- YouTube is delivering great results for our advertisers
- To help brands reach broad audiences on YouTube with even more flexibility, we introduced TrueView for Reach, which optimizes in-stream ads to reach a wide audience
- In beta testing, nine out of 10 campaigns drove a significant lift in ad recall with an average lift of nearly 20%
- We are also helping small businesses take advantage of video with the expansion of YouTube Director Onsite to over 170 U.S. cities
 - This gives SMBs access to a professional filmmaker to create and edit their video ads

Publisher Partners

- Finally, we remain focused on investing in our publisher partners
- Last year, we paid \$12.6B to publishing partners in our ad network
- We recently announced AdSense Auto ads
- This uses machine learning to analyze ad placements on a publisher's page and show ads where they are likely to perform well, while providing a good user experience

Rolling Study Halls Program

- Google's success depends not just on the success of our partners, but also on the communities where we work
- We recently announced a Rolling Study Halls program for rural areas across 12 states
- It equips school buses with Wi-Fi, devices and onboard educators, so that students with long commutes can get their homework done during the trip

Investments

- We are also making long-term investments in our offices and data centers around the country
- Last month, we announced the purchase of Manhattan's Chelsea Market building
- And in Tennessee and Alabama, we broke ground on two new data centers, which will have a big economic impact on the local economies
 - These investments are made hand-in-hand with our commitment to sustainability
- In 2017, we officially met our goal to purchase enough renewable energy to match all the electricity consumed by our operations around the world

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Closing Remarks

I want to close by saying thank you to our employees

It's been a particularly tough few weeks for the Google family, especially at YouTube

I'm so proud of the resilience that our employees have shown and I'm so grateful for the support we've gotten across our industry and from the community

QUESTION AND ANSWER SECTION

<Q - Douglas T. Anmuth>: Just first on the accounting change, I was just hoping you could clarify. For trying to normalize that, is it right that we would be adding back about \$632mm to operating income, and then reducing EPS by \$3.40 and then just on the EPS side, perhaps adjusting for the tax rate?

And then, just in terms of the business, I just wanted to ask about Waymo. If you could talk a little bit about just the latest timing for the commercial launch in Phoenix, and how quickly you'd look to expand to other markets? And then just, how you're thinking about the technology and whether you'll license it to others going forward or keep it more proprietary for Waymo services? Thanks.

<A - Ruth Porat>: On the accounting standard, we tried to lay out all the component parts clearly on the cover of the earnings release, so that you would have it all in one place. I think you've summarized it right. But I'd just direct everybody to the earnings release, the net of which was the gain from the equity investments was \$2.4B to net income. That is net of performance fees as well as the release of a deferred tax asset that we have. So, it does reflect \$3B in gains. And I think you know this, but this quarter, the accounting standard requires marks for everything where there is an observable raise. So, these are unrealized – the majority of them are unrealized, not actually monetized by Alphabet, and then the performance fees are calculated based on investment returns. They're accrued, but not paid until an exit event occurs and they do appear in OpEx. And as you noted, there's also, therefore, the benefit that flows through on the tax line, and that is 5 percentage points of benefit offset to the effective tax rate for the quarter.

As it relates to your Waymo question, I think there was a lot in there. We do remain very excited about the opportunity with Waymo, and our continued progress on multiple fronts. It is still very early. In terms of our progress, this year is about offering a service that is safe, that works, that delights users in the Phoenix area. The rider program in Phoenix is open to members of the public, and riders will use the Waymo app to hail one of our fully self-driving cars without a driver at the wheel, and we'll pay for the service.

We've also had progress on the vehicle partnerships. As I mentioned in my opening comments, last month Waymo announced it signed a long-term strategic partnership with Jaguar, beginning with a collaboration to design and manufacture self-driving I-PACE vehicles for Waymo's transportation service. These are all electric cars. This new partnership in the vehicles adds to our strong position with FCA and the production of the cars begins in 2020.

And then, we are expanding our testing to more states. We're also working on additional areas like applying the technology to logistics and deliveries and working with cities to help strengthen public transportation and for personal-use vehicles.

And as we've talked about on a bunch of calls, the opportunity is here for us, because we started with the safety and we remain a leader in safety and we do believe that's the foundation for success and it builds on all the testing miles that we've done. So, we keep coming back to when you create vehicles that drive themselves safely, we think there's a lot of potential uses and business opportunities, and that's what we're focused on.

<Q - Heather Bellini>: I wanted to ask two quick questions. One, just one on GDPR, and then one on cloud. On GDPR, just wondering if you could share with us kind of any impact you're thinking about as the implementation occurs later in May. And so any thoughts you could share there would be great.

And then on cloud, Sundar, you had mentioned you're seeing a lot of momentum. You said G Suite, I believe, accelerated in Q1. I was wondering if there was any color on the GCP side that you could share, from a growth

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perspective, if that business accelerated or not and kind of how were the deal size is trending for that business in particular. Thank you.

<A - Sundar Pichai>: GDPR, I realized, is a fairly new public topic. But for us, it's not new. We started working on GDPR compliance over 18 months ago and have been very, very engaged on it. It's really important and we care about getting it right. And overall, we've long had a very robust and strong privacy program at Google, too. So, we are committed to meeting requirements on May 25 and also, the long term. We are working very closely with advertisers, publishers, and our partners. And we'll also update all the privacy policies and controls we provide to users worldwide. So, it's a big effort. We are very committed to it. We are very focused on getting it right by our users and partners, and that's where our focus is now.

Heather, on cloud, I guess, your question was about overall growth.

<Q - Heather Bellini>: GCP [ph] in particular (33:39).

<A - Sundar Pichai>: And we are continuing – the momentum has been very strong on cloud as well. We hadn't talked about G Suite much, and so we highlighted the momentum there. But cloud is continuing its great growth. We are seeing it across the board. Things worth, I would call out, is we're seeing larger deals as well. We are seeing good synergies between G Suite and cloud, areas where we have done acquisitions like Apigee. They are beginning to work in terms of driving synergies to cloud.

And the efforts we are beginning to put, particular with our partners, that is beginning to bear fruit as well. So, we have go-to-market programs now with SAP, Cisco, and Salesforce. And I think we're beginning to see early results from that and, hopefully, that translates into more momentum going forward.

<Q - Eric J. Sheridan>: Maybe two for Sundar, if I can. One, on mobile search, continue to call that as a point of strength in the results. What are you most excited about in terms of either product innovation or the ability to get consumers to adopt mobile search more broadly on devices globally, which could lead to more ad budgets moving into mobile search?

And then, on hardware, you've now been through two years of sort of Pixel devices. You've made the acqui-hire of the HTC engineers. Can you give us a sense of what you've learned so far from your hardware efforts and how that might evolve product innovation or go-to-market strategies long-term? Thanks so much.

<A - Sundar Pichai>: On mobile search, for me, mobile obviously raises the bar. And if you look at the evolution of Search, we came from – we evolved to stay ahead of user expectations and we evolved from just providing links to answers. I just feel at a high level the next big evolution we are doing as part of mobile search and Assistant is to actually help users complete actions, to help get things done. And that's really hard to do at scale, and that's the work we are doing. And as we do that, it'll impact just, not just the Assistant, but mobile search more broadly. And obviously, that has a commercial impact as well. So, we continue to be very excited about the opportunities there.

On hardware, the exciting part for us is now, I think we have all the end-to-end capabilities of a world-class hardware organization along with the quality of the software organizations we always had. And in this area, it truly takes long-term planning. And so, for example, if you think about [ph] silicon, (36:35) et cetera, the longer you can do it, the more advantages you have. And so, I definitely feel we are taking the steps towards being able to do this well for the long term. Part of that obviously involves scaling up our go-to-market strategies, both in the U.S. and internationally, so that we can drive adoption.

I said earlier, our Net Promoter Scores show that we are right up there with the best-in-class devices and across all the products we have, not just our Pixel, across our Nest family and everything we do. So the opportunity is clearly there. We're going to lean into it. And it takes two to three years to really get to the scale, where we want to see it and but we are committed to getting there.

<Q - Mark Mahaney>: I want to follow up on Heather's question on GDPR. And the question I want to ask is I understand that you've been working for a long time to make sure that you're complaint. But do you think that GDPR or other regulation that you see on the horizon is likely to impact materially the targeting capabilities that advertisers

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have on Google? Is there something in the regulation that's going to make Google and its properties less attractive to advertisers? That's the action question I want to ask. Thank you.

<A - Sundar Pichai>: Above everything else, as we're working through GDPR, we are making sure we are focused on getting the user experience right for our users and our partners. But to clarify your question further, first of all, it's important to understand that most of our ad business is Search, where we rely on very limited information, essentially what is in the keywords to show a relevant ad or a product. And so we've been preparing this for 18 months, and I think we are focused on getting the compliance right. It'll be a year's long effort, and we are helping not just us, but our publishers and partners. But overall, we think we'll be able to do all that with a positive impact for users and publishers and the advertisers and hence our business.

<Q - Brian Nowak>: I have two. The first one on desktop search, it's always nice to hear that your oldest business is still growing. Just curious, could you give one or two tangible examples or products that are still driving the desktop search growth? And, Sundar, I understand you're always focused on user experience. At high level, what do you see as the biggest areas of potential further improvement in desktop search? And let me ask you the same question about YouTube. What are sort of the biggest areas of tension that you're focused on improving from a user perspective on YouTube right now?

<A - Sundar Pichai>: On desktop search – sorry, is your question on the user experience on desktop search, how do we see improvements?

<A - Sundar Pichai>: First of all, users are having cross-device experiences, cross-screen experiences, right? So I think your desktop search experience, mobile search, everything goes hand-in-hand. And every – all the work we are doing to make mobile search better translates to desktop search as well. Areas where desktop search historically has been a bit behind us in terms of things like identity and payments and having all that work well to enhance the user experience. And with Chrome now, we are investing a lot in those areas as well, and I think that will contribute overall to improvements there.

On YouTube, there are many, many areas we are focused on YouTube. They're always very focused on making sure they are supporting emerging formats, be it mobile live streaming or emerging formats like VR, and so that's an area of focus for us. We are also really looking at what are all-new monetization options for creators beyond advertising. So, be it subscriptions, features like Super Chat, which we have launched, are very popular. We have beta testing sponsorships, merchandise – merchandising and concert ticketing, et cetera, right. So, these are all areas by which we're improving. And obviously, there are additional areas, like music and YouTube TV, which are seeing great momentum as well.

<Q - Ross Sandler>: Just two questions, please. Americas revenue accelerated nicely on a currency neutral basis. It's a geography that rarely comes up on your calls. So, any color about what's driving that acceleration and the sustainability of what's going on in the Americas region?

And then, Ruth, a question on sites TAC. So, I know you said the pace of deleverage is going to start to improve next quarter. Is this something that we should expect to happen for a year and then kind of normalize back to pretty steady pace of deleverage? Or is this – are we over some critical threshold and we should see this trend of moderating deleverage continue for several years into the future? Thanks.

<A - Ruth Porat>: On your first question, Other Americas, I would say, like the other regions, really pleased with the strength we have. Across the regions, this is obviously one of the smaller ones. So growing at a slightly faster clip and really pleased with the broad strength there. It starts with the sites revenue strength. But on top of that, they benefited from hardware devices launching in some additional markets over the past year.

And then in terms of TAC, I would say there's not much to add to what we've already said after some kind of a sustained period of stronger increases, we were pleased last quarter to be able to signal that this quarter, that pace of change is slowing. And I'd just leave it at that for now.

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<Q - Anthony DiClemente>: I have two, one for Ruth and one for Sundar. Ruth, on CapEx, even if we exclude the Chelsea Market one-timer, the growth in CapEx is really substantial even on a kind of recurring basis. Should we expect that sort of dramatic growth or step-up in the growth of rate in ongoing CapEx to continue throughout the year? Or other than the Chelsea Market one-timer, were there any – was there any reason to think that it was timing in terms of timing, front-end weighted into Q1 for CapEx?

And then, secondly, on Sundar, just a question on YouTube and your media strategy at a higher level. In view of the success of other competitive subscription TV products out there, Internet video products, can you just talk about YouTube Red and any thoughts on ways you can accelerate growth for your YouTube subscription video products, whether that may be organic investment in content original production or even via acquisition? Thank you.

<A - Ruth Porat>: So, in terms of CapEx, it's about equally split between facilities and our technical infrastructure. And as you know, we had the \$2.4B purchase in New York as well as this continued ground up development projects. Facilities does tend to be lumpier over time. We are continuing with the ground up development projects. And as a reminder, we do favor owning rather than leasing real estate when we see good opportunities, and that has served as well over the years.

But I think more to your question, with respect to technical infrastructure, that reflects investments in compute power to support growth that we see across Google, and the largest component is on machines. It's also on data centers and undersea cables. And on machines, the biggest contributor is the demand that we're seeing. So in particular, it's the expanding application of machine learning efforts across Alphabet, plus the requirements for cloud and Search and YouTube. And then, secondarily, the increased cost of newer technologies, CPUs, memory, network.

So I think, really, to answer your question most directly, it reflects the demand that we're seeing. So, I wouldn't want to suggest one-off in terms of the investments we're making in technical infrastructure. And then, in terms of the data centers, we are investing globally. We currently have over 20 sites on four continents, and that's under different stages of construction, as Sundar noted. And it's across the U.S., Tennessee, Alabama, South Carolina, Iowa, so we're really building out to support the growth that we're seeing.

<A - Sundar Pichai>: On the second question on YouTube, for sure, the adoption and feedback across both YouTube Red and YouTube Music has been great to see. We are doing a lot more work there. You will see us continue to invest further and develop those offerings better, and as part of that, further drive adoption. So, for example, YouTube Originals end up playing a big part in YouTube Red subscriptions. And so far, we have launched in a handful of markets, and we'll continue to roll it out to more markets there. And on YouTube Music, we are working on enhancing the product, and I think there's definitely great opportunities there as well.

<Q - Daniel Salmon>: I had two for you. First, during the quarter, there were some reports of changes in leadership at your Search and AI divisions functionally, sounds like separating leadership over those two very large, important businesses for the company. Could you talk a little bit more about that and how that may impact broader strategy for the company?

And then, second, a little bit more technical one on your advertising business you launched, Shopping Actions, during the quarter with a pay-per-sale model, pricing model. And I was just curious to hear what type of feedback you were getting from advertisers that led to a product with that pricing model in particular, any other features of Shopping Actions that you think are important to highlight?

<A - Sundar Pichai>: On the – we, obviously – Search has been leading the company in terms of how they have been adopting machine learning and AI, and it's really working well through Search and Assistant. We sense that, obviously, as a AI-first company, AI cuts across everything we do in Google. And so as an organization, it's a horizontal organization, which needs to serve all our areas, and in some ways, the change reflects that.

And we have very capable leaders. Jeff, who runs – was the Founder of Google Brain and really well-positioned to lead our AI efforts. And Ben has been at Google since the early days of Search, started in Google in 2000 and has been driving Search for over 18 years. And so we are very excited and we think the changes will serve the company well.

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On your second thing, the question was on Shopping Actions?

<Q - Daniel Salmon>: And in particular, the price-per-sale pricing model.

<A - Sundar Pichai>: We announced this new service in March. And the feedback has been very positive. I mentioned earlier, which is for retailers, when they are testing this, they see drives and increase in basket size. So that means users are interacting with the product well, and that's all I have to share for now. It's still early days.

<Q - Colin Alan Sebastian>: A couple for me, please. First, on the cloud business. I was wondering if you could provide any color, at least on the relative momentum you're seeing in that segment from infrastructure services compared to platform or software services?

And then, related to the adoption of AMP, I guess, a key question we get asked is whether that ultimately changes usage, and maybe you have some perspective on this from Android, but in the ecosystem between mobile web pages and app usage, if you're seeing any shift among users between those formats? Thank you.

<A - Sundar Pichai>: On the first question of cloud, look, I mean, I think the main thing I would say is, the fundamental drivers of adoption of Google Cloud based on what we hear back from customers is our advantage in data analytics and machine learning, the fact that we really support an open, agile developer environment. Kubernetes has literally become the standard for workloads and the fact that we are open in terms of how we approach this space.

Security is becoming a big differentiator for us and something we've been leading for a while, and I think that's driving it. G Suite, as I called out earlier, is a good synergistic driver. G Suite is doing well and, clearly, a very unique offering and it's gotten very comprehensive. And so, I think, overall, it comes together well.

On your second question around AMP, AMP has been definitely very successful. It's really made publisher content much more friendly for users in terms of latency and the user experience. And hence, the adoption has been great. For sure, AMP has definitely helped the mobile web, and that's part of the big reasons we did it. Mobile web is still a big part of how users consume content, especially around news. And so, us investing there clearly makes a difference.

I guess, for example, when we look at – I don't know – J.Crew adopted AMP, their mobile page loading times are now 90% faster. And now they are integrating the Google Payment Request API. That reduces checkout times from 2 minutes to 30 seconds or so. So, things like that. We are going to constantly stay on improving the mobile web, and that plays a big part in how our ecosystem works.

<Q - Michael B. Nathanson>: I have two, one for Sundar, one for Ruth. Firstly, Sundar, can you give us any sense of how Google Home consumers are using search in these devices differently than maybe the traditional ways of search? Any finding in those homes? Is it additive to the overall search activity?

And then for, Ruth, if you look at the last page of press release, where you've shown the new monetization metrics, you see a real increase in the cost per impression on network sites. So can you talk about maybe what's happening there? Is there a mix shift types of publishers, types of products? Or is that just market inflation? Thanks.

<A - Sundar Pichai>: For sure, Google Home gives rise to a lot of new and unique use cases. Actions are a big part of it. Call mom is a good example of something you say to Google Home a lot. [ph] I like it, (52:45) but just different than what you would say to Search. We see this as a good complementary thing. You will see Search embrace some of the capabilities you find in Google Assistant and Google Home and vice versa. And so, overall, I view this as additive in the long-term and we are definitely just getting started there.

<A - Ruth Porat>: And then on the network monetization trends. First, just to give people a bit more color, when we launched the AdSense businesses, our network revenues were actually click-based. And over time, there's been a meaningful mix change in our business given the strong growth in programmatic, which is impression-based. So, as a result, the shift now covers more of the business.

And then, in terms of the question on impression growth vs. CPM growth, as we've discussed on prior calls, the network business is actually a number of different businesses. And then within that, we had flat year-on-year growth in

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the number of impressions, that was driven by efforts to improve user experience through a reduction of less relevant ads in AFC. And so, these changes had a positive impact on the year-on-year growth in CPMs. And then the trend in impressions and CPMs can clearly be volatile from quarter-to-quarter as we're optimizing for the user, publisher and advertiser, but it really goes to the efforts that we make.

<Q - Brent Thill>: Just as a question regarding any changes on your framework for growth vs. operating margins. The last few quarters, you've seen steady top line acceleration, yet the margins were down. Can you just talk about how you think about it at a high level for this year, any changes from the past?

<A - Ruth Porat>: It's an important question. As we talked about on many, many calls, we have been and remain focused on supporting long-term revenue and profit growth. And we think the opportunity set ahead of us is quite extraordinary. And as I said in opening comments, just given our confidence and as we're looking forward, we want to make sure we're investing appropriately in the next phase of innovation, and we have clarity about some very compelling opportunities. And in our judgment, that enables us to maximize shareholder value. So, we're taking the steps really to put in place the support for long-term – longer term growth.

Part of what I'm saying, you can see in our sites revenue growth, tried to make that clear in opening comments, we see this consistent, strong momentum globally. And we're really excited about the still sizable opportunity led by mobile search. And as we're continuing to invest to enhance the user and advertiser experience and thereby, extend the growth in our ads business, you can see this also in the trend on CapEx spend. As I noted in our opening comments, the investments we're making there really provide the compute capacity to support our growth outlook, and that's supporting the opportunities that come out of machine learning and the Assistant.

And then, we also see extraordinary upside in the newer markets, as Sundar has talked about, most notably, cloud computing and hardware. And so, we're investing to support the long-term growth opportunity there. And then, finally, when we look at the market opportunity in both self-driving cars and life sciences, our judgment is it makes sense to place the kinds of investments that we are.

And with all of this, what also hasn't changed is we appreciate in the importance of prioritization and picking our spots. And we're keenly focused on steps we can take to both make the right investments with the proper intensity, while being diligent about long-term plans and returns. So, at a high level, the approach hasn't changed. You're seeing the investments here.

<Q - Stephen Ju>: One of the themes that you, as a management team, has talked about has been to, I guess, democratize advertising with AI to help SMBs who may have found advertising across Google's ad products to be perhaps overwhelming. So, can you talk about the rate of uptake among the smaller advertisers and whether or not this is helping to catalyze growth in new budgets, and where these guys might otherwise have not been able to advertise before? There's SMBs and then there's local also. So, what will be the plan to get this technology into the hands of folks who would want to use them? Thank you.

<A - Sundar Pichai>: This is a big focus for us. And today, SMBs are – play a big role in our ecosystem. And we are doing a lot of stuff to support them across the board, right? And from things like in our offerings to help SMBs get an online presence, create a website, be discovered in local, Search and Google Maps. So, we do a lot of detailed work to make sure SMBs are working well.

We're also doing a lot of stuff on local as well, including efforts even around local services. So we have very specific initiatives. This is going to be – I mean, it's actually – to us, it's bread-and-butter of what we do here. And so there's a lot of effort underway, not to mention the fact that we provide G Suite for businesses as they scale up as well. So it's an end-to-end offering. And you'll continue to see us invest more here.

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