Operator

Good day, and welcome everyone to the Google, Inc. Third Quarter 2012 Earnings Conference Call. This call is being recorded.

And at this time, I'd like to turn the call over to Jane Penner, Director of Investor Relations. Please go ahead.

Jane Penner

Good afternoon, everyone, and welcome to today's third quarter 2012 earnings conference call. With us are Larry Page, Chief Executive Officer; 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 website located at investor.google.com. So, 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 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 that 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-looking statements in light of new information or future events.

Please refer to our SEC filings for a 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.

We have 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 turn the call to Patrick.

Patrick Pichette

Hello, everybody. We're going to invite Larry to give us the first round of commentary and then I'll go through our financials and then Nikesh will have some comment before we turn to Q&A. So here you go, Larry.

Lawrence Page

Thank you, Patrick. Hello, everyone. Thanks for joining us. It's great to be on the call today and to share our progress since we last spoke six months ago. As you can hear my voice is still hoarse, so I will keep my remarks reasonably short. I am sorry for the scramble earlier today. As our printers have said, they hit send on the release just a bit early.

We had a strong quarter, I am really happy with our business. Revenue was up 45% year-on-year, and at just 14 years old, we cleared our first $14 billion revenue quarter. Not bad for a teenager. Today, we live in a world of abundance; abundant information and abundant computing. Most of us carry at least one device, all the time, every day. In fact many of us would feel naked without our smartphone. It's hardly surprising mobile search queries and mobile commerce are growing dramatically across the world.

And we use these devices interchangeably, depending on our situation. I switch between my Nexus phone, my Nexus 7 tablet and my new Chromebook that we just announced today many times a day. While this abundance causes disruption, it also creates amazing opportunity. And Google is super well-placed to take advantage of these disruptive opportunities.

Why? Because our search query volumes have grown this quarter as measured year-over-year. And we are seeing tremendous innovation in advertising, which I believe, will help us monetize mobile queries more effectively than desktop today. Indeed, our mobile monetization per query is already a significant fraction compared to desktop. In short, as we transition from one screen to multiscreens, Google has enormous opportunities to innovate and drive ever higher monetization, just like Search in 2000.

Now we took a big bet on Android back in 2005. We believed that aligning standards around an open source operating system would drive innovation across the industry. Most people thought we were nuts. Today, there are over half a billion Android devices, half a billion, with 1.3 million more being activated every day. You should all run out and buy the Nexus 7 tablet for $199. It's had rave reviews and recently won Gadget of the Year from T3, the gadget experts. You'll love the integration with Google Play. It is an amazing device.

This time last year, I announced that our run-rate for mobile advertising hit $2.5 billion. That seemed like a pretty big number even for Google. But now we have built up additional mobile revenue from users paying for content and apps in Google Play. Including these new sources grossed up, I can announce our new run-rate for mobile is now over $8 billion. That's quite a business.

We have so many opportunities today, that unless we prioritize we spread ourselves too thin. Last month, we sunset another 19 products. We've now closed or have combined 60 products and features in the last year. And we've put a ton of energy into ensuring that our remaining products work really well together. Because as screens multiply, it's more important than ever that we converge our services.

Users want one consistent, beautiful and simple Google experience. Technology should do all the hard work, liberating users to get on with the important things that matter in their lives and this screen independence is at the core of our strategy.

Take Chrome on Android, for example. We only launched in February, but the experience is already amazing. When you are using Chrome, switching devices is truly painless. All your tabs are there, ready to go. Search on your desktop and the result is right there on your smartphone. You can even click the back button, and it just works. And as more users upgrade to Google+, it's now over 400 million, users are enjoying amazing experiences across devices like instant photo upload.

In the same way, we want to make advertising super simple for customers. Online advertising has developed in very device specific ways, with separate campaigns for desktop and mobile. This makes arduous work for advertisers and agencies, and means mobile opportunities often get missed.

So we're working to significantly simplify the campaign experience, working very hard on that. Advertisers should be free to think about their audience, while we do the hard work of dynamically adapting their campaigns across devices. I'm very excited about this.

I talked at the start about the abundance of information. In the early days of Google, you would type in a query, we'd return ten blue links, and you move on fairly happily. Today, you expect more. You expect Google to understand deeply and you expect us to turn your intentions into actions in the blink of an eye.

If you search for Tom Hanks movies, chances are you want movies with Tom Hanks and thanks to our Knowledge Graph that's what we show now, right from the results page: clean, fast, and organized. And if you're shopping, say for Ugg boots, we now give you pictures, details about the different boots, prices and information about the local inventory, again right from the results page, clean, fast, and organized. There's much more we can do to get you the right information at just the right time.

You might have a really important event in the city perhaps a first date, and the traffic is bad. You need to leave early to avoid being late. Or maybe you've just landed in a new country and you're at the airport ATM trying to figure out how much cash to withdraw? Google Now, which we launched on Android in June, gives you all that information and more automatically, with zero effort required on your part.

It's still early days, but these kinds of tips and recommendations are super powerful. They really save users time and hassle. This is why I'm incredibly excited about the opportunities ahead, given our expertise in Search and Mobile, and our track record monetizing high usage products.

Everyday, I wake up and I'm delighted that our opportunities keep growing. And that we're birthing to our users great products that are defining the future. It's a truly exciting time to be at Google.

And now, you will hear from Patrick some details about our quarter.

Patrick Pichette

Thanks, Larry. Good afternoon, everyone, and thank you for joining us. Overall, we are very pleased with the growth trajectory of our business this quarter and this in fact despite significant currency fluctuations in many of our international markets.

So for example, if currencies had remained constant year-over-year, our consolidated revenue growth would actually have been 6% higher. On a positive note, our U.S. growth continues to be strong. And as Larry noted, we've got a great quarter on the product front gaining traction in a number of critical areas.

So before I dive into the financials, I just want to give you a bit more detail on the new $8 billion annual mobile run rate that Larry mentioned. The new run rate is different from the one we gave you a year ago. And more specifically, last year, it included only our gross revenue from mobile ads, but this year, in this number we also added the gross revenue from the mobile sales of Google Play content. And finally, it also includes the consumer spending on the Play apps.

So with that and now why don't I just jump into our financial performance. Our total gross consolidated revenue grew 45% year-over-year to $14.1

billion and that's also 15% quarter-over-quarter. Google's Standalone revenue grew 19% year-over-year to $11.5 billion, 5% quarter-over-quarter. In that, our Google Website revenue was up 15% year-over-year to $7.7 billion, 2% quarter-over-quarter, with strengths across most major geographies and verticals.

Our Google Network grew 21% year-over-year to $3.1 billion and 5% quarter-over-quarter. And our other revenue grew 73% year-over-year to $666 million, 52% quarter-over-quarter and this driven by the Nexus 7 sales.

If it were not for these currency fluctuations, Google Standalone revenue would actually have grown 24% year-over-year. As Larry mentioned, Google Standalone business continues to perform very well. A dramatic growth in our new devices is driving mobiles queries and clicks. And although it's early days, some of our existing ads have better monetization in desktop already today and we're confident that this transition opens a whole new space for innovation and new format and future monetization.

Turning to MMI, Motorola gross revenue was $2.6 billion. The mobile device division revenue for that period was $1.8 billion and the home division revenue was $797 million, but we're really pleased with Motorola's progress in its 150 days.

As indicated in our public filings, our team has made a lot of operational changes, we harmonized and narrowed the product portfolio, there's been streamlining of software operations and we scale back the markets in which we operate. But that said, we are just at the beginning of the Motorola Google story. And we should expect, as I mentioned before, results from this segment to be quite variable for quite a while yet. Remember that we inherited an entire product pipeline where hardware business cycles are typically in a 12 months to 18 months.

At Google, our aggregate paid click growth was very strong again this quarter up 33% year-over-year, 6% quarter-over-quarter. Our aggregate CPC or cost-per-click was down 15% and down 3% quarter-over-quarter. But once again please remember that currency headwinds also had a significant negative impact on our CPCs in Q3. In fixed FX terms, aggregate CPC would have been down only 8% almost half of the 15% and down only 1% quarter-over-quarter.

Turning to geographic performance of Google Standalone business, we continue to see robust performance in the U.S., the UK and Japan. On the other hand, we felt the continued impact of the economic situation in continental Europe, but we've seen pressure in sectors like travel and retail.

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., UK and rest of world, to show the impact of FX and the benefits of our hedging program. So please refer to those slides for the exact calculations.

Revenue from the U.S. was up 23% year-over-year to $5.4 billion. The UK was up 16% to $1.2 billion, which includes $6 million of benefit from our hedging program and in FX term; in fact the UK grew 20%. The non-U.S. revenue excluding the UK accounted for 42% of our total revenue or $4.9 billion, up 15% year-over-year, but in fixed terms, in fact was 26%. And all this includes a $56 million benefit from our hedging program.

So let's come back now to an aggregate level for total consolidated business. Our other cost of revenue was $3.6 billion in Q3 excluding our stock-based compensation. Non-GAAP operating expenses totaled $2.9 billion, which again excludes SBC and the restructuring and related charges recorded in our Motorola business. And our non-GAAP operating profit was therefore $3.8 billion in Q3, resulting in a non-GAAP operating margin of 27%.

For Google Standalone, our traffic acquisition costs were $2.8 billion or 25.5% of total advertising revenue. Our other cost of revenue was $1.6 billion and that excludes $103 million of stock-based compensation. The increase year-over-year in this other cost of revenue was driven by data center costs, equipment costs and including costs associated with the sales of the Nexus 7, and finally, content acquisition costs.

Non-GAAP operating expenses were $3.2 billion, excluding again SBC of $585 million. And finally, our non-GAAP operating profit was $4 billion in Q3 resulting in a non-GAAP operating margin of 34% for Google Standalone. Lastly many of you've asked for the depreciation and amortization expense on PPE for standalone Google, which was $465 million for this quarter.

If we flip to Motorola, our total non-GAAP operating expenses including cost of revenue totaled $2.7 billion for the quarter. And keep in mind, that intangible amortization expenses attributed to the standalone Google and Motorola are included in these non-GAAP measures. And as a result, the non-GAAP operating loss of Motorola was $151 million for Q3, resulting in a non-GAAP operating margin of 6% for that segment.

Let's switch over to headcount. For the consolidated business, it decreased by roughly 1,000 in Q3. Standalone Google added about 1,800 people. And remember that historically, we often see some seasonal effects on the hiring in Q3 as folks that we hired in the spring and early summer actually start working in September. In total, the consolidated company ended up the quarter around 53,500 full-time employees.

Our effective tax rate for this quarter was 22% in Q3, the changes from last quarter reflects the mix shift in earnings between the domestic and international subsidiaries and our hedges, but finally, fewer capital gains offsets versus last quarter.

If you allow me to turn to cash management, OI&E or other income and expenses was $62 million, which reflect the continued impact of our FAS 133 expenses of our hedging program, but also fewer capital gains versus last quarter. For more detail on OI&E, again, please refer to the slides that accompany this call on our IR website.

Operating cash flow was very strong, $4 billion. CapEx for the quarter was $872 million versus last quarter's $774 million. The majority of our CapEx spent is in – continues to be related to production equipment and facilities related purchases. All this actually delivers us a free cash flow, which was $3.1 billion with which we're quite pleased.

The success of our product really gives us the confidence to continue to fund the strategic growth areas, areas that Larry talked about such as Search, YouTube, Android, Chrome, and as always we continue to show our discipline in making the touch calls on products that just don't live up to our expectations. In Q3, we've seen a number of these decisions including the sunset of our Google TV Ad as an example.

So with that, I will hand it off to Nikesh, who will cover more detail on our business performance in the quarter. And after his remarks, we'll open up the phones for Q&A. Nikesh, here's to you.

Nikesh Arora

Thank you, Patrick. I'd like to reiterate what Patrick said. Our business had a strong quarter with $11.5 billion in Google Standalone gross revenue. I want to talk to you about our focus and progress on four major trends that are actually helping to drive our business growth.

First, a trend Larry already talked about, the rise of the multiscreen consumer. This is creating huge opportunities for us especially in our advertising business and focus on video and mobile. At the moment, everybody thinks about the online world is divided into desktops and mobile. Larry shared the amazing $8 billion run rate. And I believe in the medium-term, these screens will continue to diverge, but advertising opportunities will converge to allow our marketers to run common campaigns across all these screens.

Our teams have been putting the same focus on mobile and video the last few quarters that we brought to display a few years ago. And it's rewarding to see it bear fruit. We've intensified trading for our sales team across the globe, integrated sales tools, so we can really bring our customers' mobile video, Search, Display as a cohesive solution. We're also educating our advertisers through initiatives like Go Mobile to ensure they have the right creators and landing pages to make mobile truly work for them.

However, we feel the progress we've made is just the very first step in the journey of monetizing many screens Larry talked about. As we develop advertising that can take advantage of the context in which consumers use this many screens, we expect to continue to see better monetization. As we help marketers reach consumers closer to the point of purchase, the opportunities will only get bigger.

We're already seeing glimpses of this. Take T-Mobile, who use location based mobile ads to drive people nearby into their stores, and in their words, win the last 10 feet. They achieved a click-through rate of about 13%, in what is a very successful strategy. These rates are 3 to 4 times of what you would see without using some of these context. And our Click-to-Call ads work because consumers can respond by contacting an advertiser immediately from the ad, generating approximately 20 million phone calls per month for our clients through our various call products of advertising.

The second trend, which I'm excited about is, it's not just the context that matters, but also our ability to deliver more precise answers to consumers, something also that Larry talked about. We are working very hard in this. Larry talked Google Now and Knowledge Graph; it's exciting to see how that even makes opportunities for us happen, as Search become smarter in a commercial environment. We can do a better job of connecting marketers with consumers in the moments that matter, irrespective of what device they are using.

For example, we're pleased that as of yesterday, Google Shopping completed its transition to a fully paid model based on product listing ads. Now we're providing product information, pictures, pricing, local inventory information, over billion products from tens of thousands of merchants and over 100,000 sellers. So the new Google Shopping experience, Adorama, one of the US's largest photo retailers and mail order suppliers saw their click-through rate jump by 176%. Their conversion rate went up by 100% in June as compared to near earlier.

Using the same technology that powers our Knowledge Graph, we're providing better answers with Google Shopping in other areas where users want to make a purchase. We're going to reduce the number of steps from search to transaction, making the online experience even more valuable to consumers and marketers.

The third trend, which I'm excited about is that we're actually making real headway amplifying offline brand campaigns with online media. We have a unique approach that helps advertisers succeed across media. We allow them to use and leverage the attributes of each media and adapt their campaigns for online success. YouTube energized by new professional content and Display are the core of this business helping clients increase awareness, increase capability, and also drive engagement.

In addition, we also continue to make progress in our end-to-end technology platform to help advertisers of all sizes succeed with display advertising. Today, our top partners in the agency world and very large advertisers and publishers, are using a consistent technology stack. The number of impressions that we've been able to pass through AdX and Invite platforms have doubled over the last year.

We are also working on creating more video premium inventory without channel strategy in YouTube as more and more viewers move to online video, we expect more and more brands will do the same.

Our brand business is actually creating quite a buzz in the industry because we have great media and our solutions really work. For example, on YouTube, we looked at about 92 different ad campaigns with sales impact, we found that an average spending on YouTube was approximately 2.4 times more efficient than the equivalent television spent.

We have 200 times more video advertisers than the average U.S. television network. In our TrueView format, in which advertisers only pay for ads that users watch has really taken off. We have twice as many advertisers using TrueView since last year. That's a very important statistic, but like any good brand marketer, the best way for me to show you – tell you a story is to actually show it. So let's see what two of our leading brands have done this quarter.

We launched the YouTube Gillette Football Club with Procter & Gamble in Europe, we've created global brand platform for Gillette that will reinvent the way people watch football online. The campaigns have generated about $30 million video views. We are working with Coca-Cola on their Vitaminwater branding effort. We've partnered to build a strategic music program leveraging YouTube as a platform to anchor, distribute and syndicate the video content. It's particularly exciting to see that over 100 brands now have over 1 million followers in Google+ including ESPN, PlayStation, Ferrari, H&M, Burberry and Toyota.

Last trend I want to talk about is the trend of cloud computing in the enterprise. Our enterprise business continues to thrive. We saw especially great traction in retail and education sectors this quarter with Dillard's, Kohl's, and Office Depot, all using Google Enterprise products.

In education, there are over 20 million students, faculty and staff, non-Google apps, Princeton, Virginia Tech, and even the Philippines Department of Education which has over 600,000 users.

With the recent launch of Google+ for enterprise customers, organizations of all size – sizes including capital and Banshee Wines are starting to use our Hangouts and other tools to work together and get things done from anywhere.

In addition to all these trends, our marketing team continues to do an excellent job. We launched a global cross-product initiative to bring the 2012 Olympics to our users worldwide. YouTube streamed the games like to 64 countries. Also YouTube was the efficient live streaming provider with over 1 million hours of live content for the democratic and republic of national conventions. And we passed yet another milestone just this week and YouTube broke it's own record to reach more than 8 million concurrent live streams of Felix Baumgartner's recording breaking leap from space with the Red Bull Stratos mission.

So with that as an update, I'm going to hang your back to Patrick.

Patrick Pichette

Thank you, Nikesh. So Jennifer, if you would like to tell us the rules we will just get on for the Q&A session.

Question-and-Answer Session

Operator

(Operator Instructions) And we will take our first question from Ross Sandler with Deutsche Bank.

Ross A. Sandler – Deutsche Bank Securities, Inc.

Thanks guys. Nikesh, one quick question on revenue and Patrick one on expenses. The international and rest of world organic growth was 26% pretty strong, but down from 29% last quarter. So is there any incremental weakness that you saw or was this just mostly from a tougher comp? And then Patrick, your sales and marketing expense was up 18% from last quarter that's a bit higher than the typical increase in 3Q, can you talk about what's driving up those investments? Thanks guys.

Patrick Pichette

Okay, I'll start, Nikesh and I are pointing at each other. Yeah, on the marketing expense listen, I think what you see is the impact of the support for the Nexus 7 that we launched in Q3. Otherwise everything was pretty much in line with what we would expect. We just got such a great review of the Nexus 7, we won the support of the market and that's the biggest delta you will see in that number.

In terms of the market, I'll hand it over to Nikesh for his commentary.

Nikesh Arora

I think it's fair to say that, our revenue growth internationally has been pretty strong. You are seeing some pockets of difference in performance partly because of seasonal reasons and partly because of the continuing economic effects you're seeing in Europe. So our business is doing better than the economy in most markets in Europe, but it does get impacted a little bit with some of the fluctuations you see there. So from our perspective there is no any cause for concern.

Ross A. Sandler – Deutsche Bank Securities, Inc.

Okay. Thanks, guys.

Patrick Pichette

Thanks, Ross. Jennifer, let's go to the next caller please.

Operator

And we will take our next question from Scott Devitt with Morgan Stanley.

Scott W. Devitt – Morgan Stanley & Co. LLC

Hi, thanks. Just wondering if you could talk a little more about the strategy behind the decision to monetize product listing ads and then more broadly about the retail strategy for the company? And then secondly, Google website revenue net of distribution tax lowered to 13% from 20% last quarter, I was wondering if possible you could Patrick normalize that for currency to get a better understanding of FX neutral for website growth? Thank you.

Lawrence Page

Hello Scott, this is Larry. On this question about the strategy and product listings, I think we're just really excited about providing a better experience for our customers. When they search for something I mention boots on the call, now you search for that, I think you'll see a well organized set of product information, ways to buy it and really have a great experience there. And we see, our ability to do that on the ads or monetized product listing side, it's really helping us provide a better user experience and provide a better advertiser experience. So I'm very excited about that. I think we are still in the early stages of that. We just launched, I think yesterday really and we still got ways to go. So I'll let Nikesh or Patrick take the next question.

Patrick Pichette

On your question relative to our Google site and tech, I'm not – could you just repeat your question, I not sure, I understood what you meant?

Scott W. Devitt – Morgan Stanley & Co. LLC

I'm just trying to understand better the – you suggested the 600 basis point effect from currency and I was just wondering if there is a better way to understand the way that currency effected Google site revenue, if I should think of that any differently than the overall currency?

Patrick Pichette

I see, so no, it's even the, I mean we have – our network is slightly skewed to the US versus our Google site, so you'll have some mixed effect there because our network is slightly skewed to the US, but overall I think that it still gives you a good sense of proportion as to what's going on in the market. So that's the way I would kind of think about it from a model point of view.

Lawrence Page

Let me just add – now it's on the first part of the question, I think we are really trying to provide answers to people and so, and the strategy for the company really looking at very detailed information and giving you the exact right answer, what we're doing with knowledge [tides] [ph]. And in search, I wanted to do the same thing as with our advertising to make sure that we get you, as a user in the right answer. And I think that's a very exciting sort of a new strategy for us.

Scott W. Devitt – Morgan Stanley & Co. LLC

Thank you.

Patrick Pichette

Thanks Scott. Jennifer, let's go to the next question please.

Operator

Next question comes from Mark Mahaney with Citi.

Mark S. Mahaney – Citigroup

Great, thanks. Two questions please mobile searches are really strong, what's happening with desktop searches. At some point it's probably reasonable to assume that they're flat lined, we already reach that. And on the expense side if we just looked at the core Google it looks like the margins are coming down, but if you did roughly $200 million may be in Nexus revenue and if you really sold those devices at cost then margins are actually better than they have been in two year, which is the more accurate interpretation? Thanks.

Patrick Pichette

Actually, let me start with the margins and then I will answer your first question. On the margins you actually have a couple of effects this quarter, one of them, is clearly as you said the cost of the Nexus that will flow into our other cost of revenue, but also it's the first time that you have the full quarter effect of the amortization of intangibles from the Motorola transaction.

So that is also another big kind levered that actually kicked in. and it should noted just for the financial community that the amortization of intangibles for Motorola flows to both the Google segment and the Motorola segment in different proportion. So again, it's pretty tough, as I promised you that we'd have a lot of kind of noise in the data, I think that's a good set of indication. And for the first one, why don't I let Larry give a few comments on the issue of mobile.

Lawrence Page

So I guess, I feel like you are asking the wrong question a little bit. I think we are really starting to live in the new reality, one where the kind of ubiquity of the screens helps users really move from intent to action much faster and more seamlessly. So I think this will create a huge new universe of opportunities for advertisers where they can focus on platform. Focusing on platform specific queries won't make us much sense because advertisers will be dynamically adopting across a whole bunch of different devices to reach the right audiences at the right time.

And that's kind of how we are thinking about it and I alluded to changes that we'll make – to our ads system to improve the advertiser experience and the user experience around that. And I also think that, we are just seeing tremendous growth in the Android, which really obviously we have tremendous ability to influence and to improve the user experience, to add location, to notify your things as I mentioned around different kinds of non-commercial experiences. We can notify you of commercial experiences as well.

So I think that’s a really big and great opportunity for us. And as I’ve said, that monetization on mobile queries right now is a significant fraction of desktop. So we're kind of living the best of both worlds, we’re able to move our existing ads, our existing monetization over to mobile. And lastly in order to really innovate using Android and our strength of having ads on other mobile platforms and really move advertisers and consumers who into a new world. So I think we are uniquely positioned to get through the transition and it’s really profit from it. So I am just incredibly excited about that.

Mark S. Mahaney – Citigroup

Thanks for the correction Larry.

Lawrence Page

Thanks. Jennifer let’s got to our next question please.

Operator

Our next question comes from Carlos Kirjner with Sanford Bernstein.

Carlos Kirjner – Sanford C. Bernstein & Co. LLC

Hi, two questions, if you run a website with proprietary high quality content today and have to choose a protocol to add, meta data about this content, why would the clear choice would be the Open Graph protocol instead of RDF or one of it’s variables and if that happens and the semantic web arises on the back of open graph doesn’t it place Google at a fundamental disadvantage to achieve the vision that Larry laid out in the beginning of the call. The second question is what do think is the future of vertical search and why is that there are sites that specialize in certain vertical such as travel and local, that seem to do a better job than Google today and if this is going to change over time and what happens with vertical search? Thank you.

Lawrence Page

Yeah, Carlos, I’ll take those questions. I think if you - I'm not an expert on the protocols you’re talking about, I think in general we made a huge investment in knowledge graph and really understanding in detail about everything. And that's a major effort for us, and we'd obviously love to have other people help us with that. I think it's been a little bit of a challenge in the past to get all the labeling aligned and all those things. I think we have a big part to play in that. We're absolutely very excited about that and I think we're going to do a lot work in that area. And I think we're doing well in that space.

Vertical searches, as you asked about, I think our goal has always been to get you to the right place, but we also – to do that we need to really understand in detail, your context, what you need, what's really going on with that information, if it's airline tickets, what are the flights between, what do they cost, products, some one selling we need to know how much they cost to get to know what the shipping is and so on. So I think any place we can get that information accurately, we can present it to our users. However we are very happy to do so.

In general, we found that we knew it's really, build more of that experience in order to provide a really high quality experience to our users. But again, we're always open alsoto working with partners.

Carlos Kirjner – Sanford C. Bernstein & Co. LLC

Thanks you.

Patrick Pichette

Thank you, Carlos, for your question. Jennifer, let's go to our next question.

Operator

And we will take our next question from Ben Schachter with Macquarie.

Ben Schachter – Macquarie Research Equities

One question for Larry and then a couple of housekeeping points on the Apple relationship for Patrick. Larry, there is a lot of this talk about internet use on mobile devices, but switching gears a little, I just wonder if you could talk about the potential for internet access on television screens and how Google might benefit from that? And then Patrick, just two quick housekeeping questions on Apple. One, is 100% of the TAC that you pay, Apple recognized in the Google.com TAC line, and then on iOS 6 there is a seemingly small change in the default search bar right now, says the word search where they used to say Google. How does if at all that change the economic relationship between Apple and Google? Thanks.

Lawrence Page

Okay, so Ben thanks for the question. I mean, obviously we were exited about television, television screens, displays and we have been for a while. We've had Google TV, it was a product for quite sometime, I'd just say, I love it and I think it's a great time to have a real browser, mail on your television, easily access You Tube and all those kind of things.

YouTube is integrated on many, many devices from DVD players and so on to game consoles and things like that. So we obviously are working hard to get distribution for YouTube, for Chrome and for the internet as a whole on television screens, as well as our own products, and we're very excited about that. I think we are obviously still in the early stages of that, something we really has a great user experience, and we work hard to make that happen.

Patrick Pichette

On the – sorry, just want to talk about the TAC line and just to say that, yes, I mean obviously all the TAC that we paid to Apple, it is just another partner for distribution, so it all is tied to our – the TAC line that we have for Google.com. On your question of the default, I mean although there is – nothing is changed, right, I mean, when you use Google, we are a great partner with Apple, we're a great partner with many of them, and in doing so, when you do search, I mean we have a great, we have the – the fact that they've changed from Google to search is still kind of run by our engines. So I hope that clarifies the point Ben.

Ben Schachter – Macquarie Research Equities

Okay, thanks.

Patrick Pichette

Thanks, Ben. Jennifer let's go to the next question please.

Operator

Next question come from Anthony Diclemente with Barclays.

Anthony Diclemente – Barclays

Hi, thanks. I started to harp on the CPC question, but you mentioned them being down 8% XFS. Can you just Patrick, talk a little bit about the other drivers, I think everybody assumes that the bulk of the down 8% is mobile, but I know there are other factors driving that down 8%, so if you could just kind of give us order of magnitude in emerging markets and so forth if possible?

And then secondly, on allocation of your sizable free cash flow and on your cash balance Patrick in the past you've talked about reviewing and considering capital returns at the Board level. And at the same time you've talked about your cash balance being a strategic asset for Google, just wondering if you could give us an update on yours, on Larry's, Board's thinking on allocation of capital and use of your cash balance? Thanks for the question.

Patrick Pichette

Yeah, listen, on the CPC trends nothing has changed from last two quarters. And in fact, I think people have a tendency just to harp and assuming that it's automatically mobile…

Anthony Diclemente – Barclays

Right.

Patrick Pichette

And if you look through our results, I just kind of point to a few areas, if you look at our mix between our Google properties and our network, right, our network grew quite a bit again this quarter and that would drive a lot of pack as well. So I and again that's the reason why I kind of want to educate and tell and remind everybody that just all of these mix effects whether it would be mobile versus laptop versus desktop, but also emerging market versus developed markets and also our Google.com versus network.

And then we haven't even talked about the changes in our ads quality, which actually can change quite a bit as well. So I think that matters a lot, and I think that it's really important now we understand that all these mix effects are actually playing or play there in the CPC. So and that's what we don't give, if we start giving down all the breakdown right, it's just endless.

So for us, the real issue for us is, but what really matters is, they are going down, but on the flip side of that, right, given all these mix issues, what we really see is our pay clicks going up at a pretty healthy rate at 33% again this quarter, which actually gives you a sense of people who are engaged, people are using our products, it's really about this transformation of multi-devices and in fact that there is a little bit less CPC is not a concern compared to all the offside that we see on the other side.

On the issue of our cash and capital balance, I think, you get the same answer and maybe Larry wants to kind of chime in if he wishes to, but we just review this on a constant basis. We ask ourselves the question, is there real options for us actually to use the cash from a strategic perspective and we've come to the conclusion that it is a real strategic asset for us right now with the ability to balance. And so we think it's prudent to actually manage our capital structure to where it is as we speak.

Lawrence Page

We have nothing to announce at this time.

Anthony Diclemente – Barclays

Okay. Thank you very much.

Lawrence Page

Thank you. Thanks, Anthony.

Patrick Pichette

Thanks, Anthony.

Lawrence Page

Can we have the next question?

Operator

Next question comes from Heather Bellini with Goldman Sachs.

Heather Bellini – Goldman Sachs

Great. Thank you for the question. I have two for Patrick and then one for Larry. Patrick, I'll start out with yours first. Can you give us an idea of the run rate that you are talking about, the $8 billion for mobile, can you give us an idea of what that is on a kind of same-store sales basis, you gave us the $2.5 billion run rate last year, what is the mobile advertising piece, I think that's something people are really interested in, so extra stuff from Google Play? The follow-up question I had for you was, what's the margin profile on the Google Play content revenue that you're recognizing? And then the question for Larry is, I guess just in listening to Mark Mahaney's question, I was wondering in this new reality you mentioned in response to his question, how does Google Fiber play into this vision to have your content and search capabilities go across multiple screens? Thank you.

Lawrence Page

Okay, I'll let Patrick, take the first part.

Patrick Pichette

Okay. So on the $8 billion, so let me give you just a bit more information on it, but clearly we don't breakdown each of the categories, we just wanted to kind of give you a sense of proportion. A point that's important is, of the three categories I gave you, ads continues to be the bulk of it, the vast majority of it. And then on the case of the Google Play, it's important to note from a modeling perspective that everything's that's content, that is whether a book, a movie content is actually booked on our books on a gross basis.

Everything that is tied to apps is booked on a net basis, but it's still a huge kind of number in all cases. So without giving you, I just want to give you that, so that you don't start thinking that there is actually 8 billion that is book to revenue in our result that you see, but in fact, two of the three are there, the third one is done on a net basis, just because of our accounting rules. So and the vast majority is still ads.

Heather Bellini – Goldman Sachs

And can you just give us a sense of the margin profile on the not ad piece?

Patrick Pichette

We don't provide that. We don't give any of the details of that. But clearly, it's a different profile, because it's content, so we have partnerships that we deal with.

Heather Bellini – Goldman Sachs

Great.

Patrick Pichette

On the case of, why don't I turn it over to Larry to talk about Google Fiber and Google TV.

Lawrence Page

Hi, Heather, it's a great question. I think, Google Fiber I think we are in the early stages, right, it's just rolling in out in one city or two cities that are one city. And we're really excited about it and I'm excited about the user experience there. In fact, I think I'm about to go, went soon from my asked trials. But you control it with a Nexus 7 tablet actually, that's the remote for it. I think it will be an amazing experience from a user standpoint, one that can really drive that industry forward. So are quite excited about that like said we are in the early stages, obviously rolling that up.

Patrick Pichette

It’s worth just to close on that. It’s worth kind of noting also that we are pushing for the next chapter of the internet in the U.S. with Google Fiber. People, there is such a demand for higher speed access at reasonable prices, I think that we got a great mouth trap with Google Fiber and we hope it excites everybody and promote the environment that will actually give us that kind of connectivity in the U.S. and elsewhere as well.

Heather Bellini – Goldman Sachs

Thank you.

Patrick Pichette

Thanks. Jennifer, let’s go to a next question please.

Operator

Next question comes from Douglas Anmuth with JPMorgan

Douglas T. Anmuth – JPMorgan Securities LLC

Great, thanks. Just want to ask two questions. First is just following up on Scott’s earlier question, we saw a deceleration in Google Properties and then an acceleration on network side. But hoping that you could talk about a little bit beyond the U.S. and the international mix, is there anything else that you would attribute those dynamics to. And then secondly, you talked a lot about multiple screens and ambiguity of devices, how concerned are you that in a mobile world, behavior is different and we’re living in more of an apps-based environment and Google might not be that starting point for people on mobile devices. Thanks.

Lawrence Page

Yeah, thanks. That was a great question, Doug, I’ll take the second one first. I think a lots been made on that note, I don’t think that’s really true, kind of apps versus search. We obviously have a great position in apps, we have the Android Play Star, which has a huge number of apps. And I think that those experiences are good experiences and there are some things that are better than them, but to us some things that are better than the web of the apps. I think over time, we do our jobs right, you have the same capabilities in both places, and we have such ability in apps, you built some more usually good apps, the same way you go to webpage and so on. So I think anyway I think those differences will emerge or where it is tenures over time. I think we obliviously have a strong position in both.

So I'm not so worried about that. I think that there is obviously innovation that goes out of mobile and we talked a little bit about all the different context and location you could have on mobile, the fact they're always carrying a device with you and those things are very powerful. So you want all that when you are on desktop seller on the web, you want that same information. And so we wanted a seamless experience that goes across both mobile and desktop and TV or whatever screens you have, and that's what we are building. I think that we are going to see tremendous in these things.

The other point I make is that, there is a small, relatively small number of people right now that have Chrome on their mobile devices. And I find Chrome on my mobile device like the same is having a desktop computer a year ago or something. And it's an amazing experience. You can buy things. It remembers your credit card numbers and that means it's a very, very easy great experience. That's been, that's rolled up to a relatively small number of people, but it will be increasing quickly.

So I guess just seeing all those trends, I think it's tremendous opportunity for us. And I don't think people are really thinking about it correctly now. So Patrick, do you want the cover the detailed question?

Patrick Pichette

Yeah, with pleasure. Look just to reiterate that our Google website's revenue was up and with strength across most geographies and most verticals. I mean obviously you've heard Nikesh talk about, Douglas, we can't control the economy in the short term, so if there is a country that is slowing down a little bit then we clearly kind of see it in the result as well because Google is actually a pretty good protector of the present as far the economists are varying kind of reminds us. But then on the Google Network, I think we're just really pleased with, it's skewed slightly more to the U.S. but really pleased with the performance overall with all of our networks, that's been performing well. So nothing additional to kind of highlight apart from just a good general trends.

Douglas Anmuth – JPMorgan

Okay. Thank you.

Patrick Pichette

Jennifer, our next question please?

Operator

Next question comes from Richard Kramer with Arete.

Richard Kramer – Arete Research Services LLP

Hi, thanks very much. I've got some, one question for each of you, if I may, for Larry if you could just expand a little bit more on YouTube and maybe provide not only some metrics, but really your may be three to five year vision of its rolling video distribution between Google TV and the fiber project and some of the other options. For Nikesh, could you talk a little bit about emerging markets and where Android really is the dominant not only in scale, mobile computing platforms, and what may drive that to show faster international growth, if its having sales force or purchasing power or something else and maybe Patrick, could you help us understand a little bit the FX headwind on the top line how it might have been expressed moving down the P&L especially in sort of net profit terms. Thanks very much.

Lawrence Page

Richard, that's a great question on YouTube. I haven't had, Nikesh mentioned Google TV for a while, I think recently kind of YouTube transition from maybe a year ago, to be really something that keeps me entertained for hours on the TV. It can play back, lots of really high quality, highly exciting things, they are now kind of tailored for me, my channels and so on and I think we have tremendously increasing YouTube usage, continues to grow like crazy. And we've head increasing monetization as well which causes people to put more content on it, and to monetize it worldwide, kind of in a blink of an eye you can put things up.

So I was just, the recent video of horse dancing, came in style. I have been watching, its 400 million views now – 500 million. And that kind of thing to really just put the switch, turn it on, get a worldwide distribution and sort of – almost without doing any work, if you are a provider of this content is an amazing thing. And I think that's how we see the future, we're just kind of continue to grow that. It is going to be available everywhere on your mobile, on your TV, on your desktop wherever you want. It's going to keep track of the kinds of things you're interested in and really provides you an amazing experience, and provide a great experience for the advertisers, true view is exploding, which gives us high quality ads from an end user standpoint, because they can skip some if they want. So it encourages paths that are actually entertaining, not annoying, and that's been working or making money over that and it's coming like crazy as well. So I couldn't be more excited about all that.

Nikesh Arora

Thanks Richard. As far as the emerging markets in Android, I mean I think we're very excited about the fact that Android is becoming very successful platform in many markets, outside the U.S. not just the U.S. I think in terms of what drive, I am not sure if your question is about faster growth of Android or faster growth of monetization on Android platforms. I think on both of them, we're seeing the adoption in various markets, there OEMS are producing Android devices on the bleeding edge and doing a phenomenal job of working with operators in those market and distributing them, so we think that will continue because and Android is providing to be a great platform for innovation for all the OEM.

In addition to that as more and more people use mobile device, I think we've talked a lot in this call about have those mobile devices are being used, we are seeing an increasing in query growth and we are seeing our various new ad formats and ads where we bring context into account is actually helping us monetize. So I think both those trends are going in the right direction. Hopefully that provides more opportunity for us.

Patrick Pichette

Let me close on FX, so Richard, just two points, one is, it's been interesting in Q3, the U.S. dollar has really weakened versus a whole host of currencies, so typically you have one currency that goes down another one is more stable, we've really seen it across-the-board, it just happens with the macro economic trend, again, it's something you can't predict. So it's been across-the-board and without giving you the details of how it flows to margins, it is fair to say and we've already talked in the past that our operating expenses are skewed to the U.S. I mean Mountain View is the headquarter and so from that perspective it has some effect as well. So I think you can navigate through this. So it was definitely a significant impact for this quarter.

Anthony Diclemente – Barclays

Okay. Thanks.

Patrick Pichette

Thanks, Richard. Jennifer, let's go to our next question.

Operator

Our next question comes from Justin Post with Merrill Lynch.

Patrick Pichette

Justin, are you with us?

Justin Post – Bank of America/Merrill Lynch

Can you hear me now?

Patrick Pichette

We can.

Justin Post – Bank of America/Merrill Lynch

On a high level, I just want to know, if searches on mobile the same quality in your estimate as PC I mean are you still getting good high CPC travel and e-commerce searches on mobile? Second, maybe you could talk a little bit about the rollout of Google product search seeing those ads definitely in core search results and could that have an impact in Q4?

And then maybe some detail on the hedging program, this is one of your worst year-over-year hedging, I'm sorry, one of your worst year-over-year FX impacts down $500 million and now you get a $62 million benefit and I think you disclosed the cost was 124. I guess there is there something you can do to kind of improve that the ratio is there and not spend so much and a get a better benefit win FX is negative thanks.

Lawrence Page

Yes, Justin thanks for the question. I don't know the details of the particular queries on the Google Desktop, but I can tell you I think like for example in Travel we bought IT software for a sizable amount, we thought it was important to provide a better experience there, when you type cities and you want an airline ticket, you actually need that detailed information, and I think I'm not worried about any of that to the extend we provide great an amazing user experience for people. However they are looking for all types of different kinds of information as long as we're providing again that very detailed, very organized customer results of people, I think that translates across all of your screen is just fine. Nikesh or Patrick, do you want to?

Patrick Pichette

Again jumping on to the FX issue if you don't mind, look I think that it's interesting your question Justin, but let's remind ourselves of a couple of points, because I think our FX program has actually delivered amazing value to shareholders. One is, we don't hedge revenue, we hedge profits. And we hedge a number of kind of major currencies like the Euro, the Pound, the Canadian Dollar, few others which is the core of our program, and not only but actually our hedge program is certainly designed for long-term kind of 18 months as a risk reduction strategy and doesn't necessarily correlate in a way we should perform for three months kind of timeframe in our financial results. And it's really also build to make sure, I guess you had a cost benefit ratio, thereof making sure that it's set for bit dislocations.

So if it's just a smaller variance in the short-term, you are not going to get us much benefit as it is a big dislocation. So for all these reasons and then what I mentioned a bit earlier, which is we've seen actually FX across a whole slue of currencies this quarter, which these smaller currencies just added up and we don't hedge for them today. That's what kind of ended up in the puzzle. So we are constantly looking at our forecast and if it makes sense we will actually throw in new currencies going forward. So that's been the story on FX, but I wouldn't read in anyway (inaudible) performed that it hasn't performed well, it's performed very low. So why don't I turn it back over to Nikesh for the last question.

Nikesh Arora

Yeah, in terms of the product listing ad as we talked about, we're really excited that we actually went on a full rollout for product listing ads and as we've said we have 1 billion products that are in there. So as we've also, as Larry talked about getting more precise information. We believe that users when they search they come exploring on the web, when they have a better idea, what they are trying to buy. They start expressing intent by being more precise of what they ask for.

And we believe being able to do product listing ads gets us closer to intent because if somebody types a Nikon D800 then we know they are looking to buy or looking to get more information about a specific product and the fact that we can show them reviews pictures and pricing information gets us closer to action. And we believe in the medium term that's going to create more monetization and a better monetization for us as opposed to having just 10 blue links of ads we'd send them to other websites. So I think that's going to have a good impact in the medium term, I don't think I'm going to comment whether that has an impact in Q4 or not.

Justin Post – Bank of America/Merrill Lynch

Great. Thank you.

Patrick Pichette

Thanks, Justin, for your question. We will go for one last question. Jennifer, please?

Operator

We will take our last question from Brian Pitz with Jefferies.

Brian Pitz – Jefferies & Co.

Great. Thanks. Larry, bigger picture question on your mobile comments, would you give us some rough sense of how long it could take to close the bulk of the gap between desktop and mobile monetization, is this a matter of quarters or years that will see that come together. And then maybe just you made a quick comment on travel weakness last quarter, I think you said travel was strong across the board. And then you came back today and said it sounds like that was a weaker category, just anymore color on the weakness of travel? Thanks.

Lawrence Page

Thanks Brian for the question. And we have kind of policy of not talking about the future, so I think it's generally a good policy. I tend to be very impatient and I think, I kind of reiterate what I said that we are positioned well, very, very well, and uniquely well, because we have hardly very significant fraction to monetization on mobile and that's a great start. And we're working on changes, we do things we've been investing in this space for long, long time right, our mobile monetization is not zero, it's a very significant number.

As we try to end also with $8 billion number. And I think that it's kind of good pace there and I don't think that the things we need to do are that huge, to have us in a very good spot and I think we have opportunity to be higher monetization than where we are now. Put some innovation which we're kind of doing, it looks like that I'm very impatient and I think that, another point I make I guess that I've made already, I think that, advertisers are ads still requires they spend some metric to deal with mobile in general.

I think advertisers, mobile until very recently it's been relatively small percentage of advertising spend from those advertisers. I think that's starting to be in the long as the case, right, and that's happening relatively quickly, and I think advertisers will also react to that, and you will see them invest, more efforts in targeting those users, running apps for them in phone which holds obviously benefit our monetization there. Actually we have a lot of trends working for us, so I am not worried about this in terms of our business at all. I think it's more of an opportunity for us because we're better positioned than most other companies. I guess (inaudible) estimate, short-term impact and I am quite impatient.

Patrick Pichette

If I can just close on just travel, I mean obviously there's a couple of factors in there, one of them is clearly – there is seasonality in travel, so obviously that’s always an impact quarter-over-quarter, and then as we – the same news you read about Europe or other parts of the world that are in different economic situations. You will notice that if you kind of track Google Trends and you go and mine into the data, you will see that some sectors are performing better, others are not, and as I mentioned in my commentary, at the very beginning, travel and retail has been somewhat weak in Europe just given their situation, so no real surprises there Brian. Thank you for you questions.

Just before we close, I just want to take a ten seconds on behalf of Nikesh, Larry and myself thanking in the amazing work of our Googlers, all our employees, all our partners, what an amazing last 90 days it’s been both at Motorola and Google.

And I’ll let Larry close with the last words before we turn it over to Jennifer to close the call.

Lawrence Page

Yeah, I just want to thank all of you after spending so much time with us and following us and doing your analysis. And with that, I’ll close the call.