Presentation

Operator

Good day, everyone, and welcome to the Google Inc. Second Quarter 2014 Earnings Conference Call. This call is being recorded. At this time, I'd like to turn the call over to Jane Penner, Director of IR. Please go ahead ma'am.

Jane Penner

Good afternoon everyone and welcome to Google's second quarter 2014 earnings conference call. With us are Patrick Pichette, Senior Vice President and Chief Financial Officer; and Nikesh Arora, Senior Vice President and Chief Business Officer.

Also as you know, we distribute our earnings release through our Investor Relations Web site located at investor.google.com. So, please refer to our IR Web site for our earnings releases as well as the supplementary slides that accompany the call.

You can also visit our Google+ Investor Relations' page for latest Company news and updates. Please check it out. This call is also being Webcast from investor.google.com. A replay of the call will be available on our Web site later today.

Now, let me quickly cover the Safe Harbor. Some of the statements that we make today may be considered forward-looking including statements regarding Google's future investments, our long term growth and innovation, the expected performance of our businesses and our expected level of capital expenditures. These statements involve a number of risks and uncertainties that could cause actual results to differ materially.

Please note these forward-looking statements reflect our opinions only as of the date of this presentation and we undertake no obligation to revise or publicly release the results of any revisions to these forward look statements in light of new information or future events. Please refer to our SEC filings for more detailed description of the risk factors that may affect our results.

Please note that certain financial measures that we use on this call such as operating income and operating margin are expressed on a non-GAAP basis and have been adjusted to exclude charges related to stock-based compensation and restructuring. We've also adjusted our net cash provided by operating activities to remove capital expenditures which we refer to as free cash flow. Our GAAP results and reconciliations of non-GAAP to GAAP measures can be found in our earnings press release.

With that, I will now turn the call over to Patrick.

Patrick Pichette

Thank you, Jane. Good afternoon and thank you for joining us for our second quarter 2014 earnings call. So I will dive right into the numbers. Nikesh is going to give you a business update and then we will open-up for Q&A. So let's dive into the details of our financial performance for Q2.

Our gross total consolidated revenue grew a healthy 22% year-over-year to $16 billion and was up 3% quarter-over-quarter. Without currency fluctuations, our gross total consolidated revenue growth would in fact have been 21% year-over-year, still very healthy.

Our Google site revenue was up 23% year-over-year to $10.9 billion and was up 4% quarter-over-quarter driven by strength in our core search advertising business.

Our Network revenue was up 7% year-over-year at $3.4 billion and was up 1% quarter-over-quarter driven by year-over-year growth in our AdMob and Ad Exchange businesses.

Finally, Google other revenue grew 53% year-over-year to $1.6 billion and was up 3% quarter-over-quarter. Digital sales of apps and content in our Play Store drove the year-over-year growth.

Our global aggregate paid click was strong this quarter, up 25% year-over-year and 2% quarter-over-quarter. Aggregate CPC were down 6% year-over-year, but flat quarter-over-quarter.

And without currency fluctuation, aggregate cost per click would have been down 7% year-over-year. So currency had a very minimal -- and currency had no impact on quarter-over-quarter CPC growth.

As we indicated in our last earnings call, we're now disclosing paid clicks and cost per click changes by property type in addition to aggregate numbers. So to that end, Google sites paid clicks were up 33% year-over-year and up 6% quarter-over-quarter. Our Google site CPC were down 7% year-over-year and down 2% quarter-over-quarter.

On the Network side, network paid clicks were up 9% year-over-year and down 5% quarter-over-quarter. And our network CPCs were down 13% year-over-year and up 3% quarter-over-quarter.

Our monetization metrics continue to be impacted by a number of factors at an aggregate level, including geographic mix, device mix, property mix, as well as our ongoing product and policy changes. And since we're now disclosing additional property metrics related to our monetization, it maybe helpful to remind you all of what we include in each property. So let's start with sites.

Sites monetization metrics includes ads that were served on Google owned and operated properties across different geographies and form factors. So these properties include YouTube search obviously -- YouTube engagement ads like TrueView, and then other owned and operated properties such like Maps or Finance and otherwise.

Our Network monetization metrics include ads served on non-Google properties participating in our AdSense for Search, AdSense for Content, and AdMob businesses. We also provide corresponding historical data since Q1 of 2013 for reference, which can be found on -- in our earnings slides.

Nikesh and I'll obviously be happy to respond as usual to your question about our Q2 monetization in the Q&A today. But I'm sure that some of you may have detailed questions about monetization trends from prior quarters. And to help you with that, the IR team will be ready to answer your questions after the call.

Turning to geographic performance, we saw solid performance in the U.S. and U.K and continued strong performance in rest of the world. In our earnings slides, which you can find in our Investor Relations' website, you'll see that we've broken down our revenue by U.S., U.K., and rest of world, to show the impact of FX and the benefits of our hedging program. So please do refer to these slides for the exact calculations.

The U.S. revenue was up 12% year-over-year to $6.6 billion. The U.K. was up 22% to $1.6 billion and in fixed FX terms, the U.K. grew 15% year-over-year, a clear improvement from last quarter's performance.

As we've mentioned in previous quarters, our AdSense for search business skews toward the U.S and the U.K. And our ongoing user focused product and policy changes have continued to have a clear impact on our revenue growth in these two geographies.

Our non-U.S. revenue excluding the U.K. was up 31% year-over-year to $7.7 billion, and this accounted for 48% of our total revenue, which includes a $6 million benefit from our hedging program. So in FX term, the rest of the world grew also 31% year-over-year.

Let me now turn to expenses. Traffic acquisition costs were $3.3 billion or 23% of total advertising revenue this quarter. Our non-GAAP other cost of revenue was $2.7 billion in Q2. This is excluding stock-based compensation.

Our non-GAAP operating expenses totaled $4.8 billion, again excluding SBC and as a result, our non-GAAP operating profit was $5.1 billion and our non-GAAP operating margin stood at 32% in Q2.

Headcount was up, roughly 2,200 people in Q2 in the last 90 days. And in total, we ended the quarter with approximately 52,000 full-time employees, but please note that the headcount does include approximately 3,500 full-time employees from the Motorola business.

Our effective tax rate was 21% in Q2. Our tax rate this quarter was impacted by the continued mix shift of earnings between our domestic and international subsidiaries.

Let me now turn to cash management. Our OI&E, our other income and expense was $145 million for the quarter. Interest income and realized gains on investments offset the continued impact of expenses from our FX hedging program. And for more detail on OI&E, please refer to the slides that accompany this call on our IR Web site.

We continue to be happy with our strong operating cash flow at $5.6 billion. And CapEx for the quarter was $2.6 billion. This quarter, the majority of the CapEx spend was related to data center construction, real estate purchases and finally production equipment in that order. Investor should see our investment in CapEx as a positive signal, since it reflects our sustained optimism about Google's business.

As I've mentioned before, we will continue to invest for the long-term and our infrastructure and real estate assets remain a key strategic area of investment for us. Our free cash flow for the quarter was $3 billion.

And before I close, I want to give a brief update on Motorola. The team continues to be hard at work and we look forward to seeing them join with the Lenovo team soon. Motorola had a great Q2 with the Moto E and Moto G, both showing strong sales momentum especially in emerging markets.

So there you have it, strong results and an optimism that provides us the confidence to continue to fund strategic growth opportunities in many areas including our CapEx area that we talked about earlier.

And now I'll let Nikesh cover some more details on our business performance in the quarter and after his remarks, I will take it back to open-up the phone lines for questions. Here you go Nikesh.

Nikesh Arora

Thank you, Patrick. You've had an amazing last few months at Google and our focus in creating great multi skin experience is paying off. I hope you saw our annual IO Developer Conference a few weeks ago. We were joined by over 6,000 developers in San Francisco along with approximately 1.9 million people globally tuning in online.

We unveiled the upcoming Android L release. We also showed how we're expanding android platform to cars, watches, TVs, as well as making it easy to search Google from anywhere by simply saying okay Google. Making magical products that people love using everyday is what drives our ambition, fuels our business.

Last quarter we saw strong growth with $16 billion in gross revenue. We saw particular strength in the travel and retail verticals as well as in several countries like Japan and India.

By now you know the four areas driving our business. One, performance or direct response marketing; two helping clients build their brands; third our ad tech platforms for agencies and publishers; and four, our emerging businesses like digital content, enterprise, and hardware.

I'll quickly go through each of them and this quarter I want to highlight the investments we're making to serve the small businesses. Firstly, in performance advertising, in the long-term we're battling towards a world where people jump seamlessly across screens of all sizes on all types of surfaces.

In today's world, unlocking the mobile phone opportunity is absolutely key for every marketeer and we're seeing tremendous amounts of momentum here. We've been building popular mobile app formats for years like showcasing a businesses location or click to call, etcetera.

The teams are laser focused on making ad campaigns easier across screens and helping businesses measure their effectiveness across devices as well as offline. We already offer great solutions for marketeers wanting to promote app installs, in April at our AdWords performance forum, we supercharged our offerings for app developers across search, display and as well as YouTube.

We launched improvements like app deep linking and search to help developers re-engage users, who have already downloaded their app, better targeting options in AdMob to help them recent most likely customers, even a new app install format on YouTube and more powerful measurement tools, so they know exactly how their app is performing at every stage.

Mobile hotel booking app Hotel Tonight uses mobile search ads as a the key part of their global marketing efforts because it drives consistently high value users or more likely to purchase quickly in the apps. In fact, international mobile search campaigns drive three times higher conversion rates compared to other direct response channels.

We're also seeing tremendous amounts of momentum in the retailer segments, product listing ads across screen. In fact this past quarter, we sent over three times as much traffic to merchants on smartphones and tablet devices compared to Q2 of last year.

Let me go to the second area of brand building. I recently spend some times at Cannes Lions Festival. I know it was working Canne, where Google had a big presence, hosting over 300 meetings with creative agencies and brands. What was actually interesting this year was how much the conversation with brands has changed from years past. Whereas digital used to be just one channel, today's brand are putting digital at the center of the brand building campaign.

We see this from our clients as well and video seems to be the linchpin of the strategy. YouTube continues to be driven by the insanely popular channels from some of our top content creators like breakout hip -- hit Epic Rap Battles of History and new sensation Vice News.

We launched our Google Preferred Video offering at BrandCast in April, giving marketeers access to top content at YouTube and we've gotten phenomenal amount of support from agencies and brands so far.

Digitas was our first agency to sign on and since then Omnicom Media Group has also pledged their support. Brands including General Motors, Coca Cola, and Universal Pictures are also having tremendous amounts of success as Google preferred. Adidas was one of the major brands to leverage our global platform to reach fans during the World Cup. They engaged soccer fans by live streaming events with athletes, promoted them on YouTube through TrueView ads, as well as using beautiful light box ads across our display network.

Now a few words about our ad technologies for agencies and publishers. Again, video is at the forefront of our efforts here. Last month we introduced a premium programmatic video marketplace called Google Partner Select to help publishers monetize their video content and to help agencies reach top quality video content across the Web.

The feedback that we've gotten from agencies and publishers has been great. We continue to see strong growth across premium inventory, particularly with the growth of private exchanges across AdMob and AdSense publishers are increasing their investments in mobile sites and apps and growing their businesses using our platforms.

Before I move on to our emerging businesses, I want to talk about an area we continue to invest in, online tools for small businesses. Small businesses are the cornerstone of the world's economy and a major priority for us at Google. But there is still a huge opportunity as over 50% of SMBs still don't have a Web site. To help set them up for online success; last month we introduced Google My Business, which helps small businesses manage their online presence across search, maps and Google+.

We also have a vibrant ecosystem of partners who have local businesses optimize their AdWords campaigns and we've been improving our customer support for small businesses. In fact, over the last few years, we've doubled our advertiser customer satisfaction scores which bodes really well.

Now, let me talk about emerging new businesses, digital content, enterprise and hardware. Google Play continues to grow at breakneck speed across all types of digital content, helping developers and content partners reach users around the world. For instance, Play Movies is now available in over 90 countries, with its recent additions in Argentina, Poland and the Czech Republic.

We also recently signed deals with CBS TV and Viacom to bring their TV content to Google Play. With over a 1 billion active android users to going success of Google Play, means that more developers are building successful global businesses in our platform. As we mentioned at IO, since last June, we paid out more than $5 billion to developers through Play which clearly means it's a growing business for us as well.

Shifting gears to our enterprise business, I can report that over 60% of the Fortune 500 use our paid products. This quarter we added even more like Rockwell Collins. They signed up 20, 00 employees to use Google apps.

We also launched Google Drive for work, a premium service of businesses that includes unlimited storage. The reception so far has been great and we even closed our first sale within minutes of the announcement. Our cloud platform business also has momentum with new features announced at IO.

On the hardware side, over 1 million Chromebooks were sold into schools. Clearly a record quarter and the popularity of Chromecast continues to grow. Now available in Australia, Korea, Portugal and many more. I got to watch some World Cup games from the ESPN app using my Chromecast.

Before I close, I want to mention our marketing team, in addition to a great IO this year, we also launched the Made with Code initiatives with partners like Girl Scouts with the USA and Girls to Code, to inspire the next generation of women coders. We are really excited about the enthusiasm around this initiative and who knows hopefully some of this chorus will join us at Google.

With that, I'd like to thank today all the Googlers around the world who helped make this a fantastic quarter. On a personal note, as you might have seen, I'm moving on to a new adventure. I'd like to thank Larry and Sergey and the founders of Google, my colleagues and Larry's staff as well as everyone at Google for the amazing experiences and the phenomenal 10 years I've had. I look forward to working with them in the future and cheering them from the sidelines.

I'll hand back to Patrick.

Patrick Pichette

Thank you, Nikesh. And as you've just heard, this will be Nikesh's last call. So I want to take a minute on behalf of Nikesh, your friends here at Google, your colleagues and also all of Google -- all of our Googlers, to thank you for all of your contributions to Google over like what has been really a decade of work. So thank -- huge thanks. Well many of you on the call may have questions about transition, if you don't mind, we'd like to the keep the discussion focused on our performance in the last quarter, if you don't mind. So that's really where we will focus our questions.

And with that, why don't I turn it over to Jamie who will line us up for our Q&A. Jamie?

Question-and-Answer Session

Operator

Thank you. (Operator Instructions) We will take our first question from Mark Mahaney with RBC.

Mark Mahaney - RBC Capital Markets

Thank you. Two quick questions. The recovery in the growth rate in the U.K., could you provide more color around that or was it just you had hard comps last quarter, but the growth rate really consistent with what you had seen before. And then there was been some recent reporting about YouTube revenues. Could you just clarify even if its just historical data, the size of that asset? And any more color around the growth there, new monetization initiatives etcetera. Thank you.

Patrick Pichette

Yes, so it's Patrick. And as we -- Mark as we've discussed in the last quarter, we had talked about the U.K. having had a tough comp the year before. So you can see basically the recovery of that in the numbers and we're pretty pleased with the momentum there. In terms of YouTube, I mean we -- I know there has been lot of speculation out there, but in essence, where we've is a great opportunities in front of us and we don't comment on outside estimates. YouTube, you know it serves as a powerful starting point for advertisers, for looking to anchor their brand campaigns online and coupled with the online measurement of the digital audience is being Neilsen, ComScore, everything that we just announced over the last couple quarter, right. Clearly a great runway ahead of it. So that's basically the story on YouTube.

Mark Mahaney - RBC Capital Markets

Thank you, Patrick.

Mark Mahaney - RBC Capital Markets

Thanks. Jamie, what's our next question please?

Operator

We will go next to Eric Sheridan with UBS.

Eric Sheridan - UBS

Thanks for taking the question. I guess, on the cash may be you can give update on your e-commerce initiatives. You called out retail as one of the strongest verticals in the quarter. Why didn't you get a little more detail on what (indiscernible) in San Francisco? Thanks.

Patrick Pichette

Yes, thanks Eric for your question. I think two quick answers that, as we've talked in the past PLAs is actually a fundamental sort of existential need of our product. So research business, because as people go to tablets, as people go to mobile devices, they're looking for more and more precise answers when they search and the ability for them to go directly to the entity they're searching for is phenomenally powerful when you're searching lots for these things and Sridhar and his team have done a great job working with every retail out there, try and get as many products listed. And our product listing service, so when you actually search you get a plethora of option in terms of where you can buy the product, what it's priced at and how many products are available in their category. So it’s actually very, very good evolution from a search perspective, which clearly translates into people clicking on those and thereafter hopefully driving more commerce towards our partners and retail segment. As I said, we drove three times as much traffic this quarter’s and we did same time last year. So its clearly good. In terms of Google shopping express, its start of as an experiment, clearly I use that delighted with the service. I mean, I cant seem to find people who are not happy with Google shopping express. And we’re seeing tremendous results. We’re learning a lot. We are getting a logistics right. We’re getting our processes right and you believe its clearly an opportunity for us and our teams are really, really excited about continuing to invest in that area and you keep experiment with different formats and different solutions to make sure that we can provide the most optimized experience to our users. Yes, just a point of clarification, you talked about an overnight service in San Francisco. In fact, we’ve launched overnight deliver in all of northern California. But that continues to be an amazing demand for the product?

Patrick Pichette

Thanks and good luck going forward Nikesh.

Nikesh Arora

Thanks, Erik.

Patrick Pichette

Thank you very much. Jamie, let’s go to our next question please.

Operator

And we will go next to Ben Schachter with Macquarie.

Ben Schachter - Macquarie

Nikesh, good luck in your new role from me as well. Patrick when you’re budgeting for some of the longer term projects and you’re trying to think about sort of a timeframe to get to profitability. For instance, the team at Google X or Google fiber or something on self driving cars. How do you think about the timeframe for getting to profitability? Is there any general rule on how far away it needs to be? And related to that, in terms of the potential financial contribution within the next say three to five years. What are the new initiatives that you expect to have the most impact? Thanks.

Patrick Pichette

Thanks for your question, Ben. And what you really have is, as I've explained many times before, we set up our kind of governance around a bit of like a BC model where we actually have gating and funding. And projects that have -- there are more software based. We will have much shorter life times before we expect a bunch of returns. Projects that are much more kind of fundamental physics R&D, will have much longer life, like kind of timelines for actually funding and expected milestones. But in both cases they're all set around the boundaries of -- you have a business case, you have a thesis and that thesis is basically tested on a regular basis through the gating of the funding that they get. And in some cases like self driving cars, obviously multiyear and we've a couple of other projects and (indiscernible) of that nature were it will take -- we think of kind of half decade, sometimes even a bit longer before we know that -- you can get kind of real momentum on revenue and profitability. Others are much shorter. So that's how we kind of think about it. What matters most is really that we actually set up that gating and that we have these refinements to the business models and you know Google Shopping Express another great example of that where you just kind of have the gating and then they come back for funding every so many months to kind of look at where its going. So that's what we have in terms of the next three to five years, I wouldn't be able to comment on the specifics of anyone of those, but you can basically through the guidance I've just given you. You can come through what is really an asset in terms of versus a software kind of intensive kind of play and then it gives you a guidance of how fast and how slow we should expect our returns to be.

Ben Schachter - Macquarie

Great. Thank you.

Patrick Pichette

Thanks, Ben. Great question. Jamie let's go to our next question please.

Operator

And we will go next to Justin Post with Merrill Lynch.

Justin Post - Bank of America Merrill Lynch

Okay, thank you. Couple ones. You mentioned on the prepared remarks that the U.S growth has been impacted by some of the network changes. I don't suppose you could quantify it, but please do if you can. When do you think you kind of work through all those changes and we can start seeing a normalized growth rate or maybe you can answer by how far you're along that process? And then the second question, pretty excited about Google

Play opportunity. Can you just tell us what -- what's the margin opportunity related to Google Play or the profit opportunity? Thank you.

Patrick Pichette

I will take the first and then I will let Nikesh talk about the second. On the first one, we have -- we've talked about this again as you said so rightly Justin, we have talked about a couple of things going on right as early as -- early kind of Q1 of 2013 we announced these DLA policy changes and you all remember that and we also reminded you at the time that by announcing these changes, it will take time to actually flow through to a bunch of partners across 2013. So clearly there is an effect there on a year-over-year basis, as it all -- it didn't all happen in Q1 of '13. In addition to that, I mentioned in my prepared remarks that we continue to have ongoing user focused product changes and they continue to impact our AFS business is an example. So AFS, right and then what you end up with is you all remember that AFS or AdWords for search -- essence for search, it really skews to the U.S and the U.K. And because of that, that's why you see the disproportion into those results. So on the DLA obviously, they will lapse over the course of this year and -- but the additional kind of continued product changes and user focused product changes and policy changes will continue to kind of hammer them to make sure that we get the perfect balance between what is right for the user and what's right for the advertiser. And so that's why all in all, I feel pretty confident in what I said, when I said that we're pretty pleased with our growth rate in the U.S. As for the Play, why don't I actually let Nikesh give you a bit of comment on that?

Nikesh Arora

I think its important to step back and look at what the Google Play team has achieved. I mean its -- it come from nowhere. It's a phenomenal platform which provides services, apps, content around the world as we mentioned over 90 countries of Google Play movies. And as Patrick would say, $5 billion developer which is 5,000 million, so lot of money. And its actually really great for innovation. Its phenomenal for the app developer ecosystem and it's a really good binding glue for the android ecosystem, because people find tremendous (indiscernible) and all the apps and all the services they get at Google Play. For us we're really, really very excited about the Google Play opportunity. I think in terms of margin, you should be able to look at the market and understand how typically these relationships work and should we know different than what the current market is around the margin opportunity for services in the long-term.

Justin Post - Bank of America Merrill Lynch

Great. Thank you.

Patrick Pichette

Thank you, Justin. Jamie, let’s go to our next question please.

Operator

We will go next to Ross Sandler with Deutsche Bank.

Ross Sandler - Deutsche Bank

Thanks guys. I have two questions, product related. So at IO you announced some new innovation in search and discovery for apps, including opening up app indexing globally. So what kind of timeline do you think Google is on before we start to see a lot of app content appearing in core search results more regularly and what kind of revenue opportunity do you see around that? And then the second question somewhat related is you also announced a bunch of new screen for android, watches, TVs etcetera. I know its still very early days, but do you envision the long-term business model for these being similar to the existing model with ads in Google Play or do you see potentially feeling close loop transactions as an example? Thanks.

Patrick Pichette

Ross, thank you for your question. Let’s talk about the app indexing first and then about the screen stuff. I mean, if you think about it, Google has been in the business of making sure that we drive traffic on behalf of people and advertise and help people find things. And as you look at mobile phone behavior, people spend a lot of time on apps as well as in the browser searching for things. So I think it’s important for us to make sure that we provide the content that users are looking for. So, you should expect us to most aggressively try and make sure that App Indexing all happens and its available and easily accessible across devices and people are looking for things we’ve provided them the most relevant answer in which in certain cases that happens to be the app. So allowing for people to discover apps as well as creating more engagement for apps that people may not have been engaging with for a while. So, I think clearly an area of focus and clearly you should see -- expect us to see activity in that space. And in terms of revenue its not unlike any revenue we cerate in the search where we help people find things and that allows us to create an advertising opportunity where people are -- we’re able to monetize that on behalf of sort of our properties. In terms of your second question, I think you have to take a longer term point of view towards the screen question. As you can see all the screens are sort of almost designed as island where every screen has its own operating system, has its own ability to work. But we’re noticing more and more people want to switch from screens and retain the service experience. And towards that end, the android team is doing a phenomenal job making sure that we provide that seamlessness across screens and the fungibility of services across those screens. So, I think long-term we have to think about this as a user centric model. We're helping users take their services fungibily from one screen to the other and making that happen seamlessly. And if that works out I think there is will phenomenal business opportunities for us in the future. But at Google we always worry about the user first and we'll figure out the monetization when we have a lot of users excited about it.

Patrick Pichette

Thank you.

Patrick Pichette

Jamie, why don't we go to our next question?

Operator

And we'll go next to Carlos Kirjner with Bernstein.

Carlos Kirjner - Sanford C. Bernstein & Co.

Thank you. Two questions if I may. One on revenue, is there a significant positive net impact of growing penetration in usage of smartphones on search place and revenue? And what happens to search revenue growth if there is no more benefit in developed markets as smartphone penetration approaches a 100%? Second, you added more than 2,400 employees to Google in the quarter versus 1,400 in the second quarter last year; I think that's the highest quarter of the headcount addition in more than two years. Patrick, it is the new normal in terms of the rate in which you grow headcounts for the core. How do you think about the rate of headcount growth versus gross profit or you don't think about it at all? Thank you.

Patrick Pichette

Let me tackle that second one and then I'll let Nikesh, talk about the first one. On the issue of headcount, look we have this amazing opportunity and machine to actually look around the world to look for the best engineers. And we promised ourselves that, given the bar it's very, very high. When we do find people that fit the culture and that we think will actually do a great contribution and be great Googlers, we actually don't hesitate and we hire them. Because if we hire them a bit too early or a bit too late it might unbalance, we're very happy to have them early on. You're right that, if you look at the last couple of quarters I mean the trend has been pretty kind of solid. And in addition to that you have to look at the impact also of our acquisitions when we make acquisitions that kind of compound's a bit the numbers. But from that perspective Carlos, we don't set up a specific target we say we're going to end up with X amount for this quarter and then that once we hit our quarter we see everybody else next quarter. So from that perspective we're a bit more organic about it. And we are -- the vast majority of our hiring to kind of give comfort to our investors is, it is really still in the engineering field and the product management field which is really where we want to focus our attention, and we continue to focus there. So, that's basically the puzzle with which we work. On the question, maybe Nikesh can talk about revenue and smartphone penetration.

Nikesh Arora

Yes, of course (indiscernible) the answer is, yes. As we see more and more users with penetration of smartphones, people spend more time looking for things in their smartphones. And I think there's a very, very long sort of runway that this opportunity has, because we're just seeing people getting on to smartphones. Now you're beginning to see businesses and other websites take mobile very, very seriously. They want to be present on mobile. I think the revenue opportunity is phenomenally high, because right now mobile does not monetize as well as certain other forms. But given the huge influx of queries we're seeing, we expect as people make it more and more relevant to be able to find information in the long-term, mobile should be monetizing even better than desktops. So, I think as a tremendous runway going forward, I don't think we have to fear the sort of saturation of smartphone penetration in developed markets for a while.

Patrick Pichette

Thank you, Carlos. We'll take our next question, Jamie.

Operator

And we'll go next to Anthony DiClemente with Nomura.

Anthony DiClemente - Nomura Securities

Thanks very much. Patrick, can you give us an update on your internet access initiatives particularly Google Fiber. Maybe update us on the evolution of the economics of that business and then perhaps even the timing of the Google Fiber rollout for more recently announced cities? And then a separate question on the Google Compute Engine business. How big of a growth driver can GCE be? And what do you guys see as the competitive advantage that Google has and what seems to be an increasingly competitive space in terms of the Cloud? Thanks.

Patrick Pichette

So why don't I jump on the first one, and Nikesh if you don't mind talking about GCE afterwards. Look, here's what's going on with Google Fiber. It's important to bear in mind the following. First is, the economics of a fiber network today are clearly much cheaper than they were say a decade ago. There have been a lot of improvements in cost reductions and technology components all through the fiber network, but also in the way we build it. The second one is, I just want to remind everyone that, an important part of our strategy is actually to build the demand. So, unlike the typical over builder, actually we have a very different kind of business model and thesis for that. And we do work closely with each city to streamline the process that keeps again the cost of construction way down. So, as an update to you right now, Anthony we have as you know we are working with 34 cities, separate cities with a kind of completed checklist of items to help us prepare for the next kind of wave of our construction project. And we're going to be basically, they are in the last rows of finishing these checklists and its coming back with us. Over the coming months we'll actually be going through all of the details with them, whether it would be write away or permitting or otherwise, and that's what we're going to use to make decisions as to how broad a program will have. We expect that to kind of give an update between now and the end of the year as the information comes along. So, we're really thrilled about the opportunity. It continues to be kind of a great piece of focus for us. And just stay tuned for more, the next update on it. As per the GCE, do you want to take it Nikesh or?

Nikesh Arora

Yes. So I think, what's very important on sense, we've talked about this in the past, that we believe there is a lot of businesses out there have still to shift to the Cloud. We think in the long-term every business will be most efficient when they shift to the Cloud. So we're not really concerned about trying to compete with other Cloud providers. What we're really concerned about is making sure we have an amazing offering for businesses so they find value in working with us and making sure that we can support them in their transition to the Cloud. We think we have a great set of products. Our team is really excited, we're beginning to ramp up. So, I think there is tremendous opportunity going forward. I think it won't be time to slice the pie for a long time because a lot of businesses are clambering to move their business to the Cloud, because that's where the users already are, because we're used to the Cloud and are personalized and its about time that our businesses that we work in actually got to the bleeding edge of technology as much as the consumer services are.

Anthony DiClemente - Nomura Securities

Thank you very much.

Patrick Pichette

Thanks, Anthony. Jamie, lets go to our next caller please.

Operator

And we'll go next to Mark May with Citigroup.

Mark May - Citigroup

Thanks for taking my questions. A follow-up on the network business. I think some of the quality initiatives that you've been undergoing and continued too for a while, part of the intended consequence result I would imagine would be to recognize higher overall CPCs or pricing every time, but that doesn't seem to have been the case so far. So, I wonder if you could shed a whole light as to why we're not seeing that show up in some of the metrics of kind of what your expectations are going forward, is that in fact one of the intended consequences that we should be expecting going forward? And then secondly, you've highlighted not just this quarter, but previously that one of the main headwinds to the company's overall CPCs has been the mix shift around geography. I wonder if you could shed some light on if you've been seeing or making any progress in closing the gap there maybe in markets like APAC and what exactly are you doing to try to improve pricing outside the domestic and more stylish markets?

Patrick Pichette

Yes, so Mark, it's Patrick. I think that you really pointed a fact that we are spending, there's so many factor's. The issue we have with the CPC -- one of the key things about CPC is clearly it gives you a trend, but the trend is really shaped by the combination of CPC and clicks. So, you can't just look at one in isolation of the other, it's really that mix of the two. And in the case of network for example, I mean we just discussed at the beginning of the call that, we've put a lot of time and a lot of energy in the last 18 months to actually work on quality issues. And that clearly has an impact when you push on quality to -- when you look at the mix to actually drive for the kind of revenues and growth rates that you see in our results on the network. Having said that, it's also compensated by all of the other positive factors that we see whether it be as you said geography or product mix or otherwise. So, all in all I think that the team is doing a good job, both on network and on sites, and you can see that as well on our detailed information about, of sites where we continue to see the kind of -- or certainly over the last few quarters kind of creeping back up of CPCs which actually continue to push for this quality issue. In terms of geography, I think that yes, geography makes a big difference and that CPCs are much in some cases lower in international markets or emerging market. But the team continues with a number of localization initiatives to, like so we don't take CPCs as just one general. We will focus on each country, look for initiatives on localizations for each country to get the maximum CPCs on a geographic basis country-by-country basis, and that's why you'll see a lot of localization initiatives. They're just one again, one contributor. And it's really early days. There's so much potential in many of these areas and that's why Sridhar's team and our Search teams continue to work side-bye-side to continue to push on these areas. So, we see a lot of runway in this one, and geography is just one of these areas. And you mentioned like APAC, but APAC was a combination of more mature markets like Australia and Japan, and then we had the real emerging markets in there as well like Indonesia or India. So, even APAC itself is again localization matters immensely because very different answers for different countries. But all in all a pretty good story, and we're really proud to continue to focus with this balance between user first and then make sure that we have the right monetization. So, thanks for your question, Mark. Jamie, lets go to our next question please.

Operator

And we'll go next to Douglas Anmuth with JPMorgan.

Douglas Anmuth - JPMorgan

Great. Thanks for taking the question. I just wanted to ask two things. First thing to the added disclosure just on volume and CPCs. If we look at the sites data on pricing, it looks like we've seen an inflection here over the last two quarters, and then now more flattish here sequentially in 2Q. Can we interpret from that, that we've seen the worst in terms of the negative pricing impact from mobile? And can you give us some color on what you're seeing in terms of like-for-like mobile pricing as this point? And then secondly just on CapEx, Patrick, can you just help us understand how your philosophy may be has changed around CapEx spending over the last few years and if you're in this period of building out potentially a lot of excess capacity, is it reasonable to think you're at some point over the next few quarters we can also see things slow down as the business grows into that spending more? Thanks.

Patrick Pichette

So, Douglas let me start with the last question first and then I'll jump to the first. On CapEx, listen, if you listen to the script I gave a couple of minutes ago, interestingly this quarter that in priority order was construction of datacenters. Second was actually real-estate which typically would have been historically, you would have heard me talk about kind of equipment, and then equipment was third. So, CapEx continues -- we think continues to be a strategic asset of ours. And you're correct, and we've signaled that, that we're actually building -- we have a big building program right now because these are long lead time items for our datacenters, and we've just talked about a minute ago about GCE and other Cloud services that continue to grow. So, to strategically have the capacity versus not having the capacity is such a strategic asset to us that will continue to look at way. In terms of real-estate we found the same time. We found that we have, when we have opportunities to actually acquire real-estate that it's a make versus so buy versus lease option. And if you think of our growth and the growth in the strategic areas where we want to be, when we find great opportunities I think that we have a no-regret move in actually taking that action. So, you're seeing more activities on that front which answers a bit, a lot of questions have been around, is the core business kind of capital intensity growing? Well you can see from these kind of data points that it's not really that, it's really a strategic focus that we have right now in making sure that we have the long-term assets necessary to win. So, that's basically the mindset in which we're kind of investing in CapEx. In the volume of CPCs, you're talking about more flattish sequential in Q2, this is for sites I assume. Was that for sites?

Douglas Anmuth - JPMorgan

For sites, and the lower or smaller decline over the last two quarters?

Patrick Pichette

Yes, again I would refer you back to the IR team to get a lot of more detailed questions. But I think on a quarterly basis there can be so many fluctuations. I think year-over-year gives you a much more kind of realistic trend about what is fundamentally going on in the business, because one or two changes can really kind of swing, even seasonality can swing quite a bit both in terms of growth rates or CPCs -- clicks and CPCs. So, be aware always of -- and if you can see that in the network numbers, clearly on the quarter-over-quarter as well there is a lot of noise in the data. So you have to be careful in the quarter-over-quarter. But year-over-year actually gives you a pretty good story of the efforts we're putting into this. That's how I would do it. Thank you very much for your questions. Jamie, lets go to our next question please.

Operator

And we'll go next to Peter Stabler with Wells Fargo Securities.

Peter Stabler - Wells Fargo Securities

Thanks for taking the questions. I just wanted to revisit the topic of small business for a second. Could you help us understand a little bit on some of the qualities of the small business growth profile? Is this about bringing businesses that have no online identity online or is it about taking more mature small businesses and getting a greater share of the spending? Just wondering if you could step back and maybe give yourself a report card on the small business progress you've made and where the best opportunities are? Thanks very much.

Nikesh Arora

Thanks Peter for the question. I think again, if you think about the phenomenal scale at which the Google team operates vis-à-vis small businesses it's staggering. And we have millions of advertisers, millions of publishers we deal with. And we're trying to make sure that millions of publishers get monetization through advertising at the same time we're trying to work, make sure that millions of small businesses achieve their goals in trying to drive traffic both online and offline into whatever services they're offering to their end users. Now, as we've gone through this transition to mobile and it's very important that these small businesses make their transition effectively, because all the user traffic is slowly and steadily shifting towards mobile. And part of our effort is to make sure that we work closely with all of our small business advertisers existing to help them go mobile, at the same time trying to bring on more small businesses both onto the mobile and the desktop platform. So, it's really a concerted effort to try and support small businesses around the world through very targeted program's to show them ROI, to show them the value of living online because we believe in the long-term that's where most businesses are going to get conducted. So, it's really a long-term strategic effort to bring them all onboard, and I think the teams are doing a phenomenal job executing that ground.

Peter Stabler - Wells Fargo Securities

Thanks for the color, Nikesh.

Patrick Pichette

Thank you, Peter. Jamie lets go to our next question please.

Operator

And we'll go next to Heather Bellini with Goldman Sachs.

Heather Bellini - Goldman Sachs & Co.

Great. Thank you so much for taking the question. I had two, I guess, given the success of Chromebooks over the past few years, how you think about the direction of Android and Chrome from a development standpoint as you look out, and also when you think about the multi-screen comments that you made before, that the value being able to transfer peoples experiences across screens?

Patrick Pichette

Did you say, you had two questions Heather?

Heather Bellini - Goldman Sachs & Co.

Yes, and then I had a second one which just I was going to start with that one since it was long winded. And then the second one was just, Google Shopping Express seems to be a great way to impact the small business environment. I'm just wondering now that we're seeing that expand into different areas. Is that kind of the, should we start to see an inflection in small business advertising adoption?

Patrick Pichette

Okay, we've got the two questions. I think Google Shopping Express is really about local and local is really about both small businesses as well as large businesses. So, it really -- so absolutely small businesses will be as part of the focus area. And we're engaging with many of them which is actually pretty terrific, but it's really about local. So it's not only with the focus of small businesses, and that's really the focus of Shopping Express. In the case of Chromebook's and Android, I mean we've discussed this many times in the past where basically you have a great convergence because there is humongous strength in both of these platforms, and they're basically converging in many ways. Today you can get -- for example, on an Android phone right Chrome kind of powers the search and vice versa. So we have a lot of these cross-pollinization between the two teams. They're under one leadership which is Sundar, and he basically actually makes sure that these two teams continue to work into an integrated fashion. Everybody knows that Chrome has a huge focus on security, and that is in fact a great focus to kind of migrate over into the Android ecosystem to make sure that we have kind of the equivalent of enterprise grade security for all of our users whether they be Chrome or Android. So, I think that, when you think of multi-screen there are both of these OSS are actually very complementary to each other, and that's why we continue to kind of work in parallel. I think that across these multi-screens you should expect, Android continues to be very much the thing of choice for mass and Chrome continues to be very much the enterprise infrastructure, and you should continue to see kind of that evolve with that collaboration. So that’s how we think about it, Heather. There’s no kind of, its one or the other. I think that they are perfect compliments. So, thank you for your question. Jamie, we’ll go through our next question please.

Operator

And we’ll take our next question from Youssef Squali with Cantor Fitzgerald.

Youssef Squali - Cantor Fitzgerald & Co.

Thank you very much. Two quick questions please. Going back to Doug’s question about CapEx; can you -- Patrick, can you give us any example of a non-search initiative where you’ve invested heavily over the last maybe three, four, five years where the ROI today exceeds your threshold, I’m assuming maybe on the display side. And then on the YouTube content strategy, how high in the professionally created content funnel do you want to get over time we’ve seen more and more professionally created content. So, if you can help us with that that will be great. Thank you.

Patrick Pichette

I mean we have a whole host of products where they are, just think of display, think of YouTube, think of maps, think of -- I mean there’s been so many of these products that, Gmail, Chrome, Android I mean all of those, whether they are directly tied to advertising because they are an advertising product or they are a platform that actually gives you distribution that gives you a great infrastructure on which kind of that fuels the searches and the advertising. I think that we have so many areas that we get absolutely terrific return. So, it’s not only about search, it’s really about the entire experience and the delivery around them. Then your second question is, could you just repeat the second question for me please?

Youssef Squali - Cantor Fitzgerald & Co.

Sure. Just trying to understand the content strategy within YouTube, so just how high do you want to go up the professionally created content funnel, and how do you plan monetization if it’s all advertising or is there another model?

Nikesh Arora

Thank you, Youssef for the question. I think it’s fair to say that YouTube has all forms of professional content available today. It has all the way from user content to very popular user content with people like Michelle Phan etcetera, and it has a lot of clips from professionally created content from various media partners we talked about CBS and Viacom in the earnings call. So, we have lots and lots of content from different players out there. And our monetization model in YouTube is working. It's a phenomenal model. It is now the linchpin of each of our brand strategies if our partners and advertisers want to come work with us to create brand campaigns because YouTube allows you to actually target a fragmented set of interest in a most efficient fashion as opposed to try and do burst advertising that you would do in television and broadcast more. So, clearly the monetization model is working. In terms of other models as you've seen in the past we have experimented with various models on YouTube and we continue to experiment to see if advertising is the only model or there are ways that we can monetize using subscription of paid for content. I think that we will continue to do and see which ones in those sticks with the users.

Youssef Squali - Cantor Fitzgerald & Co.

All right, thanks and all the best Nikesh.

Nikesh Arora

Thank you very much. I appreciate it.

Patrick Pichette

Why don't we go to our next question please, Jamie?

Operator

And we'll go next to Richard Kramer with Arete Research.

Richard Kramer - Arete Research

Thanks very much. Nikesh, could you just expand on that last comment, putting together Google Fiber and a year on from YouTube channels. How important is it for Google over time to establish a subscription based type revenue stream especially if content moves to bundles. And for Patrick two things that would help us benchmark Google versus peers. First of all can you talk about the portion of ad growth or even the overall ad sales which are being driven by mobile? And also clearly there's some questioning of the notion that large amounts of offshore cash can be permanently reinvested. Can you tell us what portion of cash is now offshore and how we should think about international opportunities that might absorb these very large volumes of cash? Thanks.

Patrick Pichette

Richard, thank you very much for the question. I think in terms of your question around Google Fiber, YouTube, content bundling, subscription, revenue streams, I think it’s a very good question and I think it’s an area where there’s a lot of moment across the board where different people are trying different models, where cable is trying to provide content over the top, where YouTube is available on television screens, where people are trying to increase the broadband speeds because everybody gets the sense that we will consume more and more broadband content. I think what's clear to us in this process is that bandwidths will continue to increase. People’s appetite for bandwidths will continue to grow up. It’s clear that people will consume content more and more in a non-linear fashion. And its clear that content will come from different places, not just the traditional mechanisms of cable and television. So, I think that’s pretty clear. It’s also clear that people will monetize content both either in some form of payment or some form of advertising. Beyond that how all of this sort of coagulates and takes form still remains to be seen. I think it’s fair to say, we are experimenting on different ends of the spectrum where we have like YouTube purely advertising based content and monetize today which is over the top which works on broadband. We have Google Fiber, we have channel bundle. So I think we are experimenting, we are playing in every space. And I think eventually the user will decide whatever is most convenient and most able to use, they will decide. But I think it’s fair to say we have a horse in every one of these races.

Patrick Pichette

That’s terrific. Let me jump into the second question. I’m going to once again kind of take a bit of exception through the premise of your argument about well how much is driven by mobile? We really are living in a multi-screen world. You start on mobile, you hop on tablet, you go to your desktop, you kind of come back to your television, you kind of Chromecast back to your TV, that’s the world in which we live. And when people say, how much of your advertising is really driven by one? And we do a lot of research that actually shows that, in fact that’s what we try to show to your advertisers is, how much attribution to kind of show to each of these elements which is in that chain of activities that actually leads to the end which is either a consumption of something or a purchase. So from that perspective that’s why we don’t actually talk about mobile as a percentage of ads. What really matters is that you have the footprint across all of these devices and modes to actually deliver the best answer to our users, and that’s why you heard about IO continuing to kind of expand that landscape. In the case of CapEx in international, like last quarter our offer cash was about kind of 60% and 40% in the U.S. We’ll share those numbers in our 10Q, so stay tuned. But in rough numbers that’s really where we stand today. It may move a percentage, here and there. We do have great opportunities outside the U.S. as well to actually invest our cash whether it be through acquisitions. You've seen a number of acquisitions in the last year that were made internationally as well as we're building datacenters outside of the U.S. where our headquarters in Ireland continues to grow and we're investing quite a bit of money there as well and to the real-estate. So, when you see our real-estate numbers, they may include over time a number of these projects in Ireland, but also in London and other places where we're investing. So, we actually have pretty exciting plans for our international portfolio both in APAC and in Europe. And so there's a real kind of great case to actually continue to keep this amount offshore. It's not a shortage of opportunities that we have. So it's just a question of pace and discipline. So, thank you for that.

Richard Kramer - Arete Research

Thank you.

Patrick Pichette

Thank you, Richard. Maybe we have time for one more. We'll take one more question.

Operator

And we'll take our final question from Colin Sebastian with Robert W. Baird.

Colin Sebastian - Robert W. Baird & Co.

Great. Thanks for taking my questions. First off, Nikesh, congratulations and good luck.

Nikesh Arora

Thank you.

Colin Sebastian - Robert W. Baird & Co.

Firstly through Google Play and applications such as Shopping Express, there already is a transactional model in place in terms of purchases and payments. I guess, I wonder if it wouldn't be natural to assume that some of that transactional functionality could be extended to Google Shopping and PLA more broadly, or is it really about just driving traffic to third party sites for those businesses. And then secondly just a clarification on the cost per click breakout from the report, why aggregated cost per click year-over-year growth is actually better than individually the Google sites and the network sites? Thank you.

Patrick Pichette

I can actually give you the answer to the last one and then you can come back. It's basically the Simpson's paradox. So, if you go on Wikipedia and you just check the Simpson's paradox you'll understand that you may have two factors that are actually correlated in the same directions. But when you actually put them together they actually may correlate in an inverse proportion, and that's where you get into the numbers and that's why you have this kind of, the discrepancy because we all kind of laughed at this number as well because when we saw it, we said hey, something doesn't add up and in fact it does add up. So, that's really the issue there Colin. And unless you already know the Simpson's paradox then don't go to Wikipedia.

Colin Sebastian - Robert W. Baird & Co.

I'll search Google first.

Patrick Pichette

On the first question …

Nikesh Arora

And on the first -- I'm sorry.

Patrick Pichette

Go ahead, Nikesh.

Nikesh Arora

Okay. On the first question I think that's a fair observation Colin, and I think if you look at some of the applications that our payments team has developed are on InstaBuy, it's the ability to do a one click buy where we can partner with merchants and any kinds of transaction providers, where they don't have to keep entering their data or entering their credit card in different places. So, it gives them the comfort, ease of transaction. So, I think over time its kind of line an open system solution where we have platforms where retailers can work with us and pick and choose what part of our platform they want to leverage and our hope is to create a more and more friction less ability to create transactions which effectively benefits commerce and hopefully creates more revenue opportunities for us.

Colin Sebastian - Robert W. Baird & Co.

Great. Thank you.

Patrick Pichette

Thanks, Colin. I usually kind of stop by kind of thanking all the Googlers, but Nikesh.

Nikesh Arora

Yes, Patrick. I just wanted to also take a moment and thank everybody on the call for tolerating and enduring me on this call and supporting me over the last many years. Thank you everyone. I look forward to working with you in the future in a different role.

Patrick Pichette

And with that, we're going to actually thank all the Googlers for their amazing work over the last 90 days. It's been a real rollercoaster. It's continuing with IO and everything else and we look forward to Q3. With that, Jamie -- again Nikesh all the best and Jamie I will let you close the call.

Nikesh Arora

Thank you, Patrick.