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EARNINGS

Google Shows First Cracks in Years

Parent company Alphabet posts slowest revenue growth since 2015

People line up to enter the Google booth during CES 2019 in Las Vegas. **PHOTO**: JUSTIN SULLIVAN/GETTY IMAGES

By Rob Copeland

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Google's once-untouchable online-advertising operation took a body blow, hurt by mounting competition and struggles within its increasingly high-profile YouTube unit.

Google parent Alphabet Inc. in the first quarter posted its slowest revenue growth since 2015. The poor results highlight the risks for one of Silicon Valley's biggest names in effectively leaning on one massive, if lucrative, business.

> For all its myriad arms and efforts to diversify, Google remains essentially an old-fashioned billboard operation with a high-tech gloss—and it now faces more rivals.

The company's results are an outlier amid what has otherwise been a steady earnings season in the technology sector. Peers like Facebook Inc. and Twitter Inc. previously posted strong earnings, while Amazon.com Inc. last week reported record profit that will allow it to pour fresh cash into improving its Prime membership program.

Alphabet shares fell 7% Monday after hours, with the drop picking up during the earnings call as executives declined to answer direct questions about the flagging growth. Nearly an hour in, one analyst, Ross Sandler of Barclays, audibly sighed. “I guess I’ll beat a dead horse on the deceleration,” he said.

“We are very excited about the opportunities across the board,” responded Chief Financial Officer Ruth Porat.

If Alphabet shares drop in regular trading on Tuesday to match the after-hours decline, that would wipe more than $60 billion from the company’s market capitalization and mark the worst single-day session in nearly seven years. Before the earnings report, shares were up 24% this year.

Alphabet reported first-quarter revenue of $36.3 billion, roughly $1 billion short of forecasts. Per-share earnings of $9.50 also disappointed, and were a substantial fall from a year earlier, when results were supercharged by the conglomerate marking up its stakes in private technology companies.

Growth slowed across the board. Revenues were up 17% year-over-year, compared with 26% in last year’s first quarter. The company’s margin, a constant concern for analysts and investors, fell to 18%, compared with 25% last year.

The crimped margin can in part be blamed on last month’s $1.7 billion fine from European regulators for abusing the dominance of its search engine and limiting competition. Excluding the fine, the company’s margin came in at 23% and its per-share earnings were $11.90.

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The longer-term issue, however, is competition. Rivals like Amazon, once content to play in their own corners of the Silicon Valley sandbox, are making big plays at online advertising. In a potentially existential threat to Mountain View, Calif.-based Google, more online shoppers now begin their searches directly on Amazon than on search engines.

Ms. Porat and Chief Executive Officer Sundar Pichai repeatedly said on the call that the company was experimenting with changes to the advertising product that hurt short-term growth, but neither went into specifics, nor said whether they applied to desktop or mobile platforms.

The shift to mobile is a long-term drag for Google, which annually pays billions to rivals like Apple Inc. to place advertisements onto rival phones. Google was able to keep a lid on such "traffic acquisition costs" in the quarter, coming in lighter than analysts expected. That figure marked one of the few bright spots in the company's earnings.

YouTube, perhaps the company's most closely watched arm, remains a financial black box. Hailed as an inspired acquisition 13 years ago, Google still hasn't broken out the unit's results in an earnings report. That has left investors to piece for clues, as expensive forays into original programming and cable-television replacement services have thus far failed to pay off.

Analysts estimate YouTube is responsible for around 15% of Google's sales. On the call, Ms. Porat said that growth in clicks on the platform fell in the first quarter.

YouTube has recently attracted criticism that it doesn't effectively control the sometimes dangerous content posted and promoted on the video-streaming service. The rising costs likely reflect additional efforts by the company to police the platform, not unlike the heavy investment Facebook has made in response to critiques about its products.

Mr. Pichai said that reducing harmful content was "the most important area of focus" for YouTube.

In a milestone long on the horizon, Google this quarter stretched to a record in employment, adding another 18,000 jobs and crossing what is at least a psychologically significant barrier of 100,000 full-time employees. That surely understates total head count, as Google doesn't detail its burgeoning contract workforce.

The new faces are a sign of success, but introduce risks. Some current and former employees lament what they call the slow degradation of the company's entrepreneurial culture, and the cost of fighting for Silicon Valley talent places increasing pressure on Google's bottom line.

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