Operator

Good day, everyone, and welcome to the Google Inc. Q1 2014 Earnings Call. Today's call is being recorded.

At this time, I'd like to turn the conference over to Jane Penner, Director of IR. Please go ahead ma'am.

Jane Penner

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

Also as you know, we distribute our earnings release through our Investor Relations 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.

You can also visit our Google+ Investor Relations' page for latest company news and updates. Please check it out.

This call is being westbound cast from investor.google.com. A replay of the call will be available on our website later today.

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

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

Please note certain financial measures we use on this call such as operating income and operating margin are expressed on a non-GAAP basis and have been adjusted to exclude charges related to stock-based compensation and restructuring.

We've also adjusted our net cash provided by operating activities to remove capital expenditures which we refer to as free cash flow. Our GAAP results and reconciliations of non-GAAP to GAAP measures can be found in our earnings press release.

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

Patrick Pichette

Good afternoon and thank you for joining us on our first quarter 2014 earnings call.

Before we jump into my usual remarks, I'd like to bring two points to everybody's attention. First, a reminder that on April 2nd, we issued our Class C stock dividend with twice as many shares outstanding, our usual per share information will look quite different starting this quarter.

Also, second, and also as a reminder, our expected sale of the Motorola business -- mobile business to Lenovo triggered discontinued operations accounting treatment which means Motorola's quarterly results are shown separately from Google net income. You'll see this new presentation in our financials starting this quarter.

So with these two caveats noted let's dive into the details of Google's financial performance in Q1. Our gross total consolidated revenue grew a healthy 19% year-over-year to $15.4 billion and it was down 2% quarter-over-quarter.

Without currency fluctuations, our gross total consolidated revenue growth would in fact have been 21% year-over-year. Google sites revenue was up 21% year-over-year to $10.5 billion and was down 1% quarter-over-quarter driven by the strength in our core search advertising business.

Network revenue was up 4% year-over-year at $3.4 billion and was down 4% quarter-over--quarter driven by improved year-over-year growth from our Ad Exchange and AdMob businesses.

Finally, Google's other revenue grew 48% year-over-year to $1.6 billion and was down 6% quarter-over-quarter. Digital sales of apps and content in our Play Store drove year-over-year growth. Chromecast sales were also strong.

Our global aggregate paid click growth was strong this quarter again up 26% year-over-year and down just 1% quarter-over-quarter. Our aggregate cost per click was down 9% year-over-year and flat quarter-over-quarter.

Currency fluctuations had a minimal impact on Q1 CPC growth. Our monetization metrics continued to be impacted by a number of factors discussed on previous calls, including geographic mix, device mix, property mix as well as products and policy changes.

And to help investors better understand the complex dynamics of these monetization metrics, we'll begin disclosing paid clicks and CPC growth by property in Q2.

To be clear this means we'll disclose CPC and paid click growth rates for both our sites and network businesses. We will continue to disclose aggregate growth rates for CPC and paid clicks.

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

U.S. revenue was up 14% year-over-year to $6.7 billion, the U.K. was up 14% year-over-year to $1.6 billion and in fixed FX terms, it grew 11% year-over-year.

Our non-U.S. revenue excluding the U.K. was up 25% year-over-year to $7.2 billion. This accounted for 47% of our total revenue, which includes a $8 million benefit from our hedging program. And in fixed FX terms, the rest of world grew, in fact, 30% year-over-year.

Let me now turn to expenses. Traffic acquisition costs were $3.2 billion or 23% of total advertising revenue. Our non-GAAP other cost of revenue was $2.6 billion in Q1, excluding our stock-based compensation.

Non-GAAP operating expenses totaled $4.6 billion, again excluding stock-based compensation and as a result, our non-GAAP operating profit was $5 billion and our non-GAAP operating margins were 32% in Q1.

Just a quick word on a few items that may have created noise in our operating expenses this quarter. We had some discrete legal expenses that hit our G&A line as well as one-time M&A related costs that increased our operating expenses, particularly in R&D. So, absent these discrete items, our expenses continue to demonstrate the same disciplined agenda we've always had.

Headcount was up, roughly 2,100 people in Q1. In total, we ended the quarter with approximately 50,000 full-time employees and please note that the headcount still includes approximately 3,700 full-time employees from the Motorola business as well as the employees from the acquisition completed in this quarter.

Our effective tax rate was 18% in Q1 and our tax rate this quarter was impacted obviously by the federal R&D credits, which expired in 2013.

Let me now turn to cash management. Other income and expense was $357 million for the quarter and realized gains on investments and interest income, offset the continued impact of expenses from our FX hedging program. For more details on OI&E, please refer to the slides that accompany this call on our IR website.

We continue to be happy with our strong operating cash flow at $4.4 billion. CapEx for the quarter was 2.3 billion this quarter; again the majority of CapEx was related to data center construction, production equipment, and real estate purchases.

As I mentioned last quarter during my remarks, we continue to invest in the long-term and our infrastructure continues to be a key strategic area of investment for us. Our free cash flow was $2 billion for Q1.

And before I close, I want to give a brief update on Motorola. Motorola had a great quarter in Q1 with the Moto G showing strong sales momentum especially in emerging markets. The team continues to be hard at work and we look forward to seeing them join up with Lenovo soon.

So, there you have it, strong results and an optimism that provides us the confidence to fund strategic growth opportunities including Android, Chrome, YouTube, enterprise just to name a few.

And now I'll cover more details -- I'll let Nikesh, in fact, cover more details of our business performance in the quarter and after his remarks, we'll open up the phone lines for questions. Here you go Nikesh.

Nikesh Arora

Thank you, Patrick. You're welcome to cover more details if you'd like.

Our business is growing well, with $15.4 billion in gross revenue; we had a particularly good advertising performance in the United States, highlighted by very strong auto sector showing around the Super Bowl. We had strong Play growth in Asia and we had a few isolated tracks.

By now you're aware of the four areas driving our business. The first one direct sponsor, or as I like to call it performance marketing; the second one helping clients build their brands; third our ad tech platform for publishers and agencies; and fourth, our emerging businesses like digital content, enterprise, and hardware.

Let me give you an you an update on all of those and talk about industry trends that are driving the investments we're making. On performance advertising, people are now always online and they want seamless, easy experience as they move from screen-to-screen.

This constant connectivity is driving our investments here as people use search to navigate their world, Google is well-positioned to help people navigate between web, apps and the places around them. They help the marketers measure the entire customer journey and to drive better monetization.

Next week, we'll be welcoming hundreds of advertisers to our adverse performance forum where we'll talk more about our work in this area for marketers. But clients are already benefiting from our recent investments like enhanced campaign and estimated total conversion.

For instance, Shutterfly recently began measuring cross device conversion networks to understand sales that start in one device and end on another. As a result, they saw 60% increase in mobile conversions for non-brand terms, leaving them to include 100% of their keywords on mobile devices.

We're seeing great momentum in product listing adds as well, with a new shop in campaign system. International retailer Farfetch upgraded shopping campaigns and increased their conversion rate by 13% while reducing cost there per acquisition or CPA by 20%.

And Domino's Pizza -- who doesn't like pizza, recently made it easy for customers to pay with Google Wallet, instant buy in their in Android app.

Moving on to brand building. For years you've all seen the rise of digital video, over-the-top networks, connected screens, streaming devices and high quality digital programming. Already for example, YouTube reaches more than 1 billion people a month through usually popular channels like fashion guru, Bethany Mota; cooking maven, Rosanna Pansino; and cult hit Nerdist.

For marketers this is an irresistible trend, and we're now at a significant industry moment. Marketers and agencies that have historically built their brand on TV are reorienting their creative, planning, and investments with digital at the center.

This year nearly all Super Bowl advertisers turned to YouTube to extend the life and reaches of their TV spots and Super Bowl related ads on YouTube have been viewed over 300 million times. That's roughly three times the size of the audience that watch the ads on TV.

In Australia, we work with Nissan to create made for YouTube video for the launch of their new Patrol SUV. The campaign which is promoted by TrueView ads and YouTube mass set for over 340% increase of daily visits to their websites, and more than 2% of those were interactive for the campaign booked a test drive.

In a few weeks in New York at our annual Brandcast Upfront Event we'll focus on our new Google preferred offering. This features exclusive access to the best, most engaging content on YouTube with guaranteed audiences through third-party measurement providers, Neilson and Counselor. We're really excited about this and we're looking forward to the results of that Upfront Brandcast Event.

We're also helping brands through our newest display ad formats. We recently teamed with Tory Burch to bring her New York Fashion Week Show to a global audience across our display network. Then also the first ever live stream of fashion show in an ad using a light box ads, and we're able to share the exclusive event with more than 7 million of their biggest fans.

Third, moving to our ad technologies and platforms; our programmatic ad technologies are seeing -- are continue to see great momentum with premium publisher partners like The Local Media Consortium.

That's comprised more than 800 daily newspapers and 200 local broadcast stations as well as timing. Both of them signed on with us in February to create private exchanges. This maximizes a value of that ad space for handpicked premium environment.

One thing we know is that agencies and publishers want to trust the environment in which they're transacting. Our ad network and exchanges are widely regarded across the industry as having the best quality controls and we continue to invest here.

In February we acquired wellium fraud fighter Spider.io and thousands of our clients are already using our MRC-accredited Active View technology to buy high-quality viewable ad impressions.

Let me switch over to our emerging new businesses, digital content, hardware and enterprise. Google Play continues to be the thriving hub of our digital content business. This quarter we introduced Google Play movies to 39 new countries, so now people in more than 65 countries can enjoy movies through Play.

We also teamed up with Sonos to bring high-fidelity play music into the home and we introduce new development tools for Google Play games including game gifting and iOS multiplayer support.

Over 75 million new users joined Google Play games in last six months; all of this is helping turn developers around the world into full-fledged businesses. In fact, we paid out more than four times as much money to developers in 2013 compared to 2012.

And following the Open Automotive Alliance that we announced with partners in January designed to bring android as a car, in March we've announced Android Wear, a project that extends android to wearables.

We're also already working with several consumer electronics manufacturers, chip makers and fashion brands who can't wait to see what developers come up with for your wrist.

We also continue to see strong momentum from our suite of hardware products, our $35 Chromecast is a real hit. Last month we brought Chromecast to 11 more countries. We also recently opened up Chromecast developers, and in just a few weeks, more than 3,000 developers worldwide sign up to bring their apps and websites to the platform.

Turning over to enterprise. We continue to see strong product adoption around the globe. We launched Chromebox for meetings, which makes it easy for any company to have high-definition video meetings through the power of Google+ Hangouts and Google apps.

We're also investing significantly in the Google cloud platform and I've seen a very positive response to our most recent product announcements.

We expect to see continued momentum in this area and we believe we can bring significant value to the many companies that opting public cloud because of our experience in building and operating one of the world's largest cloud computing environments for over a decade.

We able to pass on the savings that come from lower digital storage cost to our customers through highly competitive pricing. In addition, every day more businesses, governments and schools start using Google apps to work better together including the state of Sao Paulo who moved to Google apps for more than 4 million students and 300,000 teachers and staff.

Before I close, I want to call out our marketing team who continues to highlight the magic of Google to beep around the world, into fourth annual Google Science Fair, the doodle for Google in United States, the hugely popular ad campaigns.

They also helped to build great retail experience for Chromecast in over 6,000 stores. I'd like to thank all Googlers around the world who help makes a terrific quarter.

I'll now hand over back to Patrick.

Patrick Pichette

Thank you, Nikesh. So we'll work with Jamie to go straight to the Q&A. Jamie?

Question-and-Answer Session

Operator

Thank you. (Operator Instructions) And we'll take our first question from Ben Schachter with Macquarie.

Ben Schachter - Macquarie

Patrick, I was wondering if you could help us quantify some of the expenses you saw, the one-time nature of G&A and anything else there that was really one-time. Just to help us understand what that run rate would look like if that wasn't in there?

And then maybe the cash, if you could talk about the theme of sort of advertising attribution and how that's going to help you potentially bring over more brand dollars, and how do you think about bringing over those television dollars.

I mean is that something that's going to come sort of a big rushing in 2014, or it's just going to be a slow evolution over many years. Thanks.

Patrick Pichette

Great. Thanks Ben. When I start, look on the discrete legal expense that impacted, it really impacted our G&A if -- and then the one-time M&A deal cost impacted all of our operating lines, but most prominently our R&D line, which you'll notice will have jumped a bit.

The one-time M&A deal costs are largely stemming from the Nest deal, which was a pretty large transaction for us this quarter, but I think that the best way to describe it is that our expenses in Q1, they are completely in line with our objectives if you'd kind of take apart these two items, so that's how I would describe it. Nikesh?

Nikesh Arora

In terms of brand benefit Ben, I think -- thank you Patrick, thank you Ben. The brand question is a very good question. What we've noticed in the past let's just say 1.5 year is that people have slowly started coming to the digital medium to create extensional the existing brand campaigns like I mentioned the Super Bowl ad. People come to YouTube and say I'd like to read certain audiences which are only available on digital medium hence we see those advertising dollars shifting as an enhancing existing television or media campaigns.

Now the real fun will began when people start doing campaigns exclusively on digital to go and help them build brands. That requires us to get ahead of the curve and get into the creative process much earlier because usually what we end up doing now is we get up -- we get to the end of the period of process and they just want to extend their brand.

So we're working really hard to work with creative ad agencies, the large agency groups as well as our advertisers say how can we get ahead of that creative process, how can we help you conceive of brand campaigns that actually start and end in digital where perhaps you use TV as an extension medium as oppose to the other way around.

Now I think this is definitely the Holy Grail. This is going to take us a level of time to get there, but with things like attribution in place with our deals with Nielsen and comScore we're beginning to create the compatibility saying look the same dollar you spend on television equates to so many dollars on digital or vice versa.

The fact that we can give them sort of cross media measurement capability, we can give them comfort that their dollars are being well spent, even spent in digital. We will go long way in making sure that we get them to transition from just using traditional media to including digital in their media mix and eventually designing campaigns that start and end up digital.

Patrick Pichette

Thank you, Nikesh. Jamie, let's go to our next question. Thank you, Ben for your question.

Operator

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

Douglas Anmuth - JPMorgan

Great. Thanks for taking my questions. Just two things I wanted to ask. First, Patrick, just on the U.S. you had commented on the strength here in terms of 14% year-over-year, but it does look like on a sequential basis we saw a little bit more of a DeSale have been in recent 1Qs. Can you just comment if there's any factors there to point out.

And then Nikesh, can you just talk about the key drivers of mobile pricing going forward. How you think the gap can close with desktop over the coming quarters and years. Thanks.

Patrick Pichette

All right. Thanks for -- Doug, for your questions. So in the case of the U.S. if you think about it you have the Q4 to Q1 issues that are typical. And then, as we've said before, the network business does skew toward the U.S. on a relative basis, so network clearly grew slower than site.

So that's what really what you see is that mix of the two, but in aggregate, right, pretty pleased with the U.S. growth overall. So that was a pretty strong quarter. I'm really happy with it. Well, let Nikesh answer the mobile questions.

Nikesh Arora

Yeah, Doug, I think thank you again for the question. I've had firm belief and I continue to hold on to it that I believe in the medium to long term. Mobile pricing has to be better than desktop pricing. And I think the reason -- the way to think about it is that in mobile you have location and you have context of individuals which you don't have on the desktop.

And the more you known about the user and their context, the more effective advertising you can provide to them. The better the conversion is likely to be for a search or any piece of advertising that you do. There's a whole bunch of building blocks that need to come into play for us like you said to get the gap to close.

The good news is a lot of people are spending a lot of time on mobile devices. There's a lot of mobile search queries that we get. People are more and more focused about what they look for in mobile devices. They are closer to intent. They are closer to transaction.

You see that there's a lot of friction-less ways of paying and converting transactions into commerce which is happening but things like instant buy etcetera. You're also seeing the lot of advertisers seemed through value of making sure that their present and a great experience on the mobile devices.

So part of our challenge has been that if you guys just huge massive advertise in the desktop which over the last decade have become better at advertising, Understanding, optimization, understanding conversion, understanding truncation.

That journey is just beginning for advertisers in the mobile site. They're just beginning to understand what it takes for the end user to come transact on their website.

So like right now we can leave the horse to the water, we can't make it drink. But with all the advertisers coming on-board and working with us, we are actually begging to show them real transactions and asset beings to gain traction. I think we begin to see that gap continue to converge.

Douglas Anmuth - JPMorgan

Thanks you.

Patrick Pichette

Thanks Doug for your question. Jamie let's go to the next question.

Operator

I'm going to go to next to Ross Sandler with Deutsche Bank.

Ross Sandler - Deutsche Bank

Great. Thanks guys. I had a question on the Google Play App Store revenues and Nikesh you just mentioned that you guys paid out 300% more revenue to developers in ’13 versus ’12.

So, I guess, how much is Play contributing to the overall licensing and other line, and there is clearly some lines or some items in that line that are not growing nearly as fast to get to the current 48% average. So can you talk about maybe what's underperforming in that area?

And then last question on this topic is, I think if you go back to the infamous Andy Rubin slides from the Oracle case, the revenue share was around 5% for Google Play App Store revenue share, where is that now and is it changing as the Android ecosystem gets larger?

Patrick Pichette

Thanks. So why don’t I take a shot at this. Ross, the – if you think of our other revenue estimates for this quarter, right – first of all its – we’re really delighted by the Play business. So – and you'll remember that a year ago we had – I mean, I'm going to bring back everybody to Q1 of 2013.

We had a lot of Nexus 4 hardware sales, because we were in stock out in Q4. And that in combination with the accounting change of our Play app content revenue recognition. Again, remember till Q1 of last year both just simply created a bit of tougher year-over-year comp for this quarter, but overall very pleased with all of the kind of big lines of growth in this space.

As for the rev share, I mean, obviously, this accounting change kind of goes to this 30% rather than the what you would have seen before which would have the net and – but we don't divulge with the percentages are, that we keep going forward.

So that's basically where we stand on it and that's why we are pretty pleased with this line for this quarter.

Nikesh Arora

And if I can add to Patrick, I think, the important part is, it's taken us a while to get all the capabilities in place around the world in different markets, making sure we have all the content we need, we have all the app providers we need as well as the we have the payment mechanism. So, we really are excited about the Google Play business going forward.

Ross Sandler - Deutsche Bank

Great. Thanks guys.

Patrick Pichette

Thanks. Thanks, Ross. Jamie lets go to our next question.

Operator

And we will go next to Mark May with Citi.

Mark May - Citigroup

Thanks. A question regarding the CPC segmentation for next quarter. Why you may not be in a position to provide these specific data points for Q1. I was hoping that maybe you could give us directionally how CPCs have trended between the owned and network businesses and kind of what are your expectation is going forward? Thanks.

Patrick Pichette

So, Mark, you will get the information in Q2. What we really wanted to do with the recognition as we think about giving more transparency to our shareholders, just looking at having exactly as you just mentioned the split between kind of our core sites and then the network itself.

I think it will be useful for everybody and then, obviously, we will have the information going forward.

So a lot of insights are going to come out of that and we are very pleased to be able to share with you starting next quarter. We've just made this decision over the last little while and shared it with the Audit Committee, the Board, so just stay tuned for next quarter on it.

Mark May - Citigroup

There are number of dynamics that play into the blended CPC that you've called out before property, policy, geo and device among others. Once you provide this new layer of transparency, does that really capture the major -- is it really the property and maybe to some degree policy differences that are influencing CPCs between owned and network or will geo and devices continue to play a major role in reported CPC, even once you provide this extra segmentation?

Patrick Pichette

Well, they all will and if we do – we may change just the policies that effect network, you will see them much more in transparent way. So in that sense it’s a very positive kind of news.

Whether devices kind of have effects on network versus others, you will – it will be much more difficult to see. But, clearly, the impacts that are driven specifically for network or for sites you will be able to see on a quarter-by-quarter basis. So I think that’s good news for our investors.

All right. Thank you so much for your question, Mark. Jamie, why don’t we go to our next question, please?

Operator

And we will go next to Mark Mahaney with RBC Capital Markets.

Mark Mahaney - RBC Capital Markets

Thanks. Two questions on the U.K. revenue growth at 11% number and on the partner websites at 4%, is there anything you would want to call out that has been unusual drags on those growth rates? I think U.K. is the lowest we've seen and maybe just lot of large numbers and really successful execution of that market. But anything you want to call out for either of those two revenue streams. Thanks.

Patrick Pichette

Well, as I said, well let me start with the U.K. The U.K., look, combination of partner mix this quarter, as well as, again, year-over-year matters a lot and we have happen to have a year ago a real revenue favorable weather.

I mean, people kind of tend to forget it, but last year we had a very strong Q1 for the U.K. and the combination of these two things just kind of year-over-year made the comparison a little tighter for this quarter.

As it relates to websites – partner websites, I covered that a bit earlier. And we're – I mean, again, you back to last year where network, if you think about Ad Exchange, that model change in that model continues to be very, very strong.

And we will remember again last year that we started the DLA policy change in Q1 or maybe it was in Q4, but the impact of the DLA actually takes time to flow through.

We said that would take multi quarters. So, this has not kind of float over completely. So what you have again there is very strong on the quarters where we want sort of the Ad Exchange and AdMob, but on the flipside of that, right, you still have the tails of the DLA change policy that's for a year ago. But the effects have not fully flowed through, so even in the coming quarters you should see a bit of an effect there, but, overall, pretty pleased with actually these results, Mark.

Mark Mahaney - RBC Capital Markets

Thanks Patrick.

Patrick Pichette

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

Operator

And we go next to Carlos Kirjner with Bernstein.

Carlos Kirjner - Sanford C. Bernstein & Co.

Thank you. I have two questions. First, in the last eight quarters headcount has grown significantly slower than revenue, but this quarter you hired, I think, 2,300 people in the core and headcount grew its revenues. Was this change in hiring rate mostly because of acquisitions and marginally what prevents you from hiring 2,300 people a quarter or even more as the business grows?

And secondly, Patrick, in the spirit of giving more transparency to shareholders, can you give us some color on what has driven such a sustained increase in CapEx over the last four quarters?

Because, I – I think clearly it's not just some lumpy behavior. Are you buying data center sites in advance of demand and if this is the case can we infer that CapEx will revert to historical levels. Thank you.

Patrick Pichette

Thank you, Carlos for both of these questions. So, to the headcount question, I think, you've basically nailed it intuitively, which is, the acquisition of Nest – the acquisitions this quarter had a quite a bit of people impact on this number. Or kind of if you think of our organic numbers, have actually not changed in any material way.

So it just happened, you know, you buy Nest and it comes with a lot of people. We also had, you remember, the acquisition of DeepMind and few others. So for us we had the double hitter of having the opportunity to continue to attract people on an organic basis to our processes and these few acquisitions kind of moved the needle quite a bit for us this quarter.

As it relates to CapEx, listen, you are right that we – and I've mentioned this in the last couple of quarters, where we have – and just a reminder to everybody, if you think of the CapEx categories, right, data centers first, and data construction then production equipment then all other facilities, it's kind of like the hierarchy of needs.

And in the case of data center construction, we have found that the option value of having more capacity on standby and available to us to grow versus not having it is actually a real strategy issue for the company and in that sense if for whatever reason we continue – we had a spike in demand that was really pronounced and sustained for a couple of quarters and we did not have the capacity, it would be a real issue strategically for us, relative to the quite low cost of having the infrastructure in place.

So that's why we're really pushing ahead of the curve and so it's with this view of long-term. So from that perspective you are also right that that's the mindset we are applying and we've always said that CapEx was lumpy, so you have a good manifestation of it right now, right here. So thank you for you those two questions, Carlos.

Carlos Kirjner - Sanford C. Bernstein & Co.

Thank you.

Patrick Pichette

Cheers. Jamie, let's go to our next question, please.

Operator

And we will go next to Stephen Ju with Credit Suisse.

Stephen Ju - Credit Suisse

Hey, thanks guys. So, Nikesh, so in order to attract greater brand advertising dollars, it seems like safety and context are also important factors, because you are certainly not falling short on reads.

So how close do you think you are to either engineering or coming up with some sort of solution to contextualize all the video content on YouTube, so you can guarantee you advertisers brand safety? Thanks

Nikesh Arora

That's a good question. I think as I alluded to, we are going to do an upfront in a few weeks in New York City called Google Preferred, which is sort of our way of trying to create a premium sort of concentration of content that we can have advertisers advertise against which gives them a higher level of brand safety, a better level of measurement and hopefully plays where they believe that they can actually build the brands and hopefully that will – that will manifest itself in our ability to have a premium compared to what we can attract to the market without providing those kinds of things. So that's a very good question. I think that's what we are hoping to achieve and stay tuned for our detailed announcement of Brandcast.

Stephen Ju - Credit Suisse

Thanks.

Patrick Pichette

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

Operator

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

Justin Post - Bank of America Merrill Lynch

Great. I have three quick things. Did Enhanced Campaigns which you rolled out over the summer, impact Q4 and do you see some more benefits coming this year?

Second, on PLAs, we think you had very good success in the U.S. in Q4, did that – does that, do you still have some benefits to come from that as you roll that out in Europe. How are you looking at the timing there versus how you rolled that out in the U.S.?

And finally in the first quarter, maybe you can call out some specific verticals that might have strong or weak for you. Thank you.

Nikesh Arora

That's a good question, Justin. Thank you. Not sure I can give you a lot of detail in terms of precise impacts of any individual products that we have. But, Enhanced Campaigns are working. It's a necessity that we have to do them both for process reasons as well as the reason that consumers are going from screen to screen as well as advertisers need to advertise across multiple screens.

So from that perspective Enhanced Campaigns is working, it's part of life here. We don't do anything without Enhanced Campaigns across the board. It's sort of gone from being Enhanced Campaigns to regular campaigns because we don't have any unenhanced campaigns anymore.

In terms of PLAs, it's something, as I alluded, is actually working. It's providing a lot of color in the shopping vertical. It's providing a lot of hold in shopping campaign effort that we have. PLA is working for us and its sort of working from multiple perspectives.

It is providing users the detailed information that they need when they are declaring intent and saying and I would like to search for particular product, please don't send to me to website.

So it is working. We are going to roll that out one, separate time around the world. I cannot comment on the timing exactly. But I think both of those things are having a positive impact in our minds to everything we are doing around here.

Patrick Pichette

Just to close on this, just a few verticals here. I mean, again, completely reflecting the economy around us. If you go to – automobile has been quite strong across the world. Travel, actually quite strong in the U.S., so in the U.K. as well as in the rest of the world, a little bit less in the U.S, but just to give you a sense of. And then real estate, clearly, in the U.S. has been a strong vertical as well as in the U.K, so, again, a good reflection of the economy there, Justin.

So, Google Trends, I always encourage people to go and checkout Google Trends as well because they continue to give good insights as to what's going on in the economy which would mirror in terms of verticals.

Justin Post - Bank of America Merrill Lynch

Thanks Patrick. Thanks Nikesh.

Patrick Pichette

Thanks Justin. Jamie, let's go to your next question, please.

Operator

We'll go next to Eric Sheridan with UBS.

Eric Sheridan - UBS

Thanks for taking the question guys. So two ones. One for Nikesh. Nikesh, I would love to get your view on sort of your view of the travel industry. Sort of how are you approaching that industry as a participant from an economy basis in that industry, both the marketing funnel and potentially the booking funnel? Longer term there's been a lot sort of written lately about the way in which you guys might approach that industry vertical.

And then second, Patrick for you. Maybe taking a stab at the one-time expenses from a different approach, when we look at the model, if you take your comments before about sort of smoothing out the expenses we saw in the back part of the year and even year-over-year, it appears that one-time expenses might have been about 50 basis point to 100 basis point impact on each of those two lines which would have sort of brought the blended number back up to sort of somewhere between 75 basis point to 150 basis points on margins. But just want to take a stab at that from a different direction just to quantify it. Thanks guys.

Nikesh Arora

Thanks Eric. That's for the question. I was actually talking about pulling up the article which recently -- were Darren Huston talked about the effectiveness of Google Advertising for price line. I think that's a public endorsement that all our efforts in the last many years in rather travel industry are actually working.

They see tremendous value in our ability to help them bring more travelers to their sites and for them to help convert them into a real transaction. So whatever we are doing is working.

I think I am expecting – suspecting that the comments we are talking about is our continued efforts in providing more and more detailed information when people do searches. And as we've talked in the past before that people's information needs are getting more precise and we have to keep evolving the results at Google, whether its knowledge cards or Google Now all the things that we do towards giving them more and more precise answers, in which case sometimes we are required to go work with various industries to get the underlying data to surface it when the users are looking as opposed to send them to other sites where they have to go through that search process again.

So I think you can expect us to continue do that. But our intent there is to provide a better answer for the users, whether it's on their desktop or mobile devices. Accordingly, we also working together with the advertisers to provide them various advertising opportunities which allow them to work effectively with the end-user and provide them the answers that they are looking for or perhaps in this case the ticket or the hotel booking that they are looking for.

Patrick Pichette

Great. And then on my side, Eric, look, as I said in my earlier comment, our Q1 expenses were completely in line with our objectives and there is always seasonality.

As you've noticed, from Q4 to Q1 there is always – we spend less on marketing and so that's true for this year as well. And for the other areas, right, we would have been in line with the objectives we've set for ourselves. So these one-time costs were genuinely and that's where truly one-time.

And – I mean, when you acquire Nest for bit over $3 billion, there is just a lot of stuff that flows through the P&L, lot of accounting, and so that's really the issue there. So, I would go back to your instinct of at least kind of we should be roughly in line with what our expectations where and they – that's why the nature of truly extraordinary items. So thanks for that question.

Eric Sheridan - UBS

Thank you.

Patrick Pichette

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

Operator

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

Peter Stabler - Wells Fargo Securities

Good afternoon. Thanks for taking my question. Why don't you revisit attributions for a moment? Given aspects attribution and I think you guys are doing a great job on the cross screen attribution and taking advantage of your ubiquitous login across different platforms and Enhanced Campaigns.

Wanted to get a better understanding of how you're thinking about online versus offline attribution for those types of marketers, particularly brand advertisers, supermarket advertisers, the 30,000 SKUs and those retail channels that don't have E-Commerce and really don't have much of the search opportunity. How are you helping them close the gap between their online activity and offline sales? Thanks very much.

Nikesh Arora

Thanks Peter. Thanks again for the question. I think as you rightfully pointed out the attribution story on the advertising side is kind of becoming clearer as we partner with Nielsen and comScore, and adopted some of the mechanisms that traditional media has used to create the comparability between traditional and internet media.

I think you identity a good challenge which is that how do we bridge the gap between online commerce and offline commerce and relate that to advertising opportunity, i.e. when we sell search, we sell traffic to different people, how do we convince them, how do we make them realize that that traffic that they've got normally results in online sales, but also results in offline sales at stores and how do we encourage that activity.

So over the last many years around the world we have run specific studies, working with various advertisers which are called online to store studies where we actually try and measure what online activity created by them took to control group's results in more foot traffic in their particular stores and certain reasons about. And we've pretty much had very good results across the board.

I can't detail specifics right now because they are all specific to individual advertisers who we work with. But we do understand that opportunity and the problem and we work specifically with third-party research teams to work on figuring out how do we keep showing the online to store efficacy.

And there are other products as you can see where we start doing conversion, we start looking at things like Google Shopping which also helps us in those areas.

Patrick Pichette

Thanks again, Peter.

Peter Stabler - Wells Fargo Securities

Thanks for the color.

Patrick Pichette

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

Operator

And we will go next to Heather Bellini with Goldman Sachs.

Heather Bellini - Goldman Sachs & Co.

Great. Thank you very much. I just wanted to go back to an earlier question there was – you responded about the building blocks that were needed in order to get mobile pricing, mobile CPCs to convert to desktop.

I was just wondering if you could share with us kind of specifically what you think those building blocks are that need to happen over the medium to long-term as you said to see that conversions occur. Thank you.

Nikesh Arora

Of course, thanks Heather for the question. I mean, look, there were some very simple things and there are some complicated things. The simple things are, we will make sure that there is payment enablement for users.

So i.e. users have a mechanism that allows them to pay with lowest amount of friction, because honestly you and I don't want to spend our lives trying to enter payment information on a very small screen where you are trying to conduct the transaction. So that enablement is happening across the industry, across multiple payment platforms.

There is also the need that when people search for some things they can get quickly down to the information and they don't have to browse multiple sites, because people are more keen on declaring intent to mobile devices than going and searching multiple websites and trying to figure out what they are trying to do.

And that intent could be in the form of restaurant, could be in the form of a taxi, could be in the form of them looking for individual product. And you are beginning to see apps, you are beginning to see solutions on search that allow you to get to that granularity of information.

Of course, there is a big building block which is getting all the people out there which shows the advertisers effectively in this case the merchants who actually have to have experience in the mobile site which are simpler to execute on.

So try buying something on many companies’ mobile websites and it's more own risk than their desktop sites because they've been spending a decade trying to optimize the desktop site, but they haven’t spent enough time optimizing mobile experience, in some cases not believing that people want to transact with them in a mobile device and some cases they are just slow and they are just slowly diverting resources from desktop to mobile.

So, if you take all those things and take the notion that we need to keep sort of working hard towards getting these building blocks in place, I think there's a finite time where these building blocks will come into plays.

And as they keep coming into plays, you will see or as we talked about earlier, perhaps the conversion will happen between pricing in mobile desktop. But there's a whole bunch of other issues, I think but those are the big things that we need to think of right there.

Heather Bellini - Goldman Sachs & Co.

Thanks so much.

Patrick Pichette

Thanks for your question Heather. Jamie let's go to our next question please.

Operator

And we'll go next to Colin Sebastian with Robert Baird.

Colin Sebastian - Robert W. Baird & Co.

Great thanks. I wanted to ask you a question on the cloud platform. Since this is obviously a huge revenue opportunity for you and first-off if you could put context around the impact of this business on CapEx and OpEx, particularly on the infrastructure of the service part of the business?

And then secondly, if you could talk about how you're planning to differentiate the service, is it really about pricing or is it by tying in the software and platform as a service offering, if you could touch on that? Thanks very much.

Patrick Pichette

I can cover the first part and then I'll let Nikesh cover the second. Look we're very comfortable with our cost structure. In light of Google efficiencies, economies of scale, our vertical integration from data center to chip -- to servers, to software. I mean we really have -- we believe we have absolute unique position from a cost structure perspective and therefore, from a margin perspective makes us very, very comfortable.

In terms of differentiation, I'll just let Nikesh jump in here.

Nikesh Arora

I think Colin -- thank you again for the question. The important part to at least acknowledge in the space of cloud computing is we think that it's very, very, very early days. I mean if you think about the potential scope and scale of what this opportunity is, that's pretty much every business which is going to be around for the long-term has to operate in the cloud.

There's no efficiency compared to the efficiency of the cloud, but in compared to owning your own infrastructure running it by yourself. So, this shift is going to happen. It’s a matter of every company going through that shift one at a time. And if you look at the opportunities out there and the options, there's very few options.

So, there's a lot of room for all of us to have a great time for many, many, many years before we start worrying about differentiation and why my sort of thing is better than yours.

So, right now, the key is to be able to work with the companies out there, the enterprise customers out there to get them to shift on the legacy systems, get on to the cloud and realize that Google has been working in the cloud for more than a decade, because we have been running one of the largest cloud computing platforms in the world in the public space. And we have all of the expertise and skills that are required to be able to serve these enterprises and get them off their current legacy system onto the cloud.

So, our effort is really trying to work with each of these third-party partners, trying to get them off the legacy systems onto our cloud. I don't think the challenge right now is the need to differentiate. I think our biggest differentiator is we have the most experience in the space.

Colin Sebastian - Robert W. Baird & Co.

Great. Thank you.

Patrick Pichette

Thanks Colin. Jamie we'll go to our next question please.

Operator

And we'll go next to Jordan Monahan with Morgan Stanley.

Jordan Monahan - Morgan Stanley

Hi, thank you for taking the question. Actually two if I may. A couple of big picture questions, I think for Nikesh. The first is I think there's an ongoing debate about whether mobile web or mobile app is going to win and what the implications are for various businesses, Google included?

And I'm just curious to get your view on whether you think one will win over the other and then whether it matters for Google?

And then the second is when you look at Google's share of global advertising, you're coming up on about 10% of total, but when you look at your business in the U.K., you're north of 20% of total.

So, when you think about your global businesses as economies start to mature, do you think the U.K. is a fair proxy for thinking about your business globally or are there other factors that you think may prevent you from getting to that type of scale globally.

Nikesh Arora

I guess let me answer the second question first Jordan, because I'm standing here Patrick is looking at me asking the same question. I think the way to think about it is that we have 10% by some metric depending on what we believe the total is.

As per your metric, we have 10% of the total advertising sort of money. And the U.K. we have 20%. That just tells me there's 90% more opportunity around the world and 80% more opportunity in the U.K.

So, we're not going to constrain our thinking in terms of what believe is a stable state. Our aspiration is to be able to serve every advertiser in the long-term and our aspiration is that -- our hope is that every piece of advertising becomes digital advertising.

The question is how much of that are we able to provide through our technology platforms, how much are we able to provide through our own sort of properties and how much do we partner with others to provide on their network.

So, I guess I'm trying to tell you we don't constrain ourselves and our thinking. I'm not trying to be arrogant, say we want 100%, but we like more than what we have in every market out there.

In terms of your question around the mobile web and mobile search, that is a tough question and that is a very involved question and I think the approach -- the best way to think about it is that we're trying to make sure we can make both of them effective for the end-user and make them both work, because we're not about to try and pick winners.

Right now, you can see that people spend as much time on mobile devices -- more time mobile devices they are beginning to spend on the desktop and they are spending the time across the mobile web as well as mobile app landscape.

We're participating in both those ecosystems, whether it's somewhere placed on the app front, whether it's through our browser-based search properties or through our app-based search properties. So, we're participating across the Board and I think at the end of the day, it's going to boil down to ease-of-use and consumer choice.

Jordan Monahan - Morgan Stanley

Thank you.

Patrick Pichette

Thank you, Jordan. Let's go to our next question please Jamie.

Operator

And we'll go next to Robert Peck with SunTrust.

Robert Peck - SunTrust Robinson Humphrey

Yeah, hi. Thanks for taking my question. Two questions if you don't mind. The first is on the revenue side, can you talk a little bit -- can you maybe give us an update about the breakout of YouTube versus DoubleClick revenues, where are those today and where could they be over time?

And then on the cost side, Patrick could you just walk us through just how you think about the ROI on capital? We get a lot of questions from investors asking about spending, could you maybe tell us more about the thought process and how the company looks at the ROIC of capital going forward? Thank you.

Patrick Pichette

Okay, well Robert, let's start with the last one first and then we'll go back to revenue. ROI clearly we have -- we always look at capital intensity. The fact that we're investing quite a bit in CapEx right now is a real tribute to kind of the potential and the optimism we have about our businesses going forward.

Most of our core businesses if you think of YouTube or advertising or search are not that capital-intensive relative to other areas that we have such as for example, Google Fiber, if you think of the access portion right which is much more traditional CapEx.

For each of these areas, we actually track and make sure that we have good returns and we have a capital efficient. So even though an area that take the advertising business that we run, even though you could argue that it's phenomenally good on return on capital, the questions that we will ask internally is okay so if the utilization rate is X on our machines on this business, right, why can't it be X plus something?

So, even though we have already good return on capital in these areas, we continue to always push the envelope to make sure that our capital efficiency continues to be better and better on a year-to-year basis and then across a portfolio, every area has some capital kind of targets to make sure that we're driving for value.

Finally, there's a number of areas if you think of take the newer stuff like Loon, for example. In those cases, you test through the hurdles that we kind of we seed capital to the Loon team as they hid their hurdles and they kind of earned their right to the next cost for funding.

And in doing so, right, we continue to always have the business case in mind that says here is why this continues to make sense to fund and invest and with an ROIC or value in mind for the long-term, but in the short-term, it's really kind of delivery of milestones on very specific engineers objectives that actually gives them the next round of funding.

So, Robert as you can see, given the portfolio of mature stuff we have and growing areas as well as kind of much more R&D and innovation at the early stages, right, we just need to have a basket of tools to actually manage the concept of ROIC or ROI on each of them. And that's what we do. It's not rocket science; it just requires a lot of discipline on our part.

On the revenue side, look, we don't break out DoubleClick or YouTube. I can just tell you as I mentioned a bit earlier; we're really pleased with our network revenue in the kind of AdMob, AdExchange. Many of our areas continue to grow very well and we're very, very pleased by these investments and clearly continue to be very pleased with YouTube as mentioned -- Nikesh mentioned a bit earlier.

Robert Peck - SunTrust Robinson Humphrey

Thank you very much.

Patrick Pichette

That's the story there. Thank you. Jamie, we'll take one last question. We're running out of time. So, we'll take one last question if you don't mind.

Operator

And our final question comes from Gene Munster with Piper Jaffrey.

Gene Munster - Piper Jaffray

Hey, good afternoon. Another question regarding trends and mobile CPC. Yesterday you announced an offline conversion tracking plan and program with Datalogic. Is that something potentially the whole online to offline tracking that could have a positive impact on CPCs? And separately any updates on how you think about Fiber longer term? Thanks.

Patrick Pichette

Okay, so why don't I take the last portion and then Nikesh may have views on this data conversion plan.

On Fiber look, you've heard our announcement earlier this quarter where we're working with 34 cities and looking for working with these municipalities, they've indicated to us they are really excited about, they kind of self-selected to be really excited about getting Fiber and the next generation of access.

So, right now, we're basically working directly with them to look if we have the right conditions to actually go to the next stage which would be the build. So, very excited about it. I think that it's a really good sign of things to come in access in general.

I think that everybody now in the industry is talking about the gig. It's becoming the standard and we're absolutely thrilled for all of the users out there that can think in one day they will get a gigabit of symmetrical internet at reasonable price. So, stay tuned on the next part of the chapter, but really excited to work with these communities. And Nikesh maybe you want to talk about--?

Nikesh Arora

Yeah. Thank you, Gene. I mean as I mentioned earlier and the question earlier from -- I think it was Heather that the online to offline conversions are really important opportunity where it's important for offline merchants to be able to understand what results they get from their online activity.

And some of the experiments that we talked about required partnerships of third-party data providers to understand how that happens and I think Datalogic is one of those things, which we're looking out to see how we can help quantify the opportunity and quantify the answer for our offline partners. It's just one of those things that we're doing.

Gene Munster - Piper Jaffray

Great. Thank you.