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## **Alphabet Q3 2021 Earnings Call October 26, 2021**

**Operator:** Welcome everyone. And thank you for standing by for the Alphabet Q3 2021 earnings conference call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question and answer session. To ask a question during the session, you will need to press star one on your telephone. If you require any further assistance, please press star zero. I would now like to hand the conference over to your speaker today, Jim Friedland, Director of Investor Relations. Please go ahead.

**Jim Friedland, Director Investor Relations:** Thank you. Good afternoon, everyone, and welcome to Alphabet's third quarter 2021 earnings conference call. With us today are Sundar Pichai, Philipp Schindler and Ruth Porat. Now I'll quickly cover the Safe Harbor. Some of the statements that we make today regarding our business, operations, and financial performance, including the effect of the COVID-19 pandemic on those areas, may be considered forward-looking, and such statements involve a number of risks and uncertainties that could cause actual results to differ materially. For more information, please refer to the risk factors discussed in our most recent Forms 10-K and 10-Q filed with the SEC. During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of non-GAAP to GAAP measures is included in today's earnings press release, which is distributed and available to the public through our Investor Relations website located at [abc.xyz/investor](#). And now I'll turn the call over to Sundar.

**Sundar Pichai, CEO Alphabet and Google:** Thank you, Jim, and good afternoon, everyone. In 2016, I laid out our vision to become an AI-first company. Five years later, this quarter's results show how our investments in AI are building more helpful products for people, and for our partners and local communities. Today, I'll begin with new product highlights. Then I'll cover our Cloud business, followed by YouTube.

First, product highlights. Search remains the heart of what we do. We've made remarkable advances over the past 23 years that benefit Search and related products like Google Assistant -- which just celebrated five years. Earlier this year, we announced that we reached a significant milestone with Multitask Unified Model, or MUM for short. MUM is a thousand times more powerful than BERT and can understand information across many contexts, like text and images. At our SearchOn event in September, we shared how we're using MUM to improve Google Lens so people can search using both images and words. We also shared that we're bringing a more visual shopping experience to Search, powered by the Google Shopping Graph. It links shoppers with over 24 billion product listings from merchants across the web.

Google Maps now offers eco-friendly routing. It lets drivers in the U.S. choose a more fuel-efficient route, saving money and reducing emissions. Maps now has a wildfire layer so that people can get up-to-date details and make quick, informed decisions during emergencies.

Finally in Search and our Discover feed, we're continuing to support the news ecosystem and make quality journalism more accessible. Philipp will give a bit more detail about our News Showcase partnerships.

Turning next to Hardware, I hope you saw our Fall Pixel event last week. I'm very excited about the range of Pixel phones available this holiday season. The new Pixel 6 and 6 Pro bring together the best of Google AI, software, and hardware, with the most advanced and inclusive cameras we've ever built. They're beautiful, fast and powered by Google Tensor, our first-ever system on a chip. It is specifically built to support Google AI and machine learning on-device. And provides a long term foundation for our Pixel devices. We also introduced our new Nest Renew program, which uses Nest thermostats to support clean energy use in the home.

On to Android. Android 12 is getting great reviews. It's the biggest design change in Android's history, with new widgets to personalize your phone. We also introduced accessibility features that use gestures to control your phone and communicate. Android 12 is secure by default and private by design. New dashboards and indicators make it easier to view and adjust privacy permissions, and disable access to device sensors and location information. We've also made progress with a made-for-India affordable smartphone co-developed with Reliance. The JioPhone Next device features premium, localized capabilities, and is on track to launch in-market by Diwali.

On to Cloud, where we see continued momentum with Q3 revenue growing 45% year-over-year, with GCP's revenue growth rate above Cloud overall. At Cloud Next two weeks ago, we unveiled hundreds of new capabilities, services, and solutions. We also announced twenty new and expanded partnerships to support the growth and scale of our customers around the world. More than any other top cloud provider, Google Cloud has unique capabilities to meet the needs of enterprises, digital natives and SMBs around the world. I'll highlight three:

First, our leadership in real-time data, analytics and AI is winning customers like Carrefour Belgium, Deutsche Post DHL, and Wendy's, who are unlocking data to deliver unique business outcomes. BigQuery, our leading data warehouse solution, is reducing costs and driving productivity at Cardinal Health and ATB Financial. Our differentiated AI and ML-based industry solutions are helping leading global companies. GE Appliances, a Haier company, is integrating Vision AI into their next-generation smart home appliances. And IKEA Retail is using Recommendations AI to drive a 30% increase in customer click-through rate.

Second, customers see value in our open, scalable infrastructure that enables them to run workloads anywhere – on our Cloud, at the edge, or in their data centers. Rodan and Fields scaled its SAP environment, Siemens Energy is migrating its global network of data centers and company-wide SAP systems, and Indonesia's largest technology digital native GoTo Group is supporting over 100 million monthly active users with Google Cloud. General Mills, Bell Canada and Wells Fargo are harnessing our leadership in multi-cloud and our open development environment; and to meet the unique digital sovereignty needs of customers around the world, we announced industry-first partnerships with T-Systems in Germany and Thales in France.

Third, as consumers, businesses and schools continue their shift towards hybrid work, the threats of cybersecurity continue to increase. Customers are turning to Google Workspace and our cybersecurity platform to provide the ease of use, collaboration and security they need. These include organizations like Discovery, Common Spirit Health, and the state of Maryland who want to foster creativity while securely protecting their users.

We are also seeing strong growth in our broad portfolio of cybersecurity products. This includes Chronicle, one of our zero trust offerings, which JetBlue uses to detect cybersecurity threats, helping to protect its customers and enterprise.

We are bringing our team's deep expertise to customers through the Google Cybersecurity Action Team and a new Work Safer program, which provides best-in-class security for emails, meetings, messaging and more.

Earlier, I mentioned a few of the sustainability related product features we announced. Our Cloud customers already benefit from operating on the world's cleanest cloud, and last year we set an ambitious goal to run our data centers and campuses on 24/7 carbon-free energy by 2030. Two thirds of the electricity consumed by Google data centers in 2020 was matched with local, carbon-free sources on an hourly basis. And our new Carbon Footprint tool gives customers carbon emissions insights associated with their Google Cloud Platform usage.

Now, over to YouTube for a few highlights. We recently surpassed fifty million Music and Premium subscribers, including those in trial. And YouTube Shorts continues to see high adoption rates. In the past year, the average number of daily first time creators more than doubled. Next week, as global leaders gather in Glasgow to address climate change, YouTube is partnering with COP26 to livestream conference activities, making the event more accessible for everyone. As we grow, we're maintaining our open global platform responsibly by removing harmful content and reducing borderline content. Both our AI investments and the promotion of trusted sources have helped us significantly lower the violative view rate, which is the percentage of views on YouTube from content that violates our policies.

On to our Other Bets. Waymo began welcoming riders to its Trusted Tester program in San Francisco, in addition to its fully autonomous ride-hailing service currently in Phoenix. Next year, Waymo will open a dedicated trucking hub in the Dallas-Fort Worth area, helping support commercial freight routes across the Southwest. And we announced last week the first commercial expansion of Wing's on-demand air delivery service to Walgreens customers in select locations.

To close...the world is slowly starting to travel and meet up in person, and this quarter I joined events virtually to celebrate some big milestones in regions around the world. Earlier this month, we announced a \$1 billion investment in Africa over five years to support the continent's digital transformation. And September marked 20 years since we opened our first office outside of the U.S., in Tokyo. We now have thousands of employees in 28 offices across the Asia Pacific region, and we're investing in cloud regions and digital skills programs to help expand economic opportunity there. As you can see, our business in APAC is growing really well. In Africa, Asia-Pacific and beyond, it's been a successful quarter. And we have lots more innovation and product development on the way.

Thanks to our employees around the world for their contributions. As we continue our move to hybrid work, I hope to see more of you in person soon. Thank you, and over to Philipp.

**Philipp Schindler, SVP and CBO, Google:** Thanks, Sundar – and hi everyone. It's great to be with you all today. We're pleased with the growth in Google Services revenues in the third quarter. Year-on-year performance was driven by broad-based strength in advertiser spend. Consumer online activity also remained elevated.

In the third quarter, Retail was again by far the largest contributor to year-on-year growth of our Ads business. Media & Entertainment, Finance, and Travel were also strong contributors. Let's take a deeper look at some of the trends that drove this quarter's performance.

First, from a big picture, global recovery perspective – we continue to see a lot of unevenness. Some economies have restarted and reaccelerated – albeit at different speeds. Other countries, depending on local regulations and vaccines, have been slower to rebound.

It's clear that uncertainty is the new normal. The world is in flux. So when it comes to anticipating change, predicting demand, and investing in innovation, businesses need as much support now as they did a year and a half ago. And we continue to help.

Like in travel – where hotel free booking links are increasing traffic for many partners - from OTAs to boutique hotels. Consumers like more choice. Travel partners like free exposure. And advertisers like to augment paid campaigns with free listings. So last month we launched free booking links for “things to do” and a new ad format that makes it easier to promote local experiences. Now, when you search ziplining, aquariums, or the Tokyo Tower, you can buy tickets directly on Google. And then there are companies like Alaska Airlines that are harnessing first-party data and automation across Search to navigate market fluidity and better understand the lifetime value of their customers. They've increased return on ad spend by 30%+ vs. the same period pre-Covid.

Beyond travel, businesses of all kinds are increasingly adopting tools like AI-driven automation and insights to connect with customers – no matter what stage of the recovery they're in. 150-year-old luxury retailer De Bijenkorf turned to local insights and automation to speed up cross-border expansion beyond the Netherlands and Belgium to Germany, France, and Austria. With a multi-pronged approach, including Shopping Campaigns, De Bijenkorf drove substantial growth throughout the pandemic. Returning visitors to online stores were up fourfold in first-half 2021 vs. 2020.

Which leads me to retail – where we had another stellar quarter. We've seen explosive growth in digital over the last 20-some months, but as the world begins to reopen, shoppers are returning to stores. Brick and mortar isn't dead – instead, omnichannel is in full force. Searches for 'open now near me' are up four times globally vs. last year. Strong growth in local shopping queries means people are researching their visits to stores more often before they go. As a result, we've seen more advertisers include in-store sales alongside ecommerce goals to drive omnichannel growth – adoption has nearly doubled over the past year. Take Kohl's - it optimized media spend into trending categories and launched curbside pickup just two weeks after its 1,100 stores shut down. After testing Local Inventory Ads in Q4, Kohl's went all in on omnichannel bidding across its paid Search portfolio and is leaning heavily into a full-funnel approach on YouTube – including CTV. Kohl's net sales were up 31% year over year in Q2, led by higher foot traffic and continued strength in digital.

Innovating in omnichannel and next-gen user experiences remains core to our shopping strategy. A few of our latest launches include: easier ways for businesses to show the local services they offer – from hair extensions to auto repair – across Search and Maps. Local inventory ads that highlights which products are in-stock and when to pick them up. Free shipping and easy return annotations across Search and Shopping. AR capabilities that bring in-store moments online and let users try before they buy. And then – instantly shoppable images with Google Lens. Plus a new visual, browseable experience on Search.

There's a lot more to come...including tapping into commerce on YouTube. From shoppable livestream experiments with retailers like Sephora, Target and Walmart to pilots that let viewers buy directly from their favorite creators' videos, we're still in the early innings of what's possible.

Our direct response momentum remains strong. Video Action Campaigns are driving more conversions than previous formats, and by adding product feeds to these campaigns, advertisers are achieving, on average, over 60% more conversions at a lower cost than those without.

Our brand business is also performing well. As I said last quarter, YouTube's reach is becoming increasingly incremental to TV – we're helping advertisers find audiences they can't find anywhere else. Connected TV is driving part of this growth – it's our fastest growing screen. The precision of digital paired with the scale of linear is proving to be an awesome combo – and even more so now with the expansion of Video Action Campaigns for CTV. Advertisers can now drive conversions on the big screen.

Which brings me to how brands of all sizes continue to buy YouTube at both ends of the funnel - to create future demand while they convert existing demand. And they're seeing upside. For example, we found that advertisers using both DR and Brand video see Brand driving 28% of conversion assists. Domino's Pizza is a great example – their UK business delivered a 9X return on ad spend on their direct response campaigns when paired with their brand campaigns.

Lastly, I've said it before and I'll say it again – our success is only possible because of our customers and partners. We do well only when they do well – and it's a result of the revenue share models we've talked about many times before.

Three highlights: first, as Sundar mentioned, our commitment to high-quality journalism and open access to information remains steadfast. It's been one year since we launched News Showcase – in Q3 alone, we signed over 120 deals and launched in 3 new markets – Japan, Colombia, and Austria. And of the more than 1,000 publications across a dozen-plus countries that we now have on board, 90% are considered local, regional or community newspapers.

Second, over 2 million creators are now making money and building their businesses on YouTube via our YouTube Partner Program – with 10 different ways to monetize their content, from Super Chat to Brand Connect. The next generation of businesses and media companies are being built by creators, on YouTube – and we're excited to help them grow.

Third, I echo Sundar's excitement on Pixel. And to bring it to life, and to users, we worked with an entire ecosystem of partners. We signed partnership agreements with over 45 carriers and retailers across nine countries at launch – including deep collaboration with each of the major US carriers: AT&T, T-Mobile, and Verizon.

On behalf of many, I want to say how grateful we are to collaborate with so many amazing customers and partners every day – we can't wait to start doing more of this in person again soon. Also, a huge "thank you" to our sales, partnerships, product and support teams for their work and dedication - the impact you all continue to have is, as we say in German, "wunderbar!" With that, Ruth, over to you.

**Ruth Porat, CFO Alphabet and Google:** Thank you, Philipp. Our revenue performance in the third quarter reflects continued broad-based strength in advertiser spend and elevated consumer online activity as well as a strong contribution from Google Cloud. My comments will be on year-over-year comparisons for the third quarter, unless I state otherwise. We will start with results at the Alphabet level, followed by segment results, and conclude with our outlook.



For the third quarter, our Consolidated Revenues were \$65.1 billion, up 41%, or up 39% in constant currency. Our total cost of revenues was \$27.6 billion, up 31%, primarily driven by growth in TAC, which was \$11.5 billion, up 41%. Other Cost of Revenues, were \$16.1 billion, up 24%, reflecting in part the benefit from the change in useful lives made earlier this year. The largest driver of the growth in Other Cost of Revenues was content acquisition costs. Operating expenses were \$16.5 billion, up 19%. In terms of the three component parts of opex. First, the increase in R&D expenses was driven primarily by headcount growth. Second, the growth in Sales & Marketing expenses was driven by headcount growth, followed by the continued ramp-up of spending on ads and promo, in contrast to the pullback in the third quarter last year. Finally, the increase in G&A reflects the impact of charges relating to legal matters, followed by headcount growth. Operating income was \$21.0 billion, up 88% and our operating margin was 32%. Other Income & Expense, was \$2.0 billion, which primarily reflects unrealized gains in the value of investments in equity securities. Net income was \$18.9 billion.

We continued to generate strong Free Cash Flow of \$18.7 billion in the quarter and \$65.7 billion for the trailing twelve months. We ended the third quarter with \$142 billion in cash and marketable securities.

Let me now turn to our segment financial results. Starting with our Google Services segment, total Google Services Revenues were \$59.9 billion, up 41%. Google search and other advertising revenues of \$37.9 billion in the quarter, were up 44%, with broad-based strength across our business, led again by strong growth in retail. YouTube advertising revenues of \$7.2 billion, were up 43%, due to strength in both direct response and brand advertising. The deceleration in the growth rate vs the second quarter was driven by lapping a strong recovery in brand in the third quarter of last year. Network advertising revenues of \$8.0 billion, were up 40%. Other Revenues were \$6.8 billion, up 23%, driven by growth in YouTube non-advertising revenues; and Hardware, which benefited from the addition of Fitbit revenues. Google Services Operating income was \$24.0 billion, up 66%, and the operating margin was 40%.

Turning to the Google Cloud segment, revenues were \$5.0 billion for the third quarter, up 45%. GCP's revenue growth was again above Cloud overall, reflecting significant growth in both infrastructure and platform services. Strong revenue growth in Google Workspace was driven by robust growth in both seats and average revenue per seat. Google Cloud had an Operating Loss of \$644 million.

As to our Other Bets, in the third quarter, revenues were \$182 million. The operating loss was \$1.3 billion.

Let me close with some comments on our outlook. With respect to foreign exchange impact on reported revenues, based on current spot rates we expect virtually no impact in Q4 in contrast to a 1.5% tailwind in Q3 and 4% in Q2.

In terms of outlook by segment, for Google Services – as I noted, the strength of our revenues in Q3 reflected both underlying strength in advertiser and user activity as well as the impact from lapping weaker performance in the comparable period last year. Given the gradual recovery in results through the back half of 2020, the benefit from lapping prior year performance diminished in Q3 vs Q2 and will diminish further in Q4.

Within Other Revenues, in the fourth quarter, we expect the ongoing drivers of revenue growth to be Hardware, due to the benefit from the holiday selling season and inclusion of Fitbit, as well as YouTube subscriptions. Google Play's contribution to revenue growth will remain more muted

given the ongoing impact of both lapping the increased level of user engagement that started in the first quarter of 2020 due to the pandemic, as well as the fee change that took effect on July 1.

Within Google Services, we expect Sales and Marketing expenses to be elevated in the fourth quarter to support the holiday season.

Turning to Google Cloud, we remain focused on revenue growth, and are pleased with the trends we are seeing. In GCP, our customer wins, as Sundar noted, reflect our multi-year investments in products and solutions that are purpose-built to solve for the biggest opportunities within our targeted eight industries. The benefit of these solutions to our customers is clear and they are choosing to work with us as their long-term transformation partner. With respect to Workspace, we are pleased with the ongoing momentum in both seat growth and average revenue per seat, which underscores the value of collaborative solutions, in particular as people increasingly are embracing a hybrid work model. Across Cloud, we continue to invest aggressively, both in growing our Go-to-Market and product teams as well as building out our cloud regions.

At the Alphabet level, headcount grew by nearly 6,000 in the third quarter, including our seasonal campus hires, and we expect robust headcount growth in Q4 for both Google Services and Google Cloud.

Turning to CapEx, the results in the third quarter primarily reflect ongoing investment in our technical infrastructure, most notably in servers, to support ongoing growth in Google Services and Google Cloud. We also continue to increase the pace of investment in fit-outs and ground-up construction of office facilities to accommodate our ongoing headcount growth globally. We will continue to pursue real estate acquisition opportunities where it makes sense, as you saw in our New York City announcement in Q3. Thank you. And now Sundar, Philipp and I will take your questions.

**Operator:** Thank you. As a reminder, to ask a question, you'll need to press star one on your telephone. To withdraw your question, please press the pound key. To prevent any background noise, we ask that you please mute your line once your question has been stated. And our first question comes from Eric Sheridan, from Goldman Sachs. Your line is now open.

**Eric Sheridan, Goldman Sachs:** Thank you very much for taking the questions. Maybe first one for Sundar, big picture. Coming back to how you started the call, when you look out over the next three to five years, what do you see as some of the big investments that Google needs to make to marry your ambitions on AI and machine learning against aligning Google's broader product and services against the rising digitalization of the global economy. Would love to have that as a framing over the next three to five years. And then maybe -- I'm not sure if it's directed better at Philipp or Ruth, but on a shorter-duration basis, there seemed to be an element of headwinds and tailwinds in the broader macro economy. Can you talk a little bit about the business elements of Google's products and what elements of reopening dynamic you're seeing on a sector basis versus potential headwinds as we move into Q4 next year from things like supply chain shortages or labor shortages or things like that. Thanks so much in advance for the color.

**Sundar Pichai, CEO Alphabet and Google:** Eric, great question. You're right in the fact that AI and ML itself is the broader, deeper investments we are driving, and we are using it across our product portfolio.

The recent launch of Tensor and Pixel 6 is a great example of that. So, for example, we are willing to go as deep in the stack as needed, silicon, both on the cloud side with our Tensor Processing Units, and Google Tensor on the client side is an example of that. So overall, thinking through compute, networking, building data centers, making sure they are clean and carbon free, and really investing in, you know, the advanced models and algorithms on top, which is, a lot of it, done by our AI research teams. So making sure we are able to attract the best talent across the world is all part of that. But you will continue to see us undertake deep technology investments. And beyond that horizon, that's why we are thinking even about areas like quantum computing and so on.

**Philipp Schindler, SVP and CBO, Google:** So to the second part of your question, we continue to watch countries as vaccination rates climb and local regulations ease. We expect some amount of heterogeneity in recovery, depending, obviously, on location and vaccination rates. But because every region is different, it's hard to make a generalization from the data right now. That said, the consumer shift to digital is real and will continue, even as we start seeing people return to stores. Shopping habits have ebbed and flowed over the last 20 months. But the underlying takeaway is that people want more choice, they want more information, more flexibility. And we don't see this reversing.

Omnichannel, I talked about it, is definitely in full force. I said this earlier. We've been really focused on building features and solutions to help retailers, large and small, succeed here. And we think this will continue as the world re-opens and shoppers fluctuate between online and in-store based on whatever is really more convenient.

YouTube is exciting for many reasons. It's incredible to see the amount of content that's valuable for people across so many topics. And we're helping advertisers tap into this. And whether it's browsing for inspiration, product research, or actually making the purchase, a billion shopping sessions happen across Google every day, and they're happening on Search and YouTube and Image Search and the Shopping tab and Lens, and so on. So, frankly, we're really encouraged by the long-term opportunity in commerce. And we're laser-focused on helping businesses of all sizes connect with their customers wherever they are.

**Operator:** Thank you. And our next question comes from Brian Nowak from Morgan Stanley. Your line is now open.

**Brenda Duverce, Morgan Stanley:** Hi, it's Brenda on for Brian. Thanks for taking our questions. We have two. The first one: you have made notable strides in the retail search category over the past 12 to 18 months, and there seems to be more to come. Can you talk to us about which other Search verticals – where you are most excited to innovate and invest around the next – within the next year or two? My second question is maybe one on augmented reality. You have made some real progress here and now have some budding product integrations. Philosophically, how do you think about the key augmented reality use cases you are focused on enabling? And do you need an Alphabet-specific hardware set to capitalize on the opportunity? Thank you.

**Sundar Pichai, CEO Alphabet and Google:** Maybe I'll take the second one first. You know, in augmented reality, we have -- for a while, we have deeply focused on, you know, thinking through computing for the long term. We've talked about ambient computing, and it's just a matter of time before, beyond phones, you will see other successful form factors. And AR is an exciting part of that future.



We are looking at all the deep investments we need to make. I think it's going to take some time. And so, for example, when you look at something like Google Lens or when you look at the fact that we are making Search work in a multimodal way or when you think about YouTube and making sure it works well in a VR/AR world, so we are obviously investing in all our services. And beyond that, from a computing standpoint, both, you know, both our Hardware teams as well as our platform teams are thinking through, definitely, and it's going to be a major area of investment for us.

On the first question about -- I think Philipp spoke about shopping. We obviously -- you know, Search is -- part of what makes Search so successful is people use it for a wide variety of use cases. And so we really invest comprehensively across all experiences, be it local in Maps, be it images, be it videos. And so we are definitely investing a lot. People do come to Search for education as well. So, you know, making sure we are comprehensive. Health has been a major area of focus, particularly through the pandemic. And so the strength of Search is both in its depth and breadth. And so -- and getting it right, with a high focus on quality. And we'll continue to do that.

**Operator:** Thank you. And our next question comes from Doug Anmuth from JP Morgan. Your line is now open.

**Doug Anmuth, JP Morgan:** Thanks for taking the questions. I have two. First, I was just curious if you're seeing any impact at all from the Apple iOS changes in your business and perhaps particularly in YouTube. And then second, given retail, the biggest driver of services growth, and, of course, you're really just touching all parts of the economy, any more commentary on how you're thinking about supply and labor shortage dynamics in the fourth quarter and if you're perhaps seeing anything thus far there? Thank you.

**Ruth Porat, CFO Alphabet and Google:** Thanks for the question. Starting with the iOS 14 changes. So, overall, as we've said, we're pleased with the strength across our business. In the third quarter, it was broad-based, it was global. In terms of the iOS 14 changes specifically, they had a modest impact on YouTube revenues -- that was primarily in direct response. I think, as you all know well, focusing on privacy has been core to what we've been doing consistently. And let me have Philipp take you through some more on that.

**Philipp Schindler, SVP and CBO, Google:** Yeah. So from our standpoint, we see ATT as one aspect of the many broader ecosystem changes that are underway. And we've been investing in privacy-preserving technology for many years. Our focus is on supporting developers, small and large advertisers, creators, publishers so that they're able to mitigate impact to their businesses. And we really see the future of digital advertising being built on advances in privacy-preserving on-device technologies which support the free and open Internet and, obviously, a robust ads ecosystem.

On your supply chain questions, I would say performance in Q3 was strong across ads revenue lines, regions, and nearly all verticals. In line with the widespread reporting of supply chain weakness in the auto industry, we've seen some impact on vehicles within the auto vertical, which started earlier in the year, although the impact has really been offset somewhat by increased demand in related areas, like parts, accessories, repairs and maintenance.

**Doug Anmuth, JP Morgan:** Great. Thank you.

**Operator:** Thank you. And our next question comes from Justin Post from Bank of America. Your line is now open.

**Justin Post, Bank of America Merrill Lynch:** Thank you. One for Sundar and one for Ruth. Sundar, margins have been strong this year, and I think the depreciation changes helped. Can you just comment on how you see the current investing spending levels of the company? Are you in good shape? You know, anything where you might be increasing investment? And then for Ruth, there - news about Play Store fee cuts on the subscription piece, how do we think about that maybe impacting the business in '22, when those start to take effect? Thank you.

**Sundar Pichai, CEO Alphabet and Google:** You know, at a high level, look, I mean, I've taken a long-term view. And we are obviously investing both in foundational technologies like AI and just deep -- deeper computer science overall and applying it across a prioritized set of areas. And so no change in the framework. If anything, I do feel, with the digital transformation underway, if anything, we feel a sense of urgency to execute against the opportunities we see. So still -- still working within the long-term framework. Maybe Ruth and Philipp?

**Ruth Porat, CFO Alphabet and Google:** Yeah, if I can just add on -- on the margin -- and go to your second part of the question, just a bit of context on the third quarter here. An important point, hopefully self-evident, is that the improvement in the Q3 operating margin does reflect the strong revenue growth in the quarter.

And as I said on the second quarter call, some of our costs are less variable in the short term, such as depreciation and the operations costs of our data centers. And we did have a gross margin benefit from this in the near term. But consistent with Sundar's comments and Philipp's, we do continue to invest here.

And then to support long-term growth across both Google Services and Google Cloud, we're continuing to invest at a meaningful clip across headcount, compute, sales and marketing. You know, I noted the headcount increase in Q3 of about 6,000. And we do expect the pace of hiring to remain strong.

The benefit from the change in useful lives was obviously in the quarter as well. And that benefit does diminish, is lower in the fourth quarter. So just to put some of that in context. And as Sundar said, we are continuing to invest in the business, focusing on long-term growth.

With respect to the Play changes, again, just as it relates to this quarter, and I think as I said in opening comments, the key point to note there was that results lapped, you know, the strength that we had in the -- going into the pandemic from user engagement. And that continues, seeing user engagement. But, yes, there is a reduction in the fee that kicks in. The one that we just announced last week, it kicks in as of January 2022. And we'll let you do the modeling on that.

**Justin Post, Bank of America Merrill Lynch:** Thank you.

**Operator:** Thank you. And our next question comes from Mark Mahaney from ISI. Your line is now open.

**Mark Mahaney, Evercore ISI:** Thanks. Two questions. Is there anything that suggests that some of these ATT headwinds for other people in the industry actually cause shifts in budget over to your platforms, your different platforms? That's for Philipp. And then, Ruth, just on the

margins, is there anything other than revenue overage, that really strong revenue performance, flowing against fixed costs and the extended depreciation schedules that's causing those margins to rise? Or have you been able to, you know, work out, eke out, tweak out, new efficiencies in the model itself? Thank you very much.

**Ruth Porat, CFO Alphabet and Google:** So why don't I start on that. The key point, as I said, is, it starts with strong revenue growth and just timing lags. Some of the costs, as I said, are, you know, kind of more fixed in the near term. But we do continue to invest. And you can see that in gross margin. You can see it in operating margin. And we are continuing to -- to invest to support growth we see in both Google Services and Google Cloud.

You know, in up-leveling the question, we've consistently said -- our focus in capital allocation is investing for long-term growth and innovation and making sure that we remain focused on that, those long-term opportunities.

At the same time, we've consistently also said that it's important to ensure that we're being sharp about investments within each product area. And we're continuing to do that, and we're continuing to focus on investing in what we call operational excellence to ensure we can deliver for all of our stakeholders in a high-quality way. And that includes all of our efforts around privacy, security, and content moderation. So you're seeing us continue to invest there. A bit of puts and takes. We're trying to ensure that we're setting up all of the areas to deliver for long-term high-quality performance and results.

**Sundar Pichai, CEO Alphabet and Google:** You know, on the first question around ad budgets and shift and stuff, I don't think there's anything notable that we have observed to comment on.

**Mark Mahaney, Evercore ISI:** Thank you very much.

**Operator:** Thank you. And our next question comes from Brent Thill from Jefferies. Your line is now open.

**Brent Thill, Jefferies:** Thanks. On Google Cloud, we continue to hear from the partners that the deal size is building, and BigQuery is having a big impact for a lot of your customers. Can you just talk to and expand on what you're seeing there, and any other noticeable trends that you're seeing now that maybe you hadn't seen in the past. Thank you.

**Sundar Pichai, CEO Alphabet and Google:** Well, thanks. Look, overall, you know, we continue to see strong momentum. The team is executing well. You mentioned BigQuery. Data and analytics and AI continues to be a kind of a foundational shift for what companies are trying to accomplish, and BigQuery does stand out there. And we are definitely seeing, you know, continued momentum there. It's a source of strength.

The other areas I would highlight are, security continues to be an increasing area of focus and a differentiator for us, given over two decades of investment we have had. We've pioneered zero trust and so on. So as cybersecurity elevates in concern across companies I talk to, and the CEOs, it's definitely been an area. Multi-cloud continues to be a differentiator. I do think customers are increasingly looking for it. And we've embraced it from early on, so that is an area as well.

But above all, I think we are very, very focused on industry value propositions, so really sharpening our solutions by vertical. And that's -- that's really helped us, you know, get some of the bigger deals you mention as well. And we'll continue doing that.

**Brent Thill, Jefferies:** Thank you.

**Operator:** Thank you. And our next question comes from Michael Nathanson from Moffett Nathanson. Your line is now open.

**Michael Nathanson, MoffettNathanson:** Thanks. I have one for Sundar and then one for Philipp. Sundar, you talked earlier about the JioPhone Next and the launch next week in India. I wonder if you can talk about the longer term opportunity for Alphabet in India, you know, from opening up that product. And any type of time frame when you think you will see maybe the benefits of what you're doing on the low price phone there.

And then for Philipp, it just seems longer term as mobile targeting becomes more difficult due to all these privacy changes that there has to be a mix shift in budgets. I wonder how do you think the value proposition of Search will change going forward? And what can you do, even more than you've done before, to take advantage of what looks like real challenges in the ability to target and measure when it comes to mobile search -- I mean when it comes to mobile -- mobile advertising? Thanks.

**Sundar Pichai, CEO Alphabet and Google:** You know, on India, thanks for the question. Look, I think obviously the pandemic has been hard, but through it all, you know, people are looking for access, and there has definitely been a wave of people who have adopted smartphones, and there is still -- we see the demand for people looking to shift from feature phones to smartphones. And so part of what excites me about the upcoming partnership with Jio in building a phone is -- really investing beyond just English and getting languages and getting the local needs right for people, and doing it in a way that many more people can take advantages of a smartphone.

So I view it as laying the foundation. You know, it's a version of digital transformation, and it's palpable, the demand we see. And, you know, I think over a three- to five-year time frame, it will end up having a lot of impact.

But overall, India, just like Asia Pacific, continues to be an exciting market for us. We see strength across the categories we are involved in, and so you'll continue to see us stay focused there.

**Philipp Schindler, SVP and CBO, Google:** And to the second part of your question, look, as I said, we see the future of digital advertising being built on advances in privacy-preserving on-device technologies. This is a big area that we've invested already and that we are going to invest in even more.

And as far as how we think about our runway for growth, we really think about improving user and advertiser experience for years and years to come, and we're always asking ourselves the same questions, right? How do we drive better answers to queries, especially on Search, especially including those with commercial intent. How do you use machine learning to deliver even more relevant and higher-quality experiences for users that then drive higher clicks and more conversions for advertisers.

So really our main goal is to consistently deliver great experiences for our users, drive incremental value for our partners, and making them successful. And as long as we do this and we continue to invest in the privacy-preserving technology as I mentioned, we should continue to see budgets move our way.

**Michael Nathanson, MoffettNathanson:** Thank you.

**Operator:** Thank you. And our next question comes from Ross Sandler from Barclays. Your line is now open.

**Ross Sandler, Barclays:** Hey, guys. I just had a high-level question on YouTube. So you're obviously doing really well there, and as large as it is and as high as the engagement is compared to just about any other app that we see across the broader Internet, the revenue at just around \$30 billion this year pales in comparison to, you know, core Facebook or Instagram. So do you think that, you know, this is, obviously, a huge opportunity for YouTube, especially with Connected TV? Is there something that you guys need to change about your approach with either direct sales or kind of decoupling Search from YouTube and some of the other products that Google has under the same roof, or do you kind of think continuing along the same path is the right strategy for YouTube specifically? Any color on that would be helpful.

**Sundar Pichai, CEO Alphabet and Google:** Look, I think, you know, obviously YouTube is unique in the sense that it's a true video-native, video-first product from day one, and so you are dealing with a new form. And obviously as a company, I think we have taken a long-term view, which is why you see the engagement on the product. It's working at scale. Content responsibility has been our most important focus for the past many years.

And beyond that, I think we worked hard to make sure both creators can do well and, you know, it's a great platform for advertisers. We've had strength in brand. We've built on it with robust momentum in direct response. There's obviously, you know, newer opportunities such as shopping which we are investing in. And Shorts represents an additional early but important area for us from an investment and a growth standpoint. So I – I feel the fundamentals of the platform are strong, and with the long-term view, I see this as an area where we have more upside. And so we'll continue our investments with that in mind.

**Operator:** Thank you. And our next question comes from Colin Sebastian from Baird. Your line is now open.

**Colin Sebastian, Baird:** Thank you. A couple of big-picture questions. Sundar, first off looking at GCP and some of the innovations you've talked about like distributed cloud, I just wonder what you think the long-term future is for hybrid cloud environments. Are they really -- or is this just really a part of the process or stepping stones to bring more companies or most companies over to full cloud adoption?

And then, secondly, we're seeing a clear blurring of the lines among eCommerce, digital payments and social platforms. So I was hoping you could share the vision for Google and YouTube and the other Google apps in this context, how those pieces fit together as a closed loop shopping platform, if that's the right way to think about it. Thank you.

**Sundar Pichai, CEO Alphabet and Google:** You know, to your first question on GCP, part of our strength is, you know, we have taken a very open and scalable and flexible approach, and, you know, we don't view it as a one size fits all. So we want to meet the customers the way they



want to take this journey and I think are gearing up to support them both from a multi-cloud, from a hybrid cloud standpoint.

But I do think -- you know, I do think over time, you know, when I look at the scale at which we are investing to support, particularly to my points earlier around security and so on, I think people will see the value, more, of a hosted cloud solution. But I think we -- you know, I think we want to be customer-centric here, and, then, you know, we want to go where the market goes. And that's why we've built -- built the scalable infrastructure we have. So I'm excited about the opportunity there.

On your second question around eCommerce, digital platforms, shopping, social, how does it all fit together? You know, for me, I see it as two things. One is we want to get the primitives right, which means as a user, being able to, be it in Search, in YouTube, either on the products or as you -- you know, we are trying to connect merchants to users, right? And be it organically or through advertising. And so we are investing in identity, payments, making sure it's seamless for users. And so that's a big part of our focus.

The second is really from a user experience standpoint, both in Search and in YouTube and other areas like Maps and Discover, over time. We want to make sure if users want to act more beyond discovery and they want to do more, that it's seamless to do so. But we're going to be very focused on making sure for merchants that, you know, that they get access to users, and that's the value proposition we deeply care about, and so we'll invest with that view in mind.

**Colin Sebastian, Baird:** Okay. Thank you very much.

**Operator:** Thank you. And our last question comes from the line of Stephen Ju from Credit Suisse. Your line is now open.

**Stephen Ju, Credit Suisse:** Okay. Thank you. So, Sundar, I think in the past we've talked about the intersection of hardware and software for Google. And, you know, you touched on the Pixel 6 as well as the other examples in your prepared remarks. But as you look at all the different directions you're going with Fitbit, Nest, and all the other devices, how has your thinking evolved over the years? And what do you envision a hardware and software, you know, integrated Google meaning to the consumer over the longer term?

And I guess, Philipp, if you look at some of the emerging and developing markets today, you know, some of the companies there around the world have had to play multiple roles in helping to solve for transactional friction by rolling out payments, logistics and other solutions that we probably take for granted here in the States. So do you think Google should or could play a more expansive role in India and some of the other emerging markets to help accelerate the growth of eCommerce versus the role that, you know, you play in the U.S. and the West. Thanks.

**Sundar Pichai, CEO Alphabet and Google:** Overall, hardware and computing, obviously we -- you know, we have been doing this for a while now. You know, if you look at the Google Tensor bet, these are multi-year bets which, you know, which finally play out. And I couldn't be more excited at the reception for Pixel -- Pixel 6 and Google Tensor. And I think, you know, this lays a good foundation for what we want to do in the future.

We definitely have a long-term view on where computing is headed -- we want to make sure -- and to innovate there you have to think at the intersection of user experience, software and

hardware. I think we have a unique perspective to bring, unique point of view with our AI-first approach and applying that to bring -- bring new features and new experiences.

So we'll be doing it to push computing forward. We want to guide our ecosystem. When we do well in a category, the whole ecosystem benefits from it. And finally, we're going to be doing this with a view towards building a sustainable business. And we see this as an important area, and we are investing with that viewpoint. And I'm really excited, you know, with what Google Tensor and the Pixel 6 team has been able to accomplish, and I view it just as a start.

**Philipp Schindler, SVP and CBO, Google:** So on the second part of your question, look, every commerce experience is also a payment experience, and a friction-laden checkout can take the joy out of a purchase. I think we all have been there. So think about Google Pay as a checkout facilitator. We want to make it even easier for consumers to access whatever payment method they really want: credit card, PayPal, Shop Pay, and so on and so on. And to the global nature of your question, 150 million people across 40 countries are now using Google Pay to manage transactions and stay on top of their finances, and millions of merchants are using it to provide their customers with a simple and safe way to check out, whether it's in store or online or the via their app. So right now we continue to be very focused on helping both merchants and financial institutions create more intuitive digital experiences and connect with their customers. In the U.S., we're partnering with merchants to surface, we call them card-linked offers and coupons within Google Pay. And in August we announced the partnership with Setu – a fintech company in India, that was a part of your question, to help users open fixed deposit accounts directly from Google Pay. So we think there's much more that we can do for both consumers and our partners, so stay tuned on this one.

**Stephen Ju, Credit Suisse:** Thank you.

**Operator:** Thank you. And that concludes our question and answer session. I'd like to turn the conference back over to Jim Friedland for any closing remarks.

**Jim Friedland, Director Investor Relations:** Thanks, everyone, for joining us today. We look forward to speaking with you again on our fourth quarter 2021 call. Thank you, and have a good evening.

**Operator:** Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.