

Q3 2021 Earnings Call

Company Participants

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

Other Participants

- Analyst
- Brent Thill
- Colin Sebastian
- Douglas Anmuth
- Eric Sheridan
- Justin Post
- Mark S. Mahaney
- Michael Nathanson
- Ross Sandler
- Stephen Ju

Presentation

Operator

Welcome, everyone, and thank you for standing by for the Alphabet Q3 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there'll be a question-and-answer session. (Operator Instructions)

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

Jim Friedland {BIO 22252778 <GO>}

Thank you. Good afternoon, everyone, and welcome to Alphabet's third quarter 2021 earnings conference call. With us today are Sundar Pichai, Philipp Schindler and Ruth Porat. Now, I'll quickly cover the Safe Harbor. Some of the statements that we make today regarding our business, operations and financial performance, including the effect of the COVID-19 pandemic on those areas may be considered forward-looking and such statements involve a number of risks and uncertainties that could cause actual results to differ materially. For more information, please refer to the risk factors discussed in our most recent Forms 10-K and 10-Q filed with the SEC.

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

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

Sundar Pichai {BIO 15004624 <GO>}

Thank you, Jim, and good afternoon everyone. In 2016 I laid out our vision to become an AI-first company. Five years later, this quarter's results show how our investments in AI are building more helpful products for people and for our partners and local communities.

Today, I'll begin with new product highlights then I'll cover our Cloud business followed by YouTube. First, product highlights. Search remains the heart of what we do. We've made remarkable advances over the past 23 years that benefits search and related products like Google Assistant, which just celebrated five years.

Earlier this year, we announced that we reached a significant milestone with Multitask Unified Model or MUM for short. MUM is 1,000 times more powerful than BERT and can understand information across many contexts, like text and images. At our Search On event in September, we shared how we're using MUM to improve Google Lens, so people can search using both images and words. We also share that we are bringing a more visual shopping experience to search, powered by the Google Shopping Graph. It links shoppers with over 24 billion product listings from merchants across the web.

Google Maps now offers eco-friendly routing. It lets drivers in the U.S. choose a more fuel-efficient route, saving money and reducing emissions. Maps now has a wildfire layer, so that people can get up-to-date details and make quick informed decisions during emergencies.

Finally, in Search and our Discover feed, we are continuing to support the news ecosystem and make quality journalism more accessible. Philipp will give a bit more detail about our new showcase partnerships.

Turning next to hardware, I hope you saw our Fall Pixel event last week. I'm very excited about the range of Pixel phones available this holiday season. The new Pixel 6 and 6 Pro bring together the best of Google AI, software and hardware, the most advanced and inclusive cameras we've ever built. They're beautiful, fast, and powered by Google Tensor, a first ever System on a Chip. It's specifically built to support Google AI and machine learning on device, and provides a long-term foundation for our Pixel devices. We also introduced our new Nest Renew program, which uses Nest thermostats to support clean energy use in the home.

Onto Android. Android 12 is getting great reviews. It's the biggest design change in Android's history with new widgets to personalize your phone. We also introduced accessibility features that use gestures to control your phone and communicate. Android

12 is secure by default and private by design. New dashboards and the indicators make it easier to view and adjust privacy permissions and disable access to device sensors and location information.

We've also made progress with the Made for India affordable smartphone, co-developed with Reliance. The JioPhone Next device features premium localized capabilities and is on track to launch in market by Diwali.

Onto cloud where we see continued momentum with Q3 revenue growing 45% year-over-year with GCP's revenue growth rate above cloud overall. At Cloud Next two weeks ago, we unveiled hundreds of new capabilities, services and solutions. We also announced 20 new and expanded partnerships to support the growth and scale of our customers around the world.

More than any other top cloud provider, Google Cloud has unique capabilities to meet the needs of enterprises, digital natives and SMBs around the world. I'll highlight three. First, our leadership and real-time data, analytics and AI is winning customers like Carrefour Belgium, Deutsche Post DHL and Wendy's, who are unlocking data to deliver unique business outcomes.

BigQuery, our leading data warehouse solution is reducing costs and driving productivity at Cardinal Health and ATB Financial. Our differentiated AI and ML-based industry solutions are helping leading global companies. GE Appliances, a Haier company is integrating Vision AI into their next-generation smart home appliances. And IKEA retail is using Recommendations AI to drive a 30% increase in customer click-through rate.

Second, customers see value in our open scalable infrastructure that enables them to run workloads anywhere; on our cloud, at the edge or in their data centers. Rodan + Fields scaled its SAP environment. Siemens Energy is migrating its global network of data centers and company-wide SAP systems. And Indonesia's largest technology digital-native GoTo Group is supporting over 100 million monthly active users with Google Cloud.

General Mills, Bell Canada and Wells Fargo are harnessing our leadership in multi-cloud and our open development environment. And to meet the unique digital sovereignty needs of customers around the world, we announced industry-first partnerships with T-Systems in Germany and Thales in France.

Third, as consumers, businesses and schools continue their shift towards hybrid work, the threats of cybersecurity continue to increase. Customers are turning to Google Workspace and our cybersecurity platform to provide the ease-of-use, collaboration, and security they need. These include organizations like Discovery, CommonSpirit Health and the State of Maryland, who want to foster creativity, while securely protecting their users.

We are also seeing strong growth in our broad portfolio of cybersecurity products. This includes Chronicle, one of our zero trust offerings, which JetBlue uses to detect cybersecurity threats, helping to protect its customers and enterprise. We are bringing

our team's deep expertise to customers through the Google cybersecurity action team and a new Work Safer program, which provides best-in-class security for emails, meetings, messaging and more.

Earlier, I mentioned a few of the sustainability-related product features we announced. Our cloud customers already benefit from operating on the world's cleanest cloud and last year we set an ambitious goal to run our data centers and campuses on 24/7 carbon-free energy by 2030. Two-thirds of the electricity consumed by Google data centers in 2020 was matched with local carbon-free sources on an hourly basis. And our new carbon footprint tool gives customers carbon emissions insights associated with their Google Cloud platform usage.

Now, over to YouTube for a few highlights. We recently surpassed 50 million music and premium subscribers, including those in trial, and YouTube Shorts continues to see high adoption rates. In the past year, the average number of daily first-time creators more than doubled. Next week, as global leaders gather in Glasgow to address climate change, YouTube is partnering with COP26 to livestream conference activities, making the event more accessible for everyone.

As we grow, we are maintaining our open global platform responsibly by removing harmful content and reducing borderline content. Both our AI investments and the promotion of trusted sources have helped us significantly lower the violative view rate, which is the percentage of views on YouTube from content that violates our policies.

Onto our Other Bets. Waymo began welcoming riders to its Trusted Tester program in San Francisco, in addition to its fully autonomous ride-hailing service currently in Phoenix. Next year, Waymo will open a dedicated trucking hub in the Dallas-Fort Worth area, helping support commercial freight routes across the Southwest. And we announced last week the first commercial expansion of Wing's on-demand air delivery service to Walgreens customers in select locations.

To close, the world is slowly starting to travel and meet up in-person. And this quarter, I joined events virtually to celebrate some big milestones in regions around the world. Earlier this month, we announced \$1 billion investment in Africa over five years, to support the continent's digital transformation. And September marked 20 years since we opened our first office outside of the U.S., in Tokyo. We now have thousands of employees in 28 offices across the Asia-Pacific region, and we are investing in cloud regions and digital skills programs to help expand economic opportunity there.

As you can see, our business in APAC is growing really well. In Africa, Asia-Pacific, and beyond, it's been a successful quarter, and we have lots more innovation on product development on the way. Thanks to our employees around the world for their contributions. As we continue our move to hybrid work, I hope to see more of you in-person soon.

Thank you, and over to Philipp.

Philipp Schindler {BIO 21014597 <GO>}

Thanks, Sundar, and hi, everyone. It's great to be with you all today. We're pleased with the growth in Google Services revenues in the third quarter. Year-on-year performance was driven by broad-based strength and advertiser spend. Consumer online activity also remained elevated. In the third quarter, retail was again by far the largest contributor to year-on-year growth of our ads business. Media and entertainment, finance and travel were on contributors.

Let's take a deeper look at some of the trends that drove this quarter's performance. First, from a big picture global recovery perspective, we continue to see a lot of unevenness. Some economies have restarted and reaccelerated, albeit at different speeds. Other countries, depending on local regulations and vaccines have been slower to rebound. It's clear that uncertainty is the new normal. The world is in flux. So when it comes to anticipating change, predicting demand and investing in innovation, businesses need as much support now as they did a year and half ago, and we continue to help. Like in travel where hotel free booking links are increasing traffic for many partners from OTAs to boutique hotels.

Consumers like more choice, travel partners like free exposure, and advertisers like to augment paid campaigns with free listings. So last month we launched free booking links for things-to-do and a new ad format that makes it easier to promote local experiences.

Now, when you search zip lining, aquariums or the Tokyo Tower, you can buy tickets directly on Google. And then there are companies like Alaska Airlines that are harnessing first-party data and automation across search to navigate market fluidity and better understand the lifetime value of their customers. They've increased return on ad spend by 30%-plus versus the same period pre-COVID.

Beyond travel, business of all kinds are increasingly adopting tools like AI-driven automation and insights to connect with customers, no matter what stage of the recovery they're in. 150 year old luxury retailer, De Bijenkorf, turned to local insights and automation to speed up cross-border expansion beyond the Netherlands and Belgium to Germany, France and Austria. With a multi-pronged approach, including shopping campaigns, De Bijenkorf drove substantial growth throughout the pandemic. Returning visitors to online stores were up fourfold in first half of 2021 versus 2020, which leads me to retail. We had another stellar quarter.

We've seen explosive growth in digital over the last 20-some months. But as the world begins to reopen, shoppers are returning to stores, brick-and-mortar isn't dead. Instead, omnichannel is in full force. Searches for open now near me are up four times globally versus last year. Strong growth in local shop inquiries, means people are researching their visits to stores more often before they go. As a result, we've seen more advertisers include in-store sales alongside e-commerce goals to drive omnichannel growth. Adoption has nearly doubled over the past year.

FINAL

Bloomberg Transcript

Take Kohl's, it optimized media spend into trending categories and launched curbside pickup just two weeks after its 1,100 stores shutdown. After testing local inventory ads in Q4, Kohl's went all in an omnichannel bidding across its paid search portfolio, and is leaning heavily into a full funnel approach on YouTube, including CTV. Kohl's net sales were up 31% year-over-year in Q2, led by higher foot traffic and continued strength in digital.

Innovating an omnichannel and next-gen user experiences remains core to our shopping strategy. A few of our latest launches include, easier ways for business to show the local services they offer, from hair extensions to auto repair across search and maps. Local inventory ads that highlights which products are in stock and when to pick them up. Free shipping at easy return annotations across search and shopping, AR capabilities that bring in-store moments online and that users try before they buy. And then instantly shoppable images with Google Lens, plus a new visual browsable experience on Search. There's a lot more to come, including tapping into commerce on YouTube. From shoppable livestream experiments with retailers like Sephora, Target and Walmart, to pilots that viewers buy directly from their favorite creators' videos. We're still in the early innings of what's possible.

Our direct response momentum remains strong. Video action campaigns are driving more conversions than previous formats. And by adding product feeds to these campaigns, advertisers are achieving on average over 60% more conversions at a lower cost than those without it. Our brand business also performing well.

As I said last quarter, YouTube's reach is becoming increasingly incremental to TV. We're helping advertisers find audiences they can't find anywhere else. Connected TV is driving part of this growth. It's our fastest-growing screen. The precision of digital, paired with the scale of linear is proving to be an awesome combo, and even more so now with the expansion of video action campaigns for CTV.

Advertisers can now drive conversions on the big screen, which brings me to how brands of all sizes continue to buy YouTube at both ends of the funnel, to create future demand, while they convert existing demand, and they're seeing upside.

For example, we found that advertisers using both DR and brand videos, see brand driving 28% of conversion assist. Domino's Pizza is a great example. The UK business delivered a 9x return on ad spend on their direct response campaigns when paired with their brand campaigns.

Lastly, I've said it before and I'll say it again, our success is only possible because of our customers and partners. We do well only when they do well, and it's a result of the revenue share models we've talked about many times before.

Three highlights. First, as Sundar mentioned, commitment to high quality journalism and open access to information remains steadfast. It's been one year since we launched News Showcase. In Q3 alone, we signed over 120 deals and launched in three new markets, Japan, Columbia and Austria. And of the more than 1,000 publications across a dozen-

plus countries that we now have onboard, 90% are considered local, regional or community newspapers.

Second, over 2 million creators are now making money and building their businesses on YouTube via YouTube Partner program, with 10 different ways to monetize their content from Super Chat to Brand Connect. The next generation of businesses and media companies are being built by creators on YouTube, and we're excited to help them grow.

Third, I echo Sundar's excitement on Pixel and to bring it to life and to users, we work with an entire ecosystem of partners. We signed partnership agreements with over 45 carriers and retailers across nine countries at launch, including deep collaboration with each of the major U.S. carriers; AT&T, T-Mobile and Verizon.

On behalf of many, I want to say how grateful we are to collaborate with so many amazing customers and partners every day. We can't wait to start doing more of this in-person again soon. Also, a huge thank you to our sales, partnerships, product and support teams for their work and dedication. The impact you all continue to have is, as we say in German, wunderbar.

With that, Ruth, over to you.

Ruth M. Porat {BIO 2536317 <GO>}

Thank you, Philipp. Our revenue performance in the third quarter reflects continued broad-based strength in advertiser spend and elevated consumer online activity, as well as a strong contribution from Google Cloud. My comments will be on year-over-year comparisons for the third quarter unless I state otherwise. We will start with results at the Alphabet level, followed by segment results and conclude with our outlook.

For the third quarter, our consolidated revenues were \$65.1 billion, up 41% or up 39% in constant currency. Our total cost of revenues was \$27.6 billion, up 31%, primarily driven by growth in TAC, which was \$11.5 billion, up 41%. Other cost of revenues were \$16.1 billion, up 24%, reflecting in part the benefit from the change in useful lives made earlier this year. The largest driver of the growth in other cost of revenues was content acquisition costs.

Operating expenses were \$16.5 billion, up 19% in terms of the three component parts of OpEx: First, the increase in R&D expenses was driven primarily by headcount growth. Second, the growth in sales and marketing expenses was driven by headcount growth followed by the continued ramp-up of spending on ads and promo in contrast to the pullback in the third quarter last year. Finally, the increase in G&A reflects the impact of charges relating to legal matters, followed by headcount growth.

Operating income was \$21 billion, up 88%, and our operating margin was 32%. Other income and expense was \$2 billion, which primarily reflects unrealized gains and the value of investments in equity securities. Net income was \$18.9 billion. We continue to generate strong free cash flow of \$18.7 billion in the quarter and \$65.7 billion for the

trailing 12 months. We ended the third quarter with \$142 billion in cash and marketable securities.

Let me now turn to our segment financial results. Starting with our Google Services segment. Total Google Services revenues were \$59.9 billion, up 41%. Google Search and other advertising revenues of \$37.9 billion in the quarter were up 44%, with broad-based strength across our business, led again by strong growth in retail.

YouTube advertising revenues of \$7.2 billion were up 43% due to strength in both direct response and brand advertising. The deceleration in the growth rate versus the second quarter was driven by lapping a strong recovery in brand in the third quarter of last year. Network advertising revenues of \$8 billion were up 40%. Other revenues were \$6.8 billion, up 23%, driven by growth in YouTube non-advertising revenues and hardware, which benefited from the addition of Fitbit revenues. Google Services operating income was \$24 billion, up 66%, and the operating margin was 40%.

Turning to the Google Cloud segment, revenues were \$5 billion for the third quarter, up 45%. GCP's revenue growth was again above cloud overall, reflecting significant growth in both infrastructure and platform services. Strong revenue growth in Google Workspace was driven by robust growth in both seats and average revenue per seat. Google Cloud had an operating loss of \$644 million. As to our Other Bets in the third quarter, revenues were \$182 million, the operating loss was \$1.3 billion.

Let me close with some comments on our outlook. With respect to foreign exchange impact on reported revenues, based on current spot rates, we expect virtually no impact in Q4, in contrast to a 1.5% tailwind in Q3 and 4% in Q2. In terms of outlook by segment, for Google Services, as I noted, the strength of our revenues in Q3 reflected both underlying strength in advertiser and user activity, as well as the impact from lapping weaker performance in the comparable period last year. Given the gradual recovery and results through the back half of 2020, the benefit from lapping prior year performance diminished in Q3 versus Q2 and will diminish further in Q4.

Within other revenues, in the fourth quarter, we expect the ongoing drivers of revenue growth to be hardware, due to the benefit from the holiday selling season and inclusion of Fitbit as well as YouTube subscriptions. Google Play's contribution to revenue growth will remain more muted, given the ongoing impact of both lapping the increased level of user engagement that started in the first quarter of 2020 due to the pandemic, as well as the fee change that took effect on July 1. Within Google Services, we expect sales and marketing expenses to be elevated in the fourth quarter to support the holiday season.

Turning to Google Cloud, we remain focused on revenue growth and are pleased with the trends we are seeing. In GCP, our customer wins, as Sundar noted reflect our multi-year investments in products and solutions that are purpose-built to solve for the biggest opportunities within our targeted eight industries. The benefit of these solutions to our customers is clear and they are choosing to work with us as their long-term transformation partner.

With respect to Workspace, we are pleased with the ongoing momentum in both seat growth and average revenue per seat, which underscores the value of collaborative solutions, in particular as people increasingly are embracing a hybrid work model. Across cloud, we continue to invest aggressively both in growing our go-to-market and product teams as well as building out our cloud regions. At the Alphabet level, headcount grew by nearly 6,000 in the third quarter, including our seasonal campus hires and we expect robust headcount growth in Q4 for both Google Services and Google Cloud.

Turning to CapEx, the results in the third quarter primarily reflect ongoing investment in our technical infrastructure, most notably in servers, to support ongoing growth in Google Services and Google cloud. We also continue to increase the pace of investment in fit-outs and ground-up construction of office facilities to accommodate our ongoing headcount growth globally. We will continue to pursue real estate acquisition opportunities where it makes sense, as you saw in our New York City announcement in Q3.

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

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions) And our first question comes from Eric Sheridan from Goldman Sachs. Your line is now open.

Q - Eric Sheridan {BIO 22465717 <GO>}

Thank you very much for taking the questions. Maybe first one for Sundar, big picture, coming back to how you started the call, when you look out over the next three to five years, what do you see as some of the big investments that Google needs to make to marry your ambitions on AI and Machine Learning against aligning Google's broader product and services against the rising digitalization of the global economy, would love to, you have that as a framing over the next three to five years?

And then maybe I'm not sure if it directed better at Philipp or Ruth. But on a shorter duration basis, there seem to be an element of headwinds and tailwinds in the broader macro economy. Can you talk a little bit about the business elements of Google's products and what elements of reopening dynamic you're seeing on a sector basis versus potential headwinds as we move into Q4 next year, from things like supply chain shortages or labor shortages or things like that? Thanks so much in advance for the color.

A - Sundar Pichai {BIO 15004624 <GO>}

Eric, great question. I mean, you're right in the fact that AI and ML itself is the broader, deeper investments we are driving and we're using it to across our product portfolio.

The recent launch of Tensor and Pixel 6 is a great example of that. So for example, we are willing to go as deep in the stack as needed to silicon both on the cloud side with our Tensor processing units, and Google Tensor on the client side is an example of that. So overall, thinking through compute, networking, building data centers, making sure they are clean and carbon-free and really investing in the advanced models and algorithms on top, which is -- lot of it just done by our AI research teams. So making sure we are able to attract the best talent across the world is all part of that. So -- but you'll continue to see us take -- undertake deep technology investments. And beyond that horizon, that's why we are thinking even about areas like quantum computing and so on.

A - Philipp Schindler {BIO 21014597 <GO>}

So to the second part of your question, we continue to watch countries as vaccination rates climb and local regulations ease. We expect some amount of heterogeneity in recovery depending obviously on location and vaccination rates. But because every region is different, it's hard to make a generalization from the data right now. That said, the consumer shift to digital is real and will continue even as we start seeing people are returning to stores, shopping habits have ebbed and flowed over the last 20 months. But the underlying takeaway is that people want more choice, they want more information, more flexibility and we don't see this reversing.

Omnichannel, I talked about, it is definitely in full force, I said this earlier, we've been really focused on building features and solutions to help retailers large and small succeed here. And we think this will continue as the world reopens and shoppers fluctuate between online and in-store based on whatever is really more convenient.

YouTube is exciting for many reasons. It's incredible to see the amount of content that's valuable for people across so many topics, and we're helping advertisers tap into this. And whether it's browsing for inspiration, product research or actually making the purchase. A billion shopping sessions happen across Google every day and they're happening on Search and YouTube and Image Search and the Shopping tab and Lens and so on. So frankly, we're really encouraged by the long-term opportunity in commerce, and we're laser-focused on helping business of all sizes connect with their customers wherever they are.

Operator

Thank you. And our next question comes from Brian Nowak from Morgan Stanley. Your line is now open.

Q - Analyst

Hi, it's Brenda on for Brian. Thanks for taking our questions. We have two. The first one, you have made notable strides in the retail search category over the past 12 to 18 months, and there seems to be more to come. Can you talk to us about which other search verticals where you are most excited to innovate and invest around the next -- within the next year or two?

My second question is, maybe one on augmented reality. You have made some real progress here and now have some budding [ph] product integrations. Philosophically, how do you think about the key augmented reality use cases you are focus on enabling? And do you need an Alphabet-specific hardware set to capitalize on the opportunity? Thank you.

A - Sundar Pichai {BIO 15004624 <GO>}

Maybe I'll take the second one first. In on augmented reality, we've -- for a while, we have deeply focused on thinking through computing for the long-term. We've talked about ambient computing. And it's just a matter of time before beyond phones, you will see other successful form factors, and AR is an exciting part of that future.

We are looking at all the deep investments we need to make. I think it's going to take some time. And so for example, when you look at something like Google Lens or when you look at the fact that we are making search work in a multi-modal way or when you think about YouTube and making sure it works well, VR, AR world. So we are obviously investing in all our services. And beyond that from a computing standpoint both our hardware teams as well as our platform teams are thinking through definitely, and it's going to be a major area of investment for us.

On the first question about, I think Philipp spoke about shopping. We obviously -- searches part of what makes search so successful is people use it for a wide variety of use cases. And so, we really invest comprehensively across all experiences, be it local and map, be it images, be it videos. And so, we are definitely investing a lot, people do come to for education as well. So making sure we are comprehensive, health has been a major area of focus particularly through the pandemic. And so, the strength of search is both in its depth and breadth. And so -- and then -- and getting it right with a high focus on quality and we'll continue to do that.

Operator

Thank you. And our next question comes from Doug Anmuth from JPMorgan. Your line is now open.

Q - Douglas Anmuth {BIO 5591566 <GO>}

Thanks for taking the questions. I've two. First, I was just curious if you're seeing any impact at all from the Apple iOS changes in your business and perhaps particularly in YouTube? And then second, given retail the biggest driver of services growth, and of course, you're really just touching all parts of the economy, anymore commentary on how you're thinking about supply and labor shortage dynamics in the fourth quarter and if you're perhaps seeing anything thus far there? Thank you.

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

Thanks for the question. Starting with the iOS 14 changes. So overall, as we say, we're pleased with the strength across our business in the third quarter, it was broad-based, it was global. In terms of the iOS 14 changes specifically, they had a modest impact on

YouTube revenues that was primarily in direct response. I think as you all know well, focusing on privacy has been core to what we've been doing consistently. And let me have Philipp take you through some more on that.

A - Philipp Schindler {BIO 21014597 <GO>}

Yeah. So from our standpoint, we see ATT as one aspect of the many broader ecosystem changes that are underway and we've been investing in privacy-preserving technology for many years. Our focus is on supporting developers, small and large advertisers, creators, publishers, so that they're able to mitigate impact to their businesses. And we really see the future of digital advertising being built on advances and privacy-preserving on device technologies, which support the free and open Internet and obviously a robust ads ecosystem.

On your supply chain questions, I will say performance in Q3 was strong across as revenue lines, regions and nearly all verticals in line with the widespread reporting of supply chain weakness in the auto industry, we've seen some impact on vehicles within the auto vertical, which started earlier in the year, although the impact has really been offset somewhat by increased demand and related areas like parts, accessories, repairs and maintenance.

Q - Douglas Anmuth {BIO 5591566 <GO>}

Great. Thank you.

Operator

Thank you. And our next question comes from Justin Post from Bank of America. Your line is now open.

Q - Justin Post {BIO 3469195 <GO>}

Thank you. One for Sundar, and one for Ruth. Sundar, margins have been strong this year, and I think the depreciation changes helped. Can you just comment on how you see the current investing spending levels of the company, are you in good shape, anything where you might be increasing your investment?

And then for Ruth, there news about Play Store fee cuts on the subscription piece. How do we think about that may be impacting the business in '22, when those start to take effect? Thank you.

A - Sundar Pichai {BIO 15004624 <GO>}

At a high-level, look, I mean, I've taken a long-term view. And we are obviously investing both in foundational technologies like AI and just deeper computer science overall, and applying it across a prioritized set of areas. And so no change in the framework, if anything, I do feel with the digital transformation underway. If anything, we feel sense of urgency to execute against opportunities we see. So still working within the long-term framework. Maybe Ruth and Philipp.

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

Yeah. If I can just add on, on the margin then go to your second part of the question, just bit of context on the third quarter here. An important point, hopefully self-evident is that the improvement in the Q3 operating margin does reflect the strong revenue growth in the quarter. And as I said on the second quarter call, some of our costs are less variable in the short-term such as depreciation and the operations cost of our data centers, and we did have a gross margin benefit from this in the near-term. But consistent with Sundar's comments and Philips, yeah, we do continue to invest here.

And then to support long-term growth across both Google Services and Google Cloud, we're continuing to invest at a meaningful clip across headcount, compute, sales and marketing. I noted the headcount increase in Q3 of about 6,000 and we do expect the pace of hiring to remain strong. The benefit from the change in useful lives was obviously in the quarter as well and that benefit does diminish, does -- is lower in the fourth quarter. So just to put some of that in context, Sundar said, we are continuing to invest in the business focusing on long-term growth.

With respect to the Play changes, again just as it relates to this quarter and I think as I said in opening comments, the key point to note there was that results lapped the strength that we had in the -- going into the pandemic from user engagement and that continues in user engagement. But yes, there is a reduction in the fee that kicks in, the one that we just announced last week. It kicks in as of January 2022, and we'll let you do the modeling on that.

Q - Justin Post {BIO 3469195 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Mark Mahaney from ISI. Your line is now open.

Q - Mark S. Mahaney {BIO 3027058 <GO>}

Thanks. Two questions. Is there anything that suggests that some of these ATT headwinds for other people in the industry actually cost shifts in budget over to your platforms, your different platforms? And then, that's for Philipp.

And Ruth, just on the margins, is there anything other than revenue overage that really strong revenue performance flowing against fixed costs and the extended depreciation schedules that's causing those margins to rise, or have you been able to work out, eked out, tweak out new efficiencies in the model itself? Thank you very much.

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

So why don't I start on that. The key points as I said, it starts with strong revenue growth and just timing lags. It's some of the costs as I said are kind of more fixed in the near-term,

but we do continue to invest. And you can see that in gross margin, you can see it in operating margin. And we are continuing to invest to support growth, we see in both Google Services and Google Cloud.

You sort -- you -- in up leveling the question, we've consistently said, let's -- we -- that our focus in capital allocation is investing for long-term growth in innovation. And making sure that, we remain focused on that -- those long-term opportunities. At the same time, we've consistently also said that it's important to ensure that we're being sharp about investments within each product area and we're continuing to do that, and we're continuing to focus on investing in what we call operational excellence to ensure we can deliver for all of our stakeholders in a high-quality way, and that includes all of our efforts around privacy, security and content moderation. So you're seeing us continue to invest there, a bit of puts and takes, we're trying to ensure that we're setting up all of the areas to deliver for long-term, high-quality performance and results.

A - Sundar Pichai {BIO 15004624 <GO>}

On the first question around ad budgets and shift and stuff, I don't think there's anything notable that we have observed to comment on.

Q - Mark S. Mahaney {BIO 3027058 <GO>}

Thank you very much.

Operator

Thank you. And our next question comes from Brent Thill from Jefferies. Your line is now open.

Q - Brent Thill {BIO 1556691 <GO>}

Thanks. On Google Cloud, we continue to hear from the partners that the deal size is building and BigQuery is having a big impact for a lot of your customers. Can you just talk to and expand on what you're seeing there? And any other noticeable trends that you're seeing now that maybe you hadn't seen in the past? Thank you.

A - Sundar Pichai {BIO 15004624 <GO>}

Thanks. Look, overall, we continue to see strong momentum. The team is executing well. You mentioned BigQuery, data and analytics and AI continues to be a kind of a foundational shift for what companies are trying to accomplish and BigQuery does stand out there, and we're definitely seeing continued momentum there, it's a source of strength.

The other areas I would highlight are security continues to be an increasing area of focus and the differentiator for us given in over two decades of investment we have had, we pioneered zero trust and so on. So as cybersecurity elevates and concern across companies I talk to and the CEOs, it's definitely been an area. Multi-cloud continues to be a differentiator. I do think customers are increasingly looking for it. And we've embraced it

from early on, so that is an area as well. But above all, I think we are very, very focused on industry value propositions, so really sharpening our solutions by vertical and that's really helped us get some of the bigger deals you mentioned as well, and we'll continue doing that.

Q - Brent Thill {BIO 1556691 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Michael Nathanson from MoffettNathanson. Your line is now open.

Q - Michael Nathanson {BIO 2009061 <GO>}

Thanks. Hi. One for Sundar, and then one for Philipp. Sundar, you talked earlier about the JioPhone Next launch next week in India. I wonder if you can talk about what are our current opportunity for Alphabet in India from opening up that product in any type of time frame, when do you think you will see maybe the benefits of what you're doing on the low price still on there?

And then Philipp, it just seems longer term as what we're targeting becomes more difficult to all these privacy changes, that there has to be a mid-shift in budgets. And I wonder, how do you think the value proposition of search will change going forward? And what can you do even more than you've done before, to take advantage of what looks like real challenges in ability to target and measure becomes to mobile search, I mean, when it comes to mobile advertising? Thanks.

A - Sundar Pichai {BIO 15004624 <GO>}

On India -- thanks for the question, look, I think obviously, the pandemic has been hard, but through it all, there people are looking for access and this definitely being a wave of people who have adopted smartphones and there is still we see the demand for people looking to shift from feature phones to smartphones. And so part of what excites me about the upcoming partnership with Jio and building a phone is really investing beyond just English and getting languages and getting the local needs, right, for people and doing it in a way that many more people can take advantages of a smartphone.

So I viewed it as laying the foundation, it's a version of digital transformation, and it's palpable the demand we see. And I think over a three to five-year time frame, it'll end up having a lot of impact. But overall, India, just like Asia-Pacific, continues to be an exciting market for us. We see strength across the categories we are involved in, and so you'll continue to see us stay focus there.

A - Philipp Schindler {BIO 21014597 <GO>}

And to the second part of your question, look, as I said, we see the future of digital advertising being built on advances and privacy-preserving on device technologies. This

is a big area that we've invested already and that we're going to invest in even more. And as far as how we think about our runway for growth, we really think about improving user and advertise experience for years and years to come.

And we're always asking ourselves the same questions, right, how do we drive better answers to queries, especially on search, especially including those with commercial intent, how do you use Machine Learning to deliver even more relevant and higher quality experiences for users, that then drive higher clicks and more conversions for advertisers. So really our main goal is to consistently deliver great experiences for users, drive incremental value for partners and making them successful. And as long as we do this, and we continue to invest in the privacy-preserving technologies I mentioned, we should continue to see budgets move our way.

Q - Michael Nathanson {BIO 2009061 <GO>}

Thank you.

Operator

Thank you. And our next question comes from Ross Sandler from Barclays. Your line is now open.

Q - Ross Sandler {BIO 15948659 <GO>}

Hey guys. I just had a high-level question on YouTube. So you're obviously doing really well there. And as large as it is and as high as the engagement is compared to just about any other app that we see across the broader Internet, the revenue just around \$30 billion this year it entails [ph] in comparison to core Facebook or Instagram. So do you think that this is obviously a huge opportunity for YouTube, especially with Connected TV? Is there something that you guys need to change about your approach with either direct sales or kind of decoupling search from YouTube and some of the other products that Google has under the same roof, or do you kind of think continuing along the same path is the right strategy for YouTube specifically? Any color on that would be helpful?

A - Sundar Pichai {BIO 15004624 <GO>}

Okay. I think, obviously, YouTube is unique in the sense that it's a true video-native video-first product from day one. And so you are dealing with in a new form and obviously, as a company, I think we've taken a long-term view, which is why you see the engagement on the product, it's working at scale, content responsibility has been our most important focus for the past many years. And beyond that, I think we have worked hard to make sure both creators can do well and it's a great platform for advertisers. We've had strengthened brand, we've built on it with robust momentum and direct response, there's obviously newer opportunities such as shopping which we are investing in, and Shorts represents an additional early but important area for us from an investment and growth standpoint. So I feel the fundamentals of the platform are strong. And with the long-term view, I see this is an area where we have more upside. And so, we'll continue our investments with that in mind.

Operator

Thank you. And our next question comes from Colin Sebastian from Baird. Your line is now open.

Q - Colin Sebastian {BIO 6373379 <GO>}

Thank you. Couple of big picture questions. Sundar, first off, looking at GCP and some of the innovations you've talked about like Distributed Cloud. I just wonder what you think the long-term future is for hybrid cloud environments? Are they really -- or is this really just a part of the process or stepping stones to bring more companies or most companies over to full cloud adoption?

And then secondly, we're seeing a clear blurring of the lines among e-commerce, digital payments and social platform. So I was hoping you could share the vision for Google and YouTube and the other Google Apps in this context, how those pieces fit together as a closed-loop shopping platform, if that's the right way to think about it? Thank you.

A - Sundar Pichai {BIO 15004624 <GO>}

To your first question on GCP, part of our strength is we have taken a very open and scalable and flexible approach. And we don't view it as a one size fits all, so we want to meet the customers the way they want to take this journey and I think are gearing up to support them both from a multi-cloud, from a hybrid-cloud standpoint. But I do think over time when I look at the scale at which we are investing to support particularly to my points earlier around security and so on, I think people will see the value more, so value more of a hosted cloud solution. But I think we want to be customer centric here, and then we want to go where the market goes and that's why we've build a scalable infrastructure we have. So I'm excited about the opportunity there.

On your second question around e-commerce, digital platforms, shopping, social, how does it all fit together? For me, I see it as two things. One is, we want to get the primitive strike, which means as a user being able to be it in Search, in YouTube either on the products or as you -- we are trying to connect merchants to users straight and be it organically or through advertising. And so we are investing in identity, payments, making sure it's seamless for users. And so, that's a big part of our focus.

The second is really from a user experience standpoint both in Search and in YouTube and other areas like Maps and Discover over time, if we want to make sure if users want to act more beyond Discovery, and they want to do more that it seamless to do so. But we are going to be very focused on making sure for merchants that they can -- they get access to users and that's the value proposition we deeply care about. And so, we'll invest with that view in mind.

Q - Colin Sebastian {BIO 6373379 <GO>}

Okay. Thank you very much.

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Operator

Thank you. And our last question comes from the line of Stephen Ju from Credit Suisse. Your line is now open.

Q - Stephen Ju {BIO 6658298 <GO>}

Okay. Thank you. So Sundar, I think in the past, we've talked about the intersection of hardware and software for Google. And you touched on the Pixel 6 as well as the other examples in your prepared remarks. But as you look at all the different directions you're going with Fitbit, Nest and all the other devices, how has your thinking evolved over the years and what do you envision a hardware and software integrated Google meaning to the consumer over the longer term?

And I guess Philipp, if you look at some of the emerging and developing markets today, some of the companies they're around the world that have had to play multiple roles in helping to solve for transactional friction by ruling [ph] our payments logistics and other solutions that we probably take for granted here in the states. So do you think Google should or could play a more expansive role in India and some of the other emerging markets to help accelerate the growth of e-commerce versus the role that you played in the U.S. and the West? Thanks.

A - Sundar Pichai {BIO 15004624 <GO>}

In overall hardware and computing, obviously, we have been doing this for a while now. If you look at the Google Tensor bet, these are multi-year bets, which finally play out. And I couldn't be more excited at the reception for Pixel 6 and Google Tensor, and I think it lays a good foundation of what we want to do in the future. We definitely have a long-term view on where computing is headed. We want to make sure and to innovate there, you have to think at the intersection of user experience software and hardware. I think we have a unique perspective to bring, a unique point of view with our AI-first approach and applying that to bring new features and new experiences.

So we'll be doing it to push computing forward, we want to guide our ecosystem. When we do well in a category, the whole ecosystem benefits from it. And finally, we're going to be doing this with a view towards building a sustainable business. And we see this as an important area and we are investing with that viewpoint. And I'm really excited with what Google Tensor and the Pixel 6 team has been able to accomplish and I view it just as a start.

A - Philipp Schindler {BIO 21014597 <GO>}

So on the second part of your question, look, every e-commerce experience is also payment experience, and friction-led and check-out can take the joy out of a purchase. I think we've all been there. So think about Google Pay as a checkout facilitator. We want to make it even easier for consumers to access whatever payment method they really want credit card, PayPal, ShopPay and so on and so on.

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And to the global nature of your question, a 150 million people across 40 countries are now using Google Pay to manage transactions and stay on top of their finances and millions of merchants are using it to provide their customers with a simple and safe way to check out, and whether it's in-store, or online or via their app. So right now, we continue to be very focused on helping both merchants and financial institutions create more intuitive digital experiences and connect with our customers. In the U.S., we're partnering with merchants to surface, we come card linked offers and coupons within Google Pay. And in August, we announced the partnership with Setu fintech company in India, that was a part of your question to help users open fixed deposit accounts directly from Google Pay. So we think there's much more that we can do for both consumers and our partners. So, stay tuned on this one.

Q - Stephen Ju {BIO 6658298 <GO>}

Thank you.

Operator

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

A - Jim Friedland {BIO 22252778 <GO>}

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

Operator

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

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