

**Operator**

Good day, everyone, and welcome to the Google Inc. Third Quarter 2011 Earnings Conference Call. This call is being recorded. At this time, I'd like to turn the conference over to Ms. Jane Penner, Head of Investor Relations. Please go ahead, ma'am.

**Jane Penner**

Good afternoon, everyone, and welcome to today's third quarter 2011 earnings conference call. With us are Larry Page, Chief Executive Officer; Patrick Pichette, Senior Vice President and Chief Financial Officer; Susan Wojcicki, Senior Vice President, Advertising; Nikesh Arora, Senior Vice President and Chief Business Officer.

First, Larry, Patrick, Nikesh, and Susan, will provide us with their thoughts on the quarter. Also, as you know, we now distribute our earnings release through our Investor Relations website located at [investor.google.com](http://investor.google.com). So please refer to our IR website for our earnings release, as well as supplementary slides that accompany the call. This call is also being webcast from [investor.google.com](http://investor.google.com). A replay of the call will be available on our website in a few hours.

Now let me quickly cover the safe harbor. Some of the statements that we make today may be considered forward-looking, including statements regarding Google's future investments and our long-term growth and innovation, the expected performance of our business 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 also expressed on a non-GAAP basis and have been adjusted to exclude charges related to stock-based compensation. We've also adjusted our net cash provided by operating activities to remove capital expenditures, which we refer to as free cash flow. Our GAAP results and reconciliations of non-GAAP to GAAP measures can be found in our earnings press release.

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

## Larry Page

Well, thank you, and it's great to be here, and thanks for taking the time to be with us today. When I look back over the last quarter, the word that springs to mind is gangbusters. Revenue was up 33% year-on-year, and our quarterly revenue was just short of \$10 billion, not bad for a 13-year-old.

I'm also incredibly excited about the progress we've made on the product side. Ever since taking over as CEO, I had to focus much of my energy on increasing Google's velocity and execution, and we're beginning to see results.

Look at Google+, we had 100 features launched in 90 days, the team is really cranking. We had Hangouts on the phone, Hangouts on air, Will.i.am did a Hangout from his concert in Central Park. You can now share Circles. You can search Google+ and you can play games in Google+. And far and most exciting of all, open sign-ups, Google+ for everyone.

Looking at the numbers for Google+, I was taken aback. I now want to announce that we passed the 40 million user mark on Google+. People are flocking into Google+ at an incredible rate and we're just getting started.

The engagement we're seeing is phenomenal too. Over 3.4 billion photos have already been uploaded in Google+. But it's still incredibly early days for Google+ because our goal is actually far bigger than the individual feature launches themselves. Our ultimate ambition is to transform the overall Google experience, making it beautifully simple, almost automagical because we understand what you want and can deliver it instantly.

This means baking identity and sharing into all of our products so that we build a real relationship with our users. Sharing on the web will be like sharing in real-life across all your stuff. You'll have better, more relevant search results and ads. Think about it this way. Last quarter, we shipped the Plus, and now we're going to ship the Google part. The new visual design, beautiful, consistent UIs for Search, News, Maps, Translate, and lots of other features, is only the beginning of that process.

Last quarter, I talked about focus, and we've made great progress here too. To create products that really change people's lives, that they use every day, 2x or 3x a day, is really hard. So we have to make tough decisions about what to focus on or we end up doing things that don't have the impact that we strive for.

Since we last spoke, we've begun the process of shutting over 20 different products including Sidewiki, Google Pack, Google Notebook, and Fast Flip, and we'll continue to simplify and streamline our products going forward.

This prioritization is crucial if we are to really invest in the extraordinary opportunities in front of Google today.

Let me give you a few examples. Chrome, usage is going through the roof. We have now hit over 200 million users and still growing fast. Turns out that people really care about getting to the web quickly and securely and having a whole ecosystem of apps at their fingertips.

I'm super pleased with Google Maps, it's a favorite with our users, especially on mobile devices. In August, we launched in 40 new countries, taking our total to 130 countries. The growth of Android is mind-boggling too. Over 190 million devices have now been activated globally. I'm super excited about the soon-to-be released new version of Android called Ice Cream Sandwich, that's right, Ice Cream Sandwich. You won't believe what we managed to get done in this release.

We're also seeing a huge positive revenue impact from Mobile, which has grown 2.5x in the last 12 months to a run rate of over \$2.5 billion. Generally, I found that high usage products will make a lot of money over time for well-managed technology companies, and that's why it's so important to run these businesses for the long term.

That said, we must never lose sight of the fact that today's revenues and growth serve as the engine that funds all of our future innovation. People are a crucial part of Google's long-term success, because great companies are no greater than the efforts and ingenuity of their employees. So our goal is to hire the best people at every level and keep them at Google. Our hiring has to be manageable, if we are to balance our short and long-term needs.

You may have noticed quite substantial hiring this quarter, driven in part by a lot of university graduates. Despite the seasonal effect, the total number of people we hired was about the same as last quarter. Our attrition remains low, which is great, though obviously it contributes to our overall current headcount. As I said previously, I continue to believe that our headcount growth is the edge of what's manageable.

Let me finish by saying that we are still at the very early stages of what technology can deliver. These tools we use online will look very different in 5 years time. We're building those tools now as Google+, which is why I'm so excited to be here.

So thank you. And again, we had a great quarter. And now I'll turn it over to Patrick.

**Patrick Pichette**

Thank you, Larry. Good afternoon, everyone, and thanks for joining us. Let me first turn to the specifics of our performance in the quarter from a financial perspective. Our gross revenue grew 33% year-over-year to \$9.7 billion and 8% quarter-over-quarter. Note that while some currency fluctuation boosted our revenue again this quarter a little bit, even in constant FX terms, our growth rates remain very strong.

Our Google website revenue was up 39% year-over-year to \$6.7 billion and 8% quarter-over-quarter, which trends across most major geographies and verticals in fact. Our Google Network revenue was up 18% year-over-year to \$2.6 billion and 4% quarter-over-quarter.

On the one hand, year-over-year network revenue growth slowed slightly due to a few factors, including the Search quality changes that we made earlier this year that we already commented on. On the other hand, the momentum of our Display business, which comprises only part of the network line, continues. And Nikesh will have more to say on this in a few minutes.

Our other revenue was up also 52% year-over-year to \$385 million, and that was up 24% quarter-over-quarter. Our global aggregate Paid Click growth was very strong, up 28% year-over-year, and up 13% quarter-over-quarter. The corollary, the aggregate cost-per-click growth was up 5% year-over-year and down 5% quarter-over-quarter. Remember too that, that's an aggregate number, which includes both Google.com and our AdSense properties. As usual, there's some variability quarter-over-quarter in these metrics but, overall, we continue to be very pleased with our revenue and the performance of our ad system. Again, Susan will give you a few more comments in a few minutes.

So turning to our geographic performance, the U.S. and rest of worlds are growing at a very healthy pace, and our results clearly reflect that. Even the U.K. continues to show some positive momentum. In our earnings slides, which you'll find on our Investor Relations website, you'll see that we've broken down our revenue by U.S., U.K. and rest of world to show the impact of FX and the benefits from our hedging program. So please refer to those slides for the exact calculations.

Our revenue from the U.S. was up 26% year-over-year to \$4.4 billion. Our non-U.S. revenue accounted for 55% of our total revenue or \$5.3 billion, up 41% year-over-year, which includes a modest \$1 million of benefits from our hedging program, and this is compared to \$89 million benefit in Q3 of last year. The U.K. was up 25% to \$1 billion and year-over-year growth and fixed FX still is pretty healthy and would have been 20% -- or is 20%.

Let me now turn to expenses. Our traffic acquisition growth and costs were \$2.2 billion or 23.7% of total advertising revenue. And our other cost of revenue was \$1.1 billion, which exclude stock-based compensation of \$72 million.

Finally, operating expenses, also excluding SBC, totaled \$2.8 billion. And SBC, itself, totaled \$499 million in Q3. So our increase year-over-year in SBC is primarily due to the annual equity refresh, which we do at this time of year. And the increase in year-over-year for our OpEx was primarily due, as usual, in payroll, increased professional services and advertising and promotion spend. So as a result of all this, our non-GAAP operating profit was \$3.6 billion in Q3, which exclude SBC, and are resulting in non-GAAP operating margin of 37.3%.

Headcount was approximately up by 2,585 versus Q2, ending the quarter with 31,353 full-time employees. And as Larry already noted, there are 2 factors at work here. Q3 usually has significant headcount additions and this quarter is no exception due to a bumper crop of university hires. In fact, we had the second-highest number of university hires in Google's history this quarter. Additionally, acquisitions this quarter added a large number of people as well. Our effective tax rate was 19% in Q3, flat with Q2, and the lower tax rate is driven by a mix of earnings between domestic and international subsidiaries.

Now let me turn to cash management. Other income and expense was \$302 million for Q3. OI&E was driven by a strong portfolio management performance and, additionally, we saw lower-than-expected FX cash flow hedging expenses due to the strengthening of the U.S. dollar in September. For more details on OI&E, again, please refer to the slide that accompanies this call on our IR website.

Operating cash flow was very strong at \$4 billion. Our CapEx for the quarter, down from last quarter, to \$680 million, and the majority of the CapEx once again in Q3 was related to facilities and production equipment. And as a reminder, we continue to make these significant investments in CapEx, and these have shown to be lumpy from quarter-to-quarter depending on where we're able to make these investments. We're very pleased with our free cash flow and consequence of all this, which was \$3.3 billion.

So before handing it over to Nikesh, I know that many of you have had questions about general economic outlook and have been kind of asking us those questions. Look, what we're seeing is not terribly surprising or different from what you're all seeing, watching on TV, reading in the press. And while, obviously, we don't control the economy or the exchange rates that fluctuate so much, we do very much control our own operating agenda.

And that's why we will, as always, stay focused on what we control, our agenda for the long term, with the strategy and investments that are not calibrated for quarter-to-quarter views but really designed to create, as Larry said, fantastic products that transform our users lives and create significant value for our shareholders.

With that, let me now hand it off to Nikesh, who will cover more details on our sales performance in this quarter. Nikesh?

### **Nikesh Arora**

Thank you, Patrick. I'll give you an update on our business activities. To reiterate what Patrick said, we saw strong performance across our portfolio, supported by the strength of our products. Our sales, customer support, marketing and partnership activities drove \$9.7 billion in revenue this quarter.

First, let me talk about the results for our advertising products, then our performance by region, and, finally, some highlights from our amazing marketing team. On Search, our core desktop Search business maintained its momentum. Google.com growth was faster than one year ago. Our syndicated Search revenue also accelerated this quarter with new large global deals contributing to our growth.

We're monetizing clicks better by working closely with our clients to grow the value of search advertising. What's interesting is, we're increasingly able to link search marketing efforts to both online and off-line sales with various other media. This quarter, we worked with our clients, such as leading apparel retailer, H&M, to promote sales through classic search campaigns. Additionally, clients like J&J and Sharpie, use search advertising support large online branding campaigns on other media, like YouTube and our Google Display Network.

Moving on to Display. Growth this quarter was robust, with products like YouTube and Google Display Network, we're giving advertisers more options to engage with their customers online. What's interesting is, we've seen a marked increase in our average spending from 2009. 2009, our top 20 display deals averaged approximately \$2 million each. Now, our top deals are over 7x larger, averaging approximately \$15 million each.

Some of our biggest display campaigns this quarter came from DreamWorks and Disney. We've launched Space Lab, a partnership between YouTube and Lenovo. It is a video competition for 14- to 18-year-olds, in which winners will have the opportunity to send a science experiment to the International Space Station. So we keep doing interesting things to try and keep driving

more usage and more revenues for YouTube and our Google Display Network.

We have equally strong traction with our ad agency partners, with whom we're very excited about the partnerships we've developed. Just over the past 6 months, we've signed display deals of agencies which total almost \$600 million to help deliver online advertising options to our shared customers, which all form part of our Display initiative.

Let's turn to mobile advertising. Larry mentioned \$2.5 billion as a run rate. Our revenue growth continues to accelerate even in Mobile, driven primarily by mobile search. This growth, obviously, is driven both by the underlying expansion of Android devices and of tablets, as well as stellar performance of our sales teams who are working closely with our customers to help them craft compelling mobile advertising solutions. Many advertisers have greatly increased the size and frequency of their mobile campaigns. Mobile is becoming a must-have. This includes clients like InterContinental Hotels Group, which spans pretty much across our entire portfolio of properties, including Mobile search, Mobile GDN and AdMob.

Moving our sights to Enterprise. We see continued revenue acceleration in our Enterprise business. More companies are fundamentally going Google. Our Apps products continue strong growth with recent app wins, such as people like Goodyear and SOFTBANK of Japan. We're particularly excited, obviously, also, that we just deployed apps to 450,000 teachers in Morocco.

Finally, Chromebooks have been available for purchase since mid-June, and we're beginning to see lots of interest and good uptake, both from the businesses and educational institutions.

Let's switch gears and look at our country performance. If you look across countries, we continue to see strong business growth despite uncertainty in the global economy. In particular, North America was broadly stable this quarter. U.S. revenues have stayed on their gross trajectory, and Canada has actually accelerated. In much of Western Europe, we have seen some softness in ad sales. However, in markets like Spain, we are seeing that the sales execution efforts are continuing to keep our revenue stable and, in some cases, accelerate the revenue growth.

Of course, across Asia and our key emerging markets, we grew much faster. Japan's post-earthquake recovery has continued and it's been driven primarily by large advertisers. We also see revenue growth in Australia, India, Brazil. They all are strong and they're continuing their strong growth trajectory.

Finally, let me spend a few minutes on marketing and partnerships. Our marketing and partnership programs continue to help scale and grow usage of our products. Start, we're very proud of our Get Your Business Online program. This is a campaign which, basically, we work with our partners, we help small businesses and bring their companies online. This is great for the business, this is great for the economy, and this is great for future ad spending.

So during Q3, we helped 7,000 U.S. businesses get online in places like Texas, Vermont, Kansas and Missouri. We also drove multiple customer launches this year. Our teams have helped expand the footprint for Google Offers, our deals business to about 11 cities in the U.S. after our pilot last quarter in Portland.

Additionally, we continue to grow Chrome user base, which I talked about, the penetration continues to grow with our campaign called a Better Web campaign. We've laid the foundation for Chromebooks, which I talked about. If you haven't had a chance, if you fly Virgin America, you might have the opportunity to surf on a Chromebook in-flight.

Finally, we've been supporting the growth of Google+, which we're very excited about, building a richer user experience by connecting users to public figures, celebrities, including Will.i.am from right onstage, Britney Spears, Richard Branson, just to name a few.

In closing, we had a phenomenal Q3 and we hope to continue the good work for our customers, partners and users in Q4. I will now turn over to my partner and colleague, Susan, who will discuss the product performance of this quarter.

### **Susan D. Wojcicki**

Thanks, Nikesh. Let start by talking about Search. We had another great quarter for Search quality with over 100 launches. We improved our preview feature so that when you hover your mouse over a search result, a large thumbnail of the site appears on the right. We also expanded the site links feature to include more links, with full snippets for each link.

A good example of this is when you search on Metropolitan Museum of Art. You can see links to exhibits, the store, and general information. What I love about features like these is they magically make Google easier to use.

The same goes for our new speedy Flight Search option. When you enter a query like SFO to JFK, and then click on the Flight link on the left-hand side panel, you can see all the different flight options. You can sort it in a variety of ways, airline, pricing, nonstop, times, and bring up a map that shows the



flight route and other potential destination and prices. Flight Search combines IT expertise with Google technology. We are still very early with the product. Think of this first version as the takeoff, not the final destination.

Turning to our Ads business. As Patrick mentioned before, our revenue growth was very strong. We are pleased with the Paid Click growth, which increased this quarter while keeping ad quality high. After a number of quarters of strong CPC growth, we continue to see year-on-year CPC growth. As we have said in the past, these average CPC metrics incorporate a number of factors, including mix effects such as Mobile and emerging markets, as well as true changes to keyword prices. It's also important to look at clicks and CPC metrics together, since more clicks can often lead to decreases in average CPC and vice versa.

We also made a number of improvements to our core advertising product. Starting with the local and the small business market, we launched AdWords Express in the U.S. and started product trials in the U.K., Germany, and France. There are a lot of businesses who want to advertise online, and they haven't done so because they're too busy running their business. AdWords Express makes it possible for these businesses to start running an ad campaign in just a few minutes. The advertiser gives us some basic information, and we do all the rest. The keywords and the bids are automated.

We're excited about this product because we believe it's the first time we successfully simplified all aspects of AdWords, while keeping its effectiveness for local and small businesses. And the results, so far, are quite positive with our advertisers.

With regard to the local market, we also expanded Google Offers to 11 cities. The latest launch was in Miami last week. On the other end of the spectrum are large businesses and agencies. We made a number of significant improvements to Google Analytics this quarter, since we know that when site owners have more insight into site traffic and better information about how to optimize their campaigns, they tend to increase their spend.

This quarter, we launched multichannel funnels in Google Analytics. This gives marketers aggregate information and insights into the full path to conversion, including clicks from paid and organic searches and display ads, not simply the last click. So advertisers can tell which marketing and ad programs are working.

We also added real-time reporting to Google Analytics so that marketers and publishers can see what is happening on their site right now. This is especially useful to measure the immediate impact of social media. So if you put up a new blog post, or you send out a Google+ update, you can instantly see what happens to your site traffic. We also launched a premium version of Analytics with more data, advanced tools, dedicated support, and service level guarantees.

Nikesh mentioned how well things are going with display advertising. From a product perspective, we'd like to highlight interest category marketing. We've completed rolling it out to all advertisers at the end of Q2. And since then, thousands of advertisers have signed up and the annual run rate has doubled. With interest categories, we look at the types of pages a user visits, and associates their browser with relevant interest categories, such as ecotourism, mobile phones, or hybrid cars. Then advertisers can show that user relevant ads across all types of sites. Users can opt out at any time, but the results of interest category ads is that they are more useful to users and more effective for advertisers, which, in turn, leads to higher returns for publishers.

We are making it a lot easier for advertisers to set up and manage video ad campaigns on YouTube, and the Google Display Network, as well. We began beta testing AdWords for Video, which integrates video buying campaigns directly into the AdWords interface.

The momentum around Google+ is starting to apply to our ad products as well. Users can now +1 Display ads on the Google Display Network, and we've had +1 buttons on search ads and results since the end of Q1. Although it's still pretty early, our data shows us that ads and results that are socially annotated are more relevant for users.

And finally, we shipped Google Wallet to Sprint Nexus S 4G phones and started working with Visa, American Express, and Discover as partners so their cards could be added to future versions of the apps. This morning, I bought my latte using my phone as a wallet. I'm looking forward to leaving my traditional wallet at home in the future.

That's it for now. Thanks, and back to Patrick.

### **Patrick Pichette**

Thank you, Susan. So we'll circle back with Jamie to open up the call and take your questions. Thank you, Susan, Nikesh, and Larry. So everybody, grab their handsets, and we're ready to go. Jamie, we'll look for you for instructions.

## **Question-and-Answer Session**

### **Operator**

[Operator Instructions] And we'll take our first question from Brian Pitz with UBS.

### **Brian J. Pitz - UBS Investment Bank, Research Division**

I've noted the proliferation of newer, richer ad formats, like product listing ads. Can you help us understand the impact on your financial model? Are they more or less profitable to you? And then secondly, on your comments on Western European ad sales softness, is the softness across all formats or are Mobile and display holding up generally better?

### **Larry Page**

I think I'll ask Nikesh to answer that.

### **Nikesh Arora**

Yes. I think we are constantly improving search as well as improving our ad formats. So if you look at our revenues, we will always be trying to drive new ad formats to our customers because we believe they are better, they provide better information, both to the user as well as they're great for the advertiser. Effectively, I'm not going to comment on the profitability of the ad formats except for the fact that they're great for users and advertisers; and good ads are delivered, and users click on them more, obviously, it will have an impact on the financial end. I'll let you figure that one out. In terms of my comment on Western European ad sales, it was more of a relative comment vis-a-vis prior quarters as opposed to an absolute comment about softness. Generally, we're seeing that the economic impact in some of those markets might flow through to some of these things, but it's just mildly soft. We're generally comfortable. Generally, queries are growing up. People are happier with Mobile, people are happier on Display. We're seeing Search query growth. So it's a bit of a mix across-the-board, but it should not -- it's just slight softness, not weakness.

### **Operator**

And we'll go next to Mark Mahaney with Citi.

### **Mark S. Mahaney - Citigroup Inc, Research Division**

On that paid click growth, that's a real sharp acceleration but the organic revenue growth didn't sharply accelerate. So could you just provide some color on that? Is that just this market shift towards Mobile searches? What's

driving that? And secondly, what's behind that other revenue that really spiked as well?

**Larry Page**

I'll let Susan take that. Susan?

**Susan D. Wojcicki**

Yes. So there were certainly a number of factors at play in terms of the CPC and the Paid Click growth. But the most important thing that I want to emphasize is that it's really important to look at these 2 factors together. Since they often move in reverse from one another. The other thing is there certainly was a mix factor where we do see changes in our mix, and that sometimes does have impacts on how our CPCs are -- how the aggregate ones are being affected.

**Nikesh Arora**

Just on other revenue, let me comment on other revenue. It really is the year-over-year impact of ITA. So, Mark, that's really the key issue there.

**Operator**

And we'll go next to Spencer Wang with Crédit Suisse.

**Spencer Wang - Crédit Suisse AG, Research Division**

Just 2 quick ones, if I could. First, Larry, on the \$2.5 billion Mobile run rate revenue, could you give us a rough sense of how much of that is Mobile search versus Display, perhaps? And then the second question relates to the people strategy. Given, Larry, what you said about being at the edge of what's manageable, should we expect headcount growth to moderate in 4Q and into 2012? And are you contemplating any sort of adjustments to base salaries as you saw earlier this year?

**Larry Page**

Yes. And I think that we're not going to break out more than we've already given you there. So we thought it was important to show the tremendous success of our business, and so we want to give you a nice milestone for that, but we're not going to break out more data. And also, on headcount, like I said, I think I had already said we're at the edge of what's manageable in terms of our headcount growth and you see our numbers are, as I said, were consistent with last quarter. I think we are always running our business very carefully and prudently, and making sure we're investing in the right

places. And we make those kind of decisions every day. And we don't give guidance on what we're going to do in the future.

## **Operator**

And we'll go next to Ben Schachter with Macquarie.

## **Benjamin A. Schachter - Macquarie Research**

A couple of questions. First, could you discuss the strategy around video content? It seems to me there's sort of UGC premium and then all the stuff in between. Is that how you're thinking about it? And if it is, how are you thinking about emphasizing each area? And then just quickly on emerging markets, you mentioned India and Brazil. Any chance you can quantify some of that, how fast are these markets growing? How big are they overall? Are these top 10 markets, how big are they in the overall scheme of the different countries?

## **Larry Page**

Ben, I think we think about -- certainly, YouTube is just tremendously successful. It's going gangbusters in every way. And we see that site is redefining the way we think about video. And I'd also note that it's very small percentage of people's overall video usage still. So we see opportunities for tremendous growth there. I think the other interesting thing about YouTube is it really blurs the lines between the kinds of content you're talking about. You can move from one type of content to another very easily. And we're finding our users don't really think about it that way. They think about having a great user experience. And we see it as serving our users well, and serving all the content creators well, regardless of their size. And that seems to be working great for us. And for the second part, Nikesh will take that.

## **Nikesh Arora**

Yes. We're not going to break out the numbers for India and Brazil. But what I can give you directionally is both of them are very, very important markets for us. Our products are successful. You see search traffic continuing to rise. YouTube is very popular. Chrome is very popular. So really, we're very happy with the usage of our products, and we believe there's tremendous sort of runway in product usage in those markets because of the changing characteristics of those markets, both from an online penetration perspective and the economic growth perspective of those markets. So with that sort of tailwind behind us, we have great teams on the ground, which are driving businesses to come online. And we're seeing tremendous growth in the ad side, pretty much across-the-board and Display, Search and Mobile. So

we're very, very happy with the success of those markets, with the progress of those markets. I'll just give you that as a directional statement.

## **Operator**

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

## **Heather Bellini - Goldman Sachs Group Inc., Research Division**

But I wanted to ask if you could give us a sense for how much growth in Mobile impacted Paid Click growth this quarter and how sustainable you think that level is? And also, if you could just tell us a little bit on the progress you're seeing in narrowing the gap between CPCs between Mobile and traditional search.

## **Susan D. Wojcicki**

Yes, this is Susan here. So first of all, we don't really break out how Mobile impacted any specific part of Paid growth or CPC. I will say that our ad system is designed to be very flexible. There are always lots of different factors at play that we see changing in terms of users, queries, advertisers, bids. And so, really, we are designing our ad system to be as flexible based on what we're seeing at that specific moment. In terms of narrowing the gap between -- in CPCs of Mobile and traditional search, we see a lot of opportunity for us to continue to grow Mobile. And for example, advertisers having landing pages that are mobile-enabled, we can continue to improve a lot of our algorithms. So we see opportunity for us to continue to improve that over time.

## **Larry Page**

Yes. And I would mention too, Heather, that the mobile phones are just getting amazing. You'll see our work there, and other people's works in coming out, that I think that your experience on phone could actually get to be better than your experience on a computer. I mean, the phone knows where you are, and can help you even when you're mobile and so on. So I definitely -- we definitely see that the experience on mobile improving greatly, especially with Android.

## **Susan D. Wojcicki**

We've introduced a number of formats, just kind of building on Larry's point. So we have advertisers, we can give location. We can actually say, if you search on one specific store, that store is 0.1 miles from where you're located right now, with a map. Or include a phone number, when you click on the phone number, then that's like a CPC. So we're seeing that there are

a lot of formats that we can really optimize for mobile, which will make for a great user and advertiser experience.

## **Operator**

And we'll go next to Justin Post with Bank of America Merrill Lynch.

## **Justin Post - BofA Merrill Lynch, Research Division**

Larry, I know you have to be careful because of litigation, but maybe you could help us understand what steps Google can take to help defend the Android ecosystem on a big picture basis? There's a lot of questions about some licensing threats out there. And then, secondly, maybe this is for Patrick. Can you tell us what verticals performed well in the quarter? I know you've been able to do that in the past. But which verticals really did well in the quarter and maybe others that might have been a little slower?

## **Larry Page**

I think we are very, like I mentioned, we are very excited about Android. And we see our partners and that whole ecosystem continuing to grow hugely. And while there's been lots of people trying to attack that and so on, we see absolutely no signs that, that's effective. And ultimately, we think that other companies' actions there will alienate their customers and their relationships with the other companies. So if anything, we see our strategy is getting stronger there. Obviously, we announced our intention around Motorola, and we're serious about protecting the Android ecosystem, making sure that, that continues to be incredibly successful. But we feel good about our efforts there.

## **Patrick Pichette**

And on my side, Justin, look, we were -- again, quite a reflection of the economy around us. So the U.S., some of the verticals that have been stronger, right, travel, auto, you go to rest of world, interestingly retail, which is not as strong in the U.S. than it would have been in rest of the world because there's more activity in real estate and in retail in rest of world. In the case of the U.K., automobiles have been kind of particularly strong. And so these are the kind of verticals, again, they are a snapshot and reflection of the economy around us. And maybe Nikesh has kind of more color commentary on it.

## **Nikesh Arora**

No. I agree with everything Patrick said. I think the only, sort of nonsecular event that's happening, is that we are continuing to see strength in the CPU

verticals. Because we are doing well on Display and CPG have traditionally verticals that advertise more in display. So there was a bit of a opportunity there, whereas search wasn't their prime focus, but those guys are doing really well with the Display offerings we have for them. But I agree with Patrick with everything else.

### **Operator**

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

### **Douglas Anmuth - JP Morgan Chase & Co, Research Division**

Two things. First, one business you didn't really talk about was Google Offers. I was hoping you could add some more color there in terms of your strategy and what you think you can do differently in this space. And then, secondly, I know this is probably tougher but just related to MMI. We've obviously seen examples in the past around CPTN and Intel and McAfee, around writing in concessions in certain ways. Is that something that Google would potentially be willing to do, in terms of licensing patents, to open source software and then, also, delivering product updates and roadmaps at the same time as for MMI?

### **Larry Page**

I think Nikesh will take the first question there.

### **Nikesh Arora**

I guess it's early days for Google Offers. As I mentioned, we have expanded from one Portland trial to over 11 cities in the U.S. And we are leveraging some of the sales efforts we already have with our Ads business. We are leveraging our relationships with small, medium sized businesses. Google Offers, for us, is just one part of the overall opportunity to work with SMB. So it's early days. We're very happy with the progress we've made so far. You might have seen us launch Google Wallet, which is also a part of an enablement strategy for that. So, so far so good, very pleased with the progress so far.

### **Larry Page**

Yes. As you know, Motorola deal is under review, and I think it would be premature for us to comment about anything we might do with regards to that.

### **Operator**

And our next question comes from Scott Devitt with Morgan Stanley.



**Scott W. Devitt - Morgan Stanley, Research Division**

Just had 2 questions. In certain areas like shopping, payments, travel, reviews and mortgages, the company seems to continue to get deeper into the purchase funnel or closer to the actual transaction. And Susan, you noted the ITA example on the call. I was wondering if you could talk a little more broadly about this more vertical approach, the benefits of it, and the categories that you're particularly focused on. And then secondly, noncash stock-based comp, I think was up 31% sequential and 50% year-over-year. Patrick, you noted the annual grant. I was just wondering if this is the new run rate or if there is something one-time or, potentially, there's been a change in the cash versus noncash comp.

**Patrick Pichette**

Why don't I answer the last question first and then flip it over to Susan. I mean, you're seeing the full year impact of our salary raises last year flowing through in all aspects of our compensation. So when we did the equity refresh this quarter, obviously, it's augmented by the fact that people have 10% more salary and all of the corollary issues around it. So it is a onetime item but you're changing the plateau, if you wish, and then it will flow through into the next year and then it will stabilize itself. That's the best way to think about it. And then on the issue of the verticalization, I'll have Larry take a crack at it, please.

**Larry Page**

Yes. Thanks, Patrick. I think that we really think about Google as providing the exact right answers when you need them. And those things are not necessarily particular websites or whatever. They're actually -- maybe actually trying to get a very specific piece of information, like you do with an airline ticket, for example, as we were talking about. So I think we see this as a general instance of a problem, of just making search work better across anything you might want to be able to do. And we're pursuing that in a lot of different areas, and have our whole history, basically. So I think you'll see us do a better job of providing a great user experience on more and more specific things over time. And that's what we do, when we make a better search engine.

**Operator**

And we'll go next to Ross Sandler with RBC Capital Markets.

**Ross Sandler - RBC Capital Markets, LLC, Research Division**

I've got 2 questions. First, a quick follow-up on Android. So we've seen some of the Android partners now agreeing to pay Microsoft licensing fees. So in order to protect the ecosystem, is Google planning on subsidizing a portion of these fees? Or is there -- how does that strategy play out? And then second question on Google Wallet. Is the long-term plan here to partner with other financial transmitters, like PayPal and maybe their credit card networks for some of the heavy lifting in the payment space? Or does Google plan on kind of vertically integrating with the banking system to offer customer service and risk management around transactions for the Google Wallet customers?

**Larry Page**

I think that maybe I'll answer it in just kind of a general way. Rather than seeing, for example, Microsoft compete in the marketplace with their own smartphones, they've really continued resorting to legal measures to hassle their own customers, right? So it seems kind of odd. And we haven't seen the details of those total agreements, and I suspect that our partners are making good deals for themselves there. And so while there's a lot of press around that, we're really looking forward to our announcements with Samsung next week, which I think will be very exciting. And like I said, we see Android going gangbusters, and we don't see anything that's going to stop that. On your second question about Google Wallet and so on, I think we're very early. We just released a phone with Sprint, the Nexus S with Sprint, that's sold out and has had tremendous demand. And we think that the customers who have gotten that experience are amazingly excited about it. And like Susan mentioned, she can buy her coffee that way. And that's an amazing experience, and we're just at the very early stages of that.

**Operator**

And we'll go next to Jeetil Patel with DB.

**Jeetil J. Patel - Deutsche Bank AG, Research Division**

A couple of questions. Can you talk about in the Mobile business as a whole, how do you structure some of the revenue sharing agreements that you have on the advertising side relative to in-browser searches? And I guess, who is it, typically, that you're typically paying for that distribution, the wireless carriers, the handset vendors, and how do you see that evolve going forward? And then I have a quick follow-up around kind of vertical integration. You've seen companies launch new devices, hardware-wise, to layer on top of some of the content and applications they sit on. You've obviously looked at Motorola now, and you're stacking from hardware OS into the applications environment. Do you think that, as you look at mobility,

the world -- there's a unique opportunity to develop a much richer, deeper relationship? And I guess maybe a little bit more elaboration on the vertical integration there that you're looking at.

### **Larry Page**

Yes, I mean, I think it's an exciting time. There's a lot of innovation going on in different business models and so on. I think we're very excited about our Android ecosystem and the growth of that. And I think we have very, very successful strategy there, as you see from the numbers that we talked about, over 190 million devices, and growing quickly. So I think there's many -- you're asking about different kinds of structures but we're very, very excited about the structure we have now, and about continuing that growth and continuing to evolve that platform ecosystem. And maybe Nikesh can take the second part there.

### **Nikesh Arora**

I think Larry's right. There are many interesting models out there. As you know, Android is an open ecosystem, and our Mobile strategy is a very partner-focused strategy. So in many cases, we work with various partners to deliver the experience to the end user. And there are different partners, there are different value they bring to the equation, whether it's distribution, whether it's making Google Search part of their services, whether it's allowing us to be an ad-serving platform there. So each of the relationships are slightly different, and they have different negotiated deals with them. But generally speaking, I think we believe there's a fair value transfer to whoever in the ecosystem brings value to the table. And we get our fair share for providing services in that ecosystem.

### **Larry Page**

We've been very successful with these models on the web, and we have a lot of experience with it, and I think we're good at doing those kind of deals.

### **Jeetil J. Patel - Deutsche Bank AG, Research Division**

It seems like owning content, at least in the Mobile space, seems to be a differentiator. Is that something that you'd possibly look at longer term? Is that owning more the content structure out there?

### **Larry Page**

I think, again, we're not going to comment on what we might or might not do. I think that we've had very, very successful models for a long time without owning content. And I think many of the models of you see don't

involve people owning content but actually selling it or distributing in various ways. And I expect that will continue.

### **Operator**

And we'll go next to Jason Maynard with Wells Fargo.

### **Jason Maynard - Wells Fargo Securities, LLC, Research Division**

One of the threads that drew a lot of these questions in the Mobile market is, how do you increase monetization, and kind of where we're at. And I think one of the things I'd love to get your view on is where we are in the process of bringing together some of the disparate local services? How does Offers intertwine? And when does that sort of take on a little bit more of a unified feel versus sort of a set of one-off products that a user would use?

### **Larry Page**

Jason, I think that's a great question. I think that -- I think first thing to keep in mind is that we're still very early in the Mobile business, and you see it's incredibly exciting business. There's a lot of activity. The user experiences are getting tremendously better, just growing like crazy. And there's a lot of economic activity and so on. So we've done well by having a long-term view about it. And I think that we also sort of want to balance having total integration with really fast iteration and fast progress and experimentation. And I think you definitely, I mentioned our unified look and feel that we've rolled out on Google which I'm very excited about, and we'll continue to do things like that, that really unify experience and make it more intuitive for people. But we're also going to do some experimentation, also, on new things, and then have a little bit less integrated. So it's always a mix of that. I think that offers, specifically, we think about our local business as being how do we help merchants and users, users like yourselves, get really good information and help the merchants get the right users at the right time and for the right amount of money, and so on. And that's a very hard problem across a whole bunch of different areas, basic information about merchants' interaction with between the merchants and the end users. And we have things going on in all of those spaces. And it's going to be a mix of, again, rapid iteration and also the integration of those things into, then, a more cohesive whole. And I'm very excited about that space.

### **Operator**

And we'll take our next question from Anthony DiClemente with Barclays Capital.

### **Anthony J. DiClemente - Barclays Capital, Research Division**

I have 2. The first question is for Patrick or Susan. You cite your Mobile business as a run rate, which was very helpful. I was wondering if you could do the same for your Display business, particularly interested in YouTube, and so if you could comment on pricing and volume trends at YouTube in the quarter, at least directionally, that will be helpful. And then I have a follow-up.

**Patrick Pichette**

So we, as you know, we don't provide any guidance. We had this extraordinary moment this quarter in Mobile where we had a confluence of so many things going on. And that we thought it was on a onetime basis, again, appropriate to kind of provide number of users, the Android ecosystem that's going gangbusters. And therefore, it was, we thought, appropriate to kind of round it up with kind of a snapshot of where we stand. So for that reason, right, and because of the competitive nature of the environment in which we are, we don't divulge typically these numbers, and you shouldn't expect us to actually give you more information in the future on them, whether it be Display, or Mobile, or others. In the case of YouTube, it's the same thing. I mean, as Larry said, we're incredibly pleased about the growth of YouTube, whether it be the number of videos viewed a day, the revenue growth rates, the performance overall of the content, and the ad system within it. So I mean, all I could say is this is a really, really kind of well-growing property for us in which we are really excited.

**Anthony J. DiClemente - Barclays Capital, Research Division**

Okay. And then just for Larry, I'm just wondering if you could comment on your broader media strategy. Unlike traditional cable providers, the Google platform isn't limited by geography. It's not limited by the contiguous networks or territories. So I just wonder -- there's been some conversation in the marketplace about a multichannel video offering in the U.S. to supplement your media product. And so I was just wondering if you could talk a little bit about that, even just philosophically, that would be helpful.

**Larry Page**

It's hard to talk about what we might do in the future, again. But I think, in general, I just think there's a lot of opportunity in providing better services for end users around media. And you see that, I mean, there's tremendous growth in all these businesses that are doing that. And I think we're, obviously, in a good position to help users find the content and the media and so on that they're looking for. And we're in a great position to also help those companies, and publishers, and authors, and content creators to find the right users, and get paid both through advertising and directly. And so I

think that's just a logical place for us to be in, and a logical place where you'll see a lot of activity in general.

**Operator**

And we'll go next to Jim Friedland with Cowen and Company.

**James H. Friedland - Cowen and Company, LLC, Research Division**

Two questions. First, you'd talk about shutting 20 products and you've got some further products in Q1, I believe. Is there any way you can give us sort of a percentage in terms of how much resource that opens up? Is that sort of a 10% increase, or any kind of color you can give us there. And then second, at what level of Google+ users do you need to see a material improvement in ROI and Search, and really move the needle for the business there, just maybe in terms of active users?

**Larry Page**

Yes, I think those are great questions, Jim. I think that I'm not prepared to give you specific numbers about projects we shut down or whatever, but I will tell you, it's been a pretty significant effort, we've had to really streamline our business and we've made, like I said, tough decisions about where we should be focusing so that we really can generate amazing products and businesses. And those are not easy decisions. So I think there's significant resources involved in the kinds of things we're talking about. And it's also -- it's a fair amount of work, also, for us to just go through those -- that process. But I'm excited about that increased focus for us. I think, as I mentioned on Google+, I think we're seeing tremendous growth, which I'm very excited about. We're still very, very early. It's been out just slightly more than one quarter now, and not even fully open until -- only for a very small part of that. So I think we're very early in that. But on the other hand, I encourage you to all try Google+, and sign up, and flock to it. And you'll find that you will see data on search about what other people are doing. You'll see someone had +1'd something or so on. And I think those things can be very meaningful to you as a user. So I have no doubt that there'll be significant impacts from that.

**Operator**

That final question will come from Colin Sebastian with RW Baird.

**Colin A. Sebastian - Robert W. Baird & Co. Incorporated, Research Division**

Just 2 brief ones. First on Chrome and your efforts there to expand penetration. Can you talk about the specific drivers of growing distribution, adoption, maybe how we might expect this to impact margins over time? And then, secondly, the growth in the Google Site revenues. I wonder if you can add just a little bit of color there on the specific uptick, if that's an acceleration from a Display on YouTube as well as Mobile, or is that core search-related?

**Patrick Pichette**

I'll take the latter, and then maybe Nikesh will cover the Chrome. On the latter, the answer is yes. Yes, yes, and yes. So yes, YouTube; yes, mobile; yes, format. And I mean, that's why you see such an acceleration of our revenue, and that's why we're so excited about it. And maybe Nikesh, if you have comments on the Chrome and our penetration and how it's working.

**Nikesh Arora**

I'd love to answer the question like that, like yes, yes, yes. But unfortunately, that's not how the question is phrased. As far as Chrome is concerned, as we have talked about in previous quarters, Chrome is very strategic for us because we believe it is a phenomenal user experience and a user benefit. It just improves the user browsing experience so phenomenally. And we believe that it's important that Chrome be distributed, shared, with almost every user around the world. And a lot of our marketing efforts, and distribution efforts, have been focused around getting Chrome in the hands of our users. We are doing distribution with partners. Our partners encourage people to download Chrome. We are doing distribution where we do direct advertising to consumers to get them to download Chrome with a clear user benefit of better browsing, better video watching, and better security. So we are doing a lot of that. I think, I'm not going to comment on the margin part, but you have to understand, a great consumer experience from Google as part of Chrome makes Google -- makes users use more Google services. So from that perspective, we're very happy with the distribution strategy we have on Chrome. And we don't see any abatement of that strategy.

**Larry Page**

And I want to thank everyone for all the time that you spent with us. We had a great quarter, very excited about our progress so far. And I also want to thank all of our employees who've worked so hard to make these results that you all see. So thank you, all, very much.