

Operator

Good day, ladies and gentlemen, and welcome to the Alphabet, Inc. Third Quarter 2015 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. [Operator Instructions] As a reminder, this call is being recorded.

I would now like to introduce your host for today's conference, Ellen West, Vice President, Investor Relations. Please go ahead.

Ellen West

Thank you. Good afternoon, everyone, and welcome to Alphabet's conference call on Google's third quarter 2015 earnings. With us today are Ruth Porat and Sundar Pichai. As you know, we distribute our earnings release through our Investor Relations website located at investor.google.com. Please refer to our IR website for our earnings releases as well as the supplementary slides that accompany the call. This call is also being webcast from investor.google.com. A replay of the call will be available on our website 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 Alphabet'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 risks and uncertainties that could cause actual results to differ materially. For more information, please refer to the risk factors discussed in our Form 10-K for 2014 filed with the SEC. Any forward-looking statements that we make are based on assumptions as of today, and we undertake no obligation to update these statements as a result of new information or future events.

During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. The press release and an accompanying investor presentation are available on our website at investor.google.com.

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

Ruth Porat

Thanks, Ellen. We turned in a strong performance in the third quarter, notwithstanding continued meaningful currency headwinds. The key highlight this quarter was the substantial growth of our mobile search revenue complemented by ongoing strong contributions from YouTube and

our programmatic business. I will first give you a summary of the quarter, followed by specific financial details and conclude with comments regarding our upcoming move to segment reporting. Sundar will then review the business and product highlights of the quarter, after which we will take your questions.

Beginning with the summary of our financial performance, total revenue was \$18.7 billion up 13% year-over-year and up 5% sequentially. As a result of the ongoing strengthening of the U.S. dollar, we realized a negative currency impact on our revenues of \$1.6 billion or \$1.3 billion after the benefit of our hedging program. Holding currency constant to prior periods, our total revenue grew 21% year-over-year and 7% sequentially.

On a GAAP basis, operating profit was \$4.7 billion and the operating margin was 25%. On a non-GAAP basis, operating profit was \$6.1 billion and the operating margin was 33%. GAAP operating income was up 26% versus last year and GAAP net income from continuing operations was up 36% year-over-year.

As a reminder, the year-on-year increases reflect a non-cash impairment charge of \$378 million in the third quarter of 2014. Non-GAAP operating income was up 15% year-over-year and non-GAAP net income was up 19% year-over-year. GAAP earnings per diluted share were \$5.73; non-GAAP earnings per diluted share were \$7.35.

As detailed in the earnings slides on our IR website, stock-based compensation totaled \$1.4 billion, up 14% year-over-year and up 27% sequentially. With respect to stock-based compensation, the increase reflects the fact that our annual equity refresh grants were made in the third quarter as well as headcount growth.

Headcount increased 16% versus last year and 5% versus 2Q 2015. Sequential growth reflects typical seasonality with new grad starting, the vast majority of whom are engineers and product managers. Let me now turn to key elements of our financial statements, starting with our primary revenue sources.

Google sites revenue was \$13.1 billion, up 16% year-over-year and up 6% sequentially, notwithstanding currency headwinds. Year-on-year and quarter-on-quarter growth reflect substantial strength in mobile search due to ongoing improvement in ad formats and delivery to better address how consumers use their mobile devices.

YouTube revenue continues to grow at a significant rate with growth driven primarily by video advertising across TrueView and Google Preferred. Network revenue was \$3.7 billion, up 4% year-on-year and up 2%

sequentially, continuing to reflect the significant growth of Programmatic, offset by the traditional network businesses. Other revenue was \$1.9 billion, up 11% year-over-year and up 11% sequentially.

Given the geographic mix of our Play business, FX also had an impact on other revenue. Year-over-year growth was driven by Google for Work, including cloud, as well as continued strong growth in Play. Both were offset by the absence of revenues included in 3Q 2014 from a licensing agreement and lower hardware sales, as we reached the end of life cycles for certain Chromecast and Nexus devices.

Next, let me discuss revenues by geography, which will highlight the impact currency headwinds continue to have on our non-U.S. business. U.S. revenue was up 19% year-over-year to \$8.8 billion and up 9% versus Q2. UK revenue was up 10% year-over-year to \$1.8 billion, and up 7% sequentially. In fixed FX terms, the UK grew 18% year-over-year, and 7% quarter-over-quarter. Rest of world revenue was up 7% versus last year to \$8.1 billion and up 2% versus Q2. In fixed FX terms revenues were up 23% year-over-year and up 5% sequentially. The acceleration in U.S. and UK growth in particular reflect the growth in mobile search.

Finally, on monetization, as a reminder, these metrics similarly are affected by currency movements. Aggregate paid clicks grew 23% year-over-year and 6% sequentially. Aggregate CPCs were down 11% year-over-year and 1% sequentially. In terms of the drivers, within Google Sites paid clicks were up 35% year-over-year and up 7% sequentially. Google site CPCs were down 16% year-over-year and down 2% sequentially.

The movement in Google Sites paid clicks and CPCs primarily reflects the continued growth in YouTube TrueView. Network paid clicks were down 5% year-over-year and flat sequentially reflecting the impact of our ongoing policy changes designed to reduce lower quality inventory on AdSense for Search, consistent with our focus on improving the user experience. Network CPCs were down 4% year-over-year and up 1% sequentially.

Let me now turn to expenses. Total traffic acquisition costs were \$3.6 billion or 21% of total advertising revenue, essentially flat as a percentage of revenue sequentially and down slightly year-over-year. As a reminder, the Sites' tagline includes the tag that we paid the search distribution partners for distributing Google Search as distinct from their own branded search. Non-GAAP other cost of revenues was \$3.2 billion in Q3, up 16% year-over-year, primarily driven by costs associated with operating our data centers, including depreciation, as well as content acquisition costs primarily for YouTube and Play.

Non-GAAP operating expenses were \$5.7 billion or 31% of revenue, up 14% year-over-year and up 7% versus Q2. The increase in operating expense versus comparable periods was primarily driven by R&D expense. A breakout of individual operating expense lines is available on our earnings slides. Other income and expense was \$183 million. The effective tax rate was 19% for the third quarter.

Turning now to CapEx and operating cash flow, CapEx for the quarter was \$2.4 billion, reflecting investments in production equipment, data center construction and facilities. Operating cash flow was \$6 billion with free cash flow of \$3.6 billion.

Finally turning to cash, we ended the quarter with a cash balance of approximately \$73 billion, of which approximately \$42 billion or 58% is held overseas. As we announced today, our board has authorized us to commence a repurchase of our Class C capital stock of up to \$5,099,019,513.59. This decision is consistent with our overall capital management framework and complements a disciplined capital allocation program. Our primary uses of capital will of course remain CapEx and M&A across the breadth of our businesses.

So now let me conclude, starting in the fourth quarter with our move to segment reporting, we intent to provide additional detail for Google on the one hand, and all the other Alphabet businesses on the other hand. We refer to those other Alphabet businesses as Other Bets. We expect Other Bets to include among others Access and Energy, Nest, Life Sciences, our investment arms and X, which is where driverless cars and certain other incubation efforts reside.

Specifically, we intend to disclose for both Google and Other Bets revenues profitability and CapEx. By doing this we expect that you will be better able to understand how we manage the businesses, including the pace and allocation of our investments. As Larry said in his CEO letter announcing Alphabet, we are focused on rigorously managing capital allocation and working denature each business is executing well.

With that preface, let me turn to for key themes. First, in terms of revenues are strong revenue growth in Q3 reflects the ongoing momentum in Google with acceleration in mobile search complemented by the strength of YouTube and programmatic. The Other Bets our earlier stage businesses, which we believe have significant longer-term revenue potential. In the near-term, the focus there is on optimizing our investments. Second, with respect to profitability, we remain focused on managing expenses within our control, while investing to support the growth areas we have in Google and Other

Bets. Segment reporting by definition provides greater insight into the profit dynamics within alphabet.

Third as to CapEx, the vast majority to date, of course has been to support Google, where we continue to invest given our exciting opportunities globally. At the same time CapEx and Other Bets is expected to increase through next year as we continue to execute on the growth agenda there. In particular in Access and Energy, which contains our fiber business, among other efforts. Fourth, our growing cash balance remains a powerful tool giving us the flexibility to invest in the breadth of opportunities we have within Google and Other Bets as well as to selectively pursue compelling new bets.

I will now turn the call over to Sundar, will go into more detail regarding our business trends and products.

Sundar Pichai

Thanks, Ruth. I'm glad to be here with you all today to talk about the areas we are focused on now and in the future at Google. There is a real sense of energy and focus throughout the company and we're seeing momentum across our businesses. Products like Search, Android, Maps, Chrome and YouTube each have over a billion users already, and Google Play crossed that milestone this quarter as well. But what's most exciting is that we are just beginning to scratch the surface.

We know that computing transforms people's lives, we've gone from the PC revolution to the Internet revolution to the mobile revolution. And 10 years from now, everything will be different again in ways no one can predict. Our vision is for Google to remain a place of incredible creativity and innovation that uses a unique technical expertise to tackle big problems and create that future. We do this, arm-in-arm with our partners around the world.

Today, I want to touch on three key areas that are important for us; first, making information accessible and useful; then how we are building computing platforms used by billions of people; and lastly, how we are driving growth in our core advertising business as well as new emerging businesses.

Let's start with the first area. Google's core mission has always been to organize the world's information and make it universally accessible and useful. Search continues to be at the center of this with people turning to search on mobile every day to find quick answers, in fact search traffic on mobile phones have now surpassed desktop traffic worldwide.

We are also seeing strong mobile momentum in many emerging markets like India, which is a number two country for mobile search queries behind the U.S. This is the result of a laser focus on helping users quickly find the right information. People just want to be able to find the information they are looking for on mobile without having to worry about whether it lives on the mobile web or within apps. Mobile app usage as well as web usage is accelerating significantly.

We have now indexed more than hundred billion deep links within third-party apps. So if you're looking for information that lives within an app will surface it as a result, and even give you an install link if you don't already have it. The teams have made great progress and 40% of search is now returned app index results in the top five results. These investments have gone well and you'll continue to see us push in this area.

We also continue to improve the Google app, for instance app developers can now build conversational voice experiences that work within the Google app, so if you ask Google to play NPR, NPR will respond by asking if you want to pick up where you left off, or catch up on the latest news. It's also very important that we help to make the mobile web better and faster for users, both through our own products and by partnering with others. Working with over 30 publication and technology partners we recently announced an open source initiative called Accelerated Mobile Pages to make it easy for publishers and content creators to build superfast webpages for their content. This will help make the mobile web a better more enjoyable experience for users.

I also want to point out that our investments in machine learning and artificial intelligence are a priority for us. Machine learning has long powered things like voice search, translation, and much more. And our machine learning is hard at work in mobile services like Now on Tap, which quickly assist you by providing additional useful information for whatever you're doing, right in the moment, anywhere on your phone. If you're an Android user that runs Marshmallow, try it out by long pressing the home button, when you're in the Map, it's very cool.

Another example is the Google photos app, which leverages powerful machine learning technology to help people discover, organize and share their photos. It's a great product that people love. In fact, in just a few months since we launched it at Google I/O, photos is now used by over a 100 million users who have collectively uploaded more than 50 billion photos and videos.

Now I want to talk about how we're building computing platforms that are used by billions of people. We'll continue to invest in large open ecosystems

that we've build with partners to reach great scale. Android is a prime example of this, and we're seeing exciting momentum on our platform. There are more than 1.4 billion 30-day active Android users around the world, and we are beginning to roll out Android Marshmallow which is our best-performing release yet.

Working with partners Huawei and LG, we announce the newest devices joining our Nexus family. The Nexus 6P and Nexus 5X. They are beautiful and powerful devices that show off the latest and greatest that the android has to offer and they've got tremendous reviews so far. We also announced the Pixel C which is the first android tablet built N2N by Google that brings together the benefits of a full-size keyboard with the portability of tablet. We're also creating platforms for newer areas of computing such as android wear, which now works with iOS as well.

Android Auto, the Internet of Things platform that we unveiled at I/O Brillo, and of course Chrome. Chrome also powers Chromecast, and our recent Chromecast update gave it a refreshed look and faster performance. We also introduced Chromecast audio, which lets you stream your favorite music from your phone to any set of speakers. To date we have sold over 20 million Chromecast devices and have seen over 1.5 billion taps of the cast button since we launched.

We're also seeing great momentum in our ads business. Our value proposition to market is of all sizes is simple, Google can help you show the right ads to the right people, at the right moment. As you've heard on these calls before, we are seeing a major shift in consumer behavior to its micro-moments. These are moments of high intent when consumers are looking to find, buy or do something. They happen throughout the day most often on mobile devices. The single biggest theme throughout our advertising business is to help small businesses, large marketers, agencies and content creators to take advantage of this mobile opportunity.

In search advertising is a huge amount going on. Advertisers like Dunkin' Donuts and Airbnb are turning to mobile search to capitalize on these key moments reach customers, and create engaging local experiences. We also recently made search ads in Google Play available to all developers letting app developers find new customers for their app at a great price where it matters.

Many smart developers are already taking advantage of this. At Adweek, we introduced Customer Match, which lets marketers reach their existing customers with customized search ads on Google.com, as well as ads in YouTube and Gmail. Of course, these are really valuable for reaching key customers at moments of high intent on mobile devices.

With the holiday season coming up, we are investing in providing great shopping experiences on mobile. We are also helping marketers understand how Search ads are driving in-store sales with products like Store Visits which uses our unique mobile location capabilities and is easy for any business to implement.

Moving to YouTube, everyday people watch hundreds-of-millions of hours on YouTube. You know from the last quarterly call about the amazing momentum that YouTube has in mobile. It's largely coming from the YouTube app. The growth in mobile watch time also extends to videos featuring product reviews and information. People turn to YouTube and they want to research, buy or fix a product. For example, mobile watch time for apparel videos has doubled this year and videos about toys have also doubled.

We see the same growth in advertising on the platform too. And we continue to invest in building ways for marketers to reach consumers effectively, like our recently announced shopping ads for YouTube, which lets people shop directly from a video, turning any relevant video into your digital storefront. And in programmatic video and display, the strong momentum continues. The number of advertisers using our programmatic solutions has nearly doubled in the last year-and-a-half, and now includes over 80% of adages top hundred advertisers.

Additionally, both mobile and video impressions served on DoubleClick Bid Manager have grown more than 3.5X since last year. This is an area that's on fire for us right now and you'll see us to continue to invest in creating the best programmatic solutions for advertisers and agencies. Before I close, I want to touch on a few of our emerging businesses where we see enormous opportunities.

First, digital content, Google Play continues to be a thriving hub for our digital content business, now with over 1 billion users. And just yesterday, I was really pleased that we announced YouTube Red, our YouTube subscription service for just \$9.99 a month. It enables you to see videos on YouTube without ads, watch them offline, or keep playing videos when you lock your screen or start using another application.

Additionally, our Google for Work business is seeing tremendous growth. In the third quarter, we crossed 1 million paying active customers using Google Drive at Work. Cloud is also a growing area where we see great opportunity and we are building a fantastic service that we'll keep investing in. Our momentum in the education space continues as well with more than 50 million Google apps for education users worldwide, and over 10 million teachers and students using Google Classroom since it launched a year ago.

There are also 30,000 new Chromebooks activated in schools in the U.S. every school day. That's more than all other devices combined.

So to wrap up, we have tremendous new opportunities in our new and existing businesses. We are really excited by the products and platforms that we are building for people everywhere in the world. And we are passionate about the transformative power of computing to improve people's lives in the years ahead.

Thank you to everyone for your keen interest in our business. And thank you to all of the Googlers around the world for another great quarter. And with that, I will hand it back to Ruth.

Ruth Porat

Thank you, Sundar. And we will now take your questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And our first question comes from Mark Mahaney from RBC Capital Markets. Your line is now open. Please go ahead.

Mark Mahaney

Great. Thanks. Two questions, could you talk about the sustainability of the mobile search revenue growth that you see there? And is that just really been driven by finally the gapping up of kind of mobile search pricing versus desktop pricing or is there something else going on?

And then, Ruth, I was just trying to figure out how you came up with that - your repurchase number and I've been Googling that number a couple of times. I can see it's 26 to the E18 of the square root of that, but outside of that, how did you come up with that particular amount of share buyback? Why not more and why not less? Thanks.

Ruth Porat

Thanks, Mark. So starting on the sustainability of mobile revenue growth, as I said, in my opening comments, revenue growth really reflects continued improvement in ad formats and delivery. And that's on top of what's a really strong industry-wide global growth in mobile usage as you know well. And then we regularly adjust the way we present ads. So we expanded ad space in some queries with particularly high commercial intent to display more relevant mobile friendly ads.

And our view is just as we saw consumer behavior change on desktop we are seeing the same on mobile. And as Sundar said, we continue to believe we're in very early innings here. And then in terms of sizing, so this is the way we approached it. If I take you back to the capital framework that I laid out last quarter, it's defined primarily by CapEx and M&A, but also includes working capital and a buffer as well as a potential return of capital.

And we remain focused on solving the biggest problems and solving them at scale and that presents sizable potential revenue opportunities. It was a key catalyst for creating Alphabet. But these opportunities also require investment. And so the focus of our team is on prioritizing these opportunities over a multiyear period. We look out, kind of as we're modeling it out a number of years. And then working with the Board we reviewed our outlook. We reviewed the opportunity set and we concluded that layering in this action at this time complements what we view as a very disciplined budgeting process, while still very importantly providing ample capacity to pursue the growth agenda.

And then, applying this framework once we had come up with the size that we believe fits and consistent with the way we do things around here, we decided to come up with some fun math similar to the way we approach sizing the IPO, which sounds like you've fit back right into what that was. We do view it as the right action at the right time. And it really is anchored in the framework.

Mark Mahaney

Thanks, Ruth.

Ruth Porat

Thanks, Mark.

Operator

Thank you. And our next question comes from Ross Sandler from Deutsche Bank. Your line is now open. Please go ahead.

Ross Sandler

Thanks. I have one for Ruth and one for Sundar. Ruth, so back to the mobile search question, the bear-case on Google has been the company's ability or lack thereof to port the search business model from PC over to mobile. And you called out mobile search is the key driver of acceleration in both the U.S. and UK. So can you just give us a little bit of more color around the volume

trends that you are seeing between desktop and mobile as you cross that 50% threshold that you talked about last quarter.

And then, Sundar, on the platform side, it seems like every few years new company crop up as the next big Android OEM. Looks like it's Huawei now. It's been other companies in the past. How do you plan on getting Android to a point where all these OEMs can build successful businesses on the back of it? And any update on when Google plans to roll out the Play Store in China would be helpful. Thank you.

Ruth Porat

So starting with mobile and our outlook there, clearly, as I said, mobile search revenue was up significantly and it was an important catalyst in the quarter. But the very important thing to note, as we discussed also last quarter, is that desktop remains a solid contributor. And so we continue to have a healthy growth there. And when we look, if you step back, overall sites revenue, we're firing on all cylinders, really strong growth in mobile, desktop is healthy and continuing to grow. And then you layer on top of it YouTube and some of the color that Sundar added there. But that's really a continuation of what we talked about last quarter as well.

Sundar Pichai

And on the platform side, look, we continue to see tremendous momentum overall on Android. In just over a year, we've gone from 1 billion to 1.4 billion users. So obviously that translates into huge opportunities for OEMs and that's what we are seeing. Especially, there are whole new markets opening up, there's next billion users coming online in emerging markets. And businesses, I mean, Enterprises, a whole opportunity for OEMs as well. So I think there is a lot of room ahead.

Operator

Thank you. And our next question comes from Carlos Kirjner from Bernstein. Your line is now open. Please go ahead.

Carlos Kirjner

Thank you. I have two questions as well, one for Sundar and one for Ruth. Sundar, in two parts, if you take a three-year view what are the three main milestones you think you need to reach to be successful as Google's CEO? And what you think would be the externally observable consequences of achieving these milestones?

And Ruth, in the last call, you talked about the 70/20/10 framework. Can you help us understand what 70/20/10 applies to? Is it related to operating expenses, or expenses in cost in the P&L, CapEx, R&D, management time? And is it an explicit constraint in the budgeting process or am I trying to read too much into something that's just a concept of framework and a broad guideline? Thank you.

Sundar Pichai

Thanks, Carlos. In terms of how I think about it, I think we are fortunate to have an incredibly broad mission statement. Organizing the world's information turns out to be something that has a lot of room ahead, we are still in the early days. Especially with mobile I think you have a computing platform that's going to reach, it's already reached half the world's population or on its way to reach the entirety of the human population in about five to 10 years.

So want to stay focused on that both from information standpoint and a computing standpoint, I think of them as two sides of the same coin, and making sure we are building the right user experience for that. And so that's what I'm focused on.

Ruth Porat

And then on 70/20/10 it's intended to be instructive and it's intended to mirror the founders' vision and really capture how we devote our resources, which for us means, how do we apply effort. And for me, one of the many very important statements from the founders that explains this framework is when they said in the letters some years ago and repeated since, incrementalism in technology leads to irrelevance and thus innovation is critical.

And so this mantra is really about pushing people to look at new areas, invest in newer areas, look for things that are adjacent the 20% and even the unrelated big bets, the 10%. It's not intended to be a specific guide to financial modeling. I think with our move to segment reporting, we look forward to giving you more information next quarter which should be helpful there, but directionally to talk about philosophically how do we think about our approach to the business.

Carlos Kirjner

Thank you.

Ruth Porat

Thank you.

Operator

Thank you. And our next question comes from Heather Bellini from Goldman Sachs. Your line is now open. Please go ahead.

Heather Bellini

Great. Thank you very much. This question is for Ruth. I was just wondering given you're likely in the midst of 2016 business planning right now. Can you share with us the way in which you're approaching budgeting versus maybe how it was done last year? And are there any specifics you can share with us in terms of how you're thinking about it? Thank you.

Ruth Porat

Well. I guess a couple of things, there has been a very strong foundation here on budgeting and the approach and setting an envelope, and working very closely with business leaders on what that that envelope should be, and we are in the midst of it in. As I said last quarter, but to emphasize our priority remains revenue growth and that doesn't give us a pass on a rigorous approach to expense growth, and that's where we're focused.

So I think really what was very encouraging for me is there is a framework, a very strong approach to financial planning and analysis, and really building on that to make sure we have reasonable but tight envelope so that we can have the right conversations collectively, collaboratively with our business leaders to assess how we can look at optimizing all of our resources, and that's what it really comes down to, it's looking at how to manage the rate of growth of expenses, while still supporting our growth initiatives and we'll be going into more of that in as we go through our segment reporting in the fourth quarter.

Heather Bellini

Thank you.

Operator

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

Brian Nowak

Thanks for taking my questions. One on YouTube, I guess could you talk some of the qualitative drivers that are really bring more advertising dollars

on the YouTube. And then, I think last quarter you'd mentioned top 100 advertisers spend was up 60% year-on-year on YouTube. I'm wondering if you could update us on that?

And the second one, on Search, sounds like mobile is accelerating, where you now in the mobile versus desktop monetization gap. And Sundar, how do you think about that long-term, you see mobile being higher, reaching equilibrium, how do you see that trending?

Sundar Pichai

On the YouTube one, look I mean to shift to video is a profound medium shift, and especially in the context of mobile. And obviously users are following that you're seeing it in YouTube as well as elsewhere in mobile. And so advertisers are being increasingly conscious, they're being very, very responsive. And so we are seeing great traction there, and we'll continue to see that, they are moving more of their traditional budgets to YouTube and that's where we're getting traction.

On mobile search - to me - increasingly we see - we already announced that or 50% of our searchers are on mobile. Mobile gives us very unique opportunities in terms of better understanding users and over time as we use things like machine learning, I think we can make great strides. So my long-term view on this is, it is ask compelling or in fact even better than the desktop, but it will take us time to get there, and we're going to be focused to be get that.

Brian Nowak

Thanks.

Operator

Thank you. And our next question comes from Eric Sheridan from UBS. Your line is now open. Please go ahead.

Eric Sheridan

Thanks for taking the question, maybe a big picture question with respect to media distribution, media consumption and monetizing that you should across all the platforms that you distribute media. I'm so curious about the various business models you're now putting in front of consumers, subscription versus advertising versus paper unit like on Google Play. How you think about the about the pros and cons and some of those distribution models? And do how think about the need to may be source content yourself for media distribution? Thanks.

Sundar Pichai

Thanks. To me, we want to stay focused on the user experience and we want to follow what users want, right. So if you take something like YouTube, we expect most users to consume, YouTube debate has been and advertising has been a strong part of providing the content for free to those users, and it's growing very, very well, but we also see a need for certain users, in certain scenarios be it music or gaming or for premium content to experience it in a different way. And we want to make sure we do that. So we don't have a prescriptive opinion on this as much as we will provide the right user experience and follow where it goes, and that applies to Google Play as well.

Operator

Thank you. And our next question comes from Justin Post from Bank of America Merrill Lynch. Your line is now open. Please go ahead.

Justin Post

Thank you. Two things, Ruth, it really does seem like there's been a change in the management philosophy this year as far as kind of expense discipline into 2Q, also have seen the disclosures and now you get the buyback announcement. Could you talk about the change there, if there has been one, and how you think about that?

And then the second thing, we were pretty focus on the cloud over here, Google. We don't have a number. It's in your other revenues, but Amazon is probably \$8 billion plus run rate, Microsoft over \$1.5 billion. Just wondering you can give us any thoughts on your cloud strategy and how you're thinking about using those really strong data center assets? Thank you.

Ruth Porat

So I guess, there were a couple of things, on expenses and expense management and clearly a lot of the foundation here has - was laid some time ago. I think after a period of big expense buildup, there was an appreciation that we needed to manage the cadence of spend. And that's what we're doing and collectively we're locked arm-in-arm to make sure that there's resource prioritization. I think that's an important part of that we have an extraordinary set of opportunities, not just within Google but across the Alphabet businesses, and we need to ensure that prioritization is a key part of all that that we do.

I would note that when you're looking at some of the expenses, operating expenses is an example. When we look forward to the fourth quarter, in

particular given the hardware launches that we've done here with the Nexus Chromecast and Pixel launches, a consistent with prior device launches we would expect higher sales and marketing and I realized I'm getting a little more specific than your question, but I think it's very important to note that there are also certain patterns to some of these similarly with CapEx, CapEx is - it's been a bit more muted here. And I indicated last quarter that where in a bit of a digestion period.

But when you look forward to 2016, we do see accelerated investment given the nature of the businesses that we're building up here. So I want to also just keep make sure, we can things and perspective. And I think, it's just, it's been an extraordinary experience joining this team, I think the with the move to Alphabet it gives us the opportunity to then provide some greater insight into the extraordinary operating performance within Google and breakouts you can see the investments that we're doing and we're working very tightly as a senior team here as we make that next step into this new environment in Alphabet.

Sundar Pichai

On the cloud side, and he observed, I mean it's an exceptional opportunity, I think it just reflects is a secular shift every businesses in the world is going to run on cloud, eventually and so we viewed as an amazing opportunity. We're uniquely qualified to do so, as he pointed out we have tremendous experiences and running large scale cloud services.

And it's been only in the past two years, and earnest we have been taking those assets and serving customers outside. For me, what's exciting as I look at new customer adoption, we are seeing tremendous momentum. We're very competitive in each of those situations, and we are investing a lot and playing for the long-term.

Operator

Thank you. And our next question comes from Douglas Anmuth from JPMorgan. Your line is now open. Please go ahead.

Douglas Anmuth

Great. Thanks for taking my question. Sundar, I want to ask about mobile. You talked about being greater than 50% of queries and want to ask if you have a view on whether - on when that will pass 50% of clicks. And then also your thoughts on what happens to desktop pricing in demand, as that happens how do you think about the tail on the desktop business as mobile just continues to take share? Thanks.

Sundar Pichai

The interesting thing, we're seeing is, when we talk about mobile, mobile is a computing paradigm is eventually going to blend with what we think of his desktop today as well. So overall it's a shift in a computing paradigm, it's not just form factors. And so overtime we see all of this is together. What matters to us as people evolve they are computing paradigm search transitions to that world, and we are the best source to provide that information.

So along that line, I expect all the metrics to follow the trend, and so we only see, all the right indicators, and so I think we are position for the long-term well, so I can't comment too much on the specifics beyond that.

Douglas Anmuth

Thank you.

Operator

Thank you. And our next question comes from Ken Sena from Evercore. Your line is now open. Please go ahead.

Ken Sena

Thank you. I just have an ad format question, maybe just to follow-up on Eric's. We noticed that there was an additional ad slot added on mobile. And can you just maybe talk through the decisioning on that? And if so, is there anything we should interpret as far as the other ad formats that have been used too? Thank you.

Ruth Porat

Well, big picture what we are doing is looking at ways to use the mobile screen space to be as useful as possible for users. So this quarter we had some important changes and we're always focused on innovation, and we're growing in a growing market. But as we've said we're looking at how consumer behavior is changing and just as it did on desktop we're seeing the same on mobile and the notion of trying to make sure were being as useful as possible for users is key driver and we'll continue to innovate.

Ken Sena

And maybe just this one follow-up. Can you see anything then it maybe in terms of the success with the efficiency that you're seeing in terms of text based mobile ads versus more of the other structured data ones that's around like part of glycerin [ph] or hotel price ads and so forth? Thanks.

Ruth Porat

Yes. There is probably not much to add there.

Ken Sena

Thank you.

Ruth Porat

Thank you.

Operator

Thank you. And our next question comes from Anthony DiClemente from Nomura. Your line is now open. Please go ahead.

Anthony DiClemente

Thanks a lot. I have two, one for Sundar and one for Ruth. Sundar is asking about something that potentially have an impact on the business either in the fourth quarter or longer term? And then, Ruth, in terms of M&A just wondering if the buyback might indicate that the company is becoming a bit more selective around larger acquisitions than it's been in prior periods of the company's lifecycle? Thanks.

Sundar Pichai

Thanks, Anthony. On the ad blocker stuff, it's not a new phenomenon. I think it's important to understand that ads today run almost all the services which people use, including products like Google Search, Google Maps many, many third-party products. For publishers, it represents the majority of the revenue and I think users are okay with the contract and we need to make sure it works well. It's also clear that that are areas where the ad experience is getting in the way, it affects performance, and so we as industry need to collectively do all that better. And so we are going to work hard to do that.

And then, so we want to make sure we transition areas like the mobile web to have better ad experiences. But overall, I think we've used to this, we've seen this for a while overwhelmingly the model works well and we expect that to continue.

Ruth Porat

And then, in terms of your M&A question, I talked about how did we think of sizing the return, I started with what's really most important as which is continuing to focus on the biggest problems and solving them at scale, and

ensuring that we're investing in those. And as I said that's primarily to find by obviously the opportunity, but how do we support the growth that's about capital expenditure and about M&A, and those are really the anchor pillars in our capital framework. And then beyond that there is working capital and a buffer and then the potential return of capital. We talked about the fact that we have six products that have over billion users. Three of those were through acquisitions, YouTube, Android and Maps that is not lost on us, and then you layer on top of that, double-click that was also through acquisition.

So we do have you viewed app and at the time, it wasn't clear, I'd say everybody that those would end up being the incredibly powerful businesses, effective businesses for users that they are today. And so it remains a part of what we consider the bar is high, but I certainly wouldn't want you to read anything into it beyond, what it is it fits right within our framework, and as I said, we reviewed is the right action at the right time.

Anthony DiClemente

That's it. Thank you.

Operator

Thank you. And our next question comes from Paul Vogel from Barclays. Your line is now open. Please go ahead.

Paul Vogel

Great. Thanks. Two questions, please. First, just when we think about search and deep linking. Can you just sort of quantify a little bit how important deep linking has been to either click, so ROI or improvements in CPC on mobile? And then, the second question is just as we think about the more transparency going forward in Q4. How should we think about businesses that currently are in the Other Bets line that may continue to growing. What would be considered to move something from other bets into core Google? Thank you.

Sundar Pichai

On the deep linking, I would view it as, we're beginning to scratch the surface in terms of how we get it information within apps. What's been exciting to us is all of the indication show that when we provide these deep links. Users respond to them the same way they've done with links to websites and the model is working well. And second think maybe...

Ruth Porat

Yes. Interesting in the way frame the question, so within other bets we have a pretty broad array of challenges, opportunities that are being tackled, as you know well from life sciences to driverless cars to what we're doing in access and energy. And those we're funding, we've got a very rigorous disciplined approach to looking at the metrics against which they're performing and growing. But you used a term, when do they move into Google. And I wouldn't assume that, that's the plan. What we're really looking at is how do we continue to broaden the nature of issues that we're able to address.

What we want with Alphabet is to be an extraordinary magnet, the best magnet for entrepreneurs, and to be an accelerant for their development. And to give them that the kind of environment where we can continue to thrive, and therefore build great businesses that generate tremendous returns as well for our stakeholders on top of solving big problems. But that doesn't necessarily mean, in fact, we're very much thinking they will continue to grow and be independent entity. So it is a broader view of what is Alphabet.

Paul Vogel

Got it. So just to be clear, it's not about that there are sort of newer or smaller or growing. It's just they're separate business that will grow on their own, separate from the core Google.

Ruth Porat

Our view is that we are seeding them and they are growing. And we're not pre-determining what ends up happening. There are big opportunities and we're excited to be in a position where we can address them in a way that is an incredible magnet for great entrepreneurs.

Paul Vogel

Thank you.

Ruth Porat

Thank you.

Operator

Thank you. And our next question comes from Stephen Ju from Credit Suisse. Your line is now open. Please go ahead.

Stephen Ju

Okay. Thanks. Sundar, so I think it was on a conference call about three years ago when Larry articulated a vision of a simple and consistent consumer experience from Google, and the same for your advertising customers as well. So as this is your first conference call with investors where do you think you are in that initiative today? Are you still on the same path or do you plan to take that on a different direction in your new role?

And Ruth, despite the high growth of YouTube and Play presumably, are your cost of goods sold where the content cost of these two businesses live is not growing as rapidly. So will you give some color on where you might be driving the opage [ph]? Thanks.

Sundar Pichai

On the first one, I think the vision that Larry articulated, it's a very compelling vision and it's still valid. To me, the way I think about it is mobile is a good forcing function in some ways. It's a good constraint for us to focus and deliver against that vision. So what I'm doing is internally all our objectives are primarily focused on mobile, and how within the context of mobile we get to a better, simpler and a consistent experience for consumers and advertisers. And so, that framework is how we are thinking about it and I think we are making solid progress.

Ruth Porat

And then, if you're focusing on the other cost to revenue line, the year-over-year and quarter-over-quarter growth was driven by ongoing data center operations, including depreciation that's in there as well, as well as content acquisition costs, as you said primarily YouTube and Play. One thing to note as we look forward to the fourth quarter with the launch of Nexus, Chromecast and Pixel, it's worth noting that we do book the hardware costs in this line.

Stephen Ju

Thank you.

Ruth Porat

Thanks.

Operator

Thank you. And our next question comes from Mark May from Citi. Your line is now open. Please go ahead.

Mark May

Thanks. I had two questions that are kind of interrelated around mobile apps. When you talk about the strength in mobile search are you including also searches that are done on some of your mobile apps like search done on the Maps app or on the mobile YouTube app? And then, kind of somewhat related I guess is, yes, I think it is six apps that have over 1 billion users globally. But some of these you're not really monetizing today or very nascent stages. Can you talk about kind of your efforts maybe to monetize some of these large and actively used apps and maybe identify one or two where you're, I guess, it's for Sundar, where you're particularly sort of excited about the opportunities? Thanks.

Sundar Pichai

Thanks, Mark. On the first one, or maybe you're specifically talking about the mobile search experience on Google.com or the Google app, but we are seeing the same traction within Maps or YouTube. We are seeing mobile usage dramatically grow and in that context people are searching as well. So it's across-the-board we are seeing strength. In terms of our app such of scale, and obviously we take a very long-term view. And several of those apps today already play huge roles, so for example, take Google Maps, it already plays a huge important role in making mobile search better. And so these are interrelated.

YouTube is obviously a big opportunity. Google Play is one. And even things like Gmail are playing a critical role in Google for Work and how we are driving big business opportunities as well. And, by the way, because we are scaling all these apps over 1 billion users, we are building the infrastructure which is what will power our cloud platform externally as well. So in many ways these are all working for us.

Operator

Thank you. And our next question comes from Colin Sebastian from Robert W. Baird. Your line is now open. Please go ahead.

Colin Sebastian

Great. Thanks. I want to ask about two areas of business mentioned on the call. One is machine learning. And it's just coming up a lot more frequently as a topic and I wonder if you could mention more specifically the vision that you have for some of the core applications and how machine learning can make them more useful.

And then, just as a follow to the question on the Google Cloud, and specifically, the Infrastructure-as-a-Service layer, I wonder there if your

strategy is more focused on price or if there are other ways that you can differentiate the service from the competition? Thank you.

Sundar Pichai

Machine learning is core transformative way by which we are rethinking everything we are doing. We've been investing in this area for a while. We believe we are state-of-the-art here. And the progress particularly in the last two years has been pretty dramatic. And so we are - we are thoughtfully applying it across all our products, be it search, be it ads, be it YouTube and Play et cetera. And we are in early days, but you will see us in a systematic manner, think about how we can apply machine learning to all these areas.

On Cloud, I think the right way to think about it over time, for a company or for a developer to build stuff on cloud, they need not just basic things like computer and storage, they need a whole set of services on top of it. We - so there is a lot in the stack. And so I think the way we will differentiate over time is because we have built large services on top of our infrastructure, we understand all the layers which you need to build great application. So you would see us increasingly provide value-added services on top of compute and storage. And that's the way I think we'll play this.