Google delivers 3Q letdown early, stock plummets (Update 2)

October 18 2012, by Michael Liedtke

In this Monday, Sept 17, 2012, file photo an unidentified man's shadow reflects on a commercial bus with an advertisement for Google Mail, in Lagos, Nigeria. Google Inc.'s stock plunged suddenly on Thursday Oct. 18, 2012, after a contractor prematurely released the search company's third-quarter earnings report. (AP Photo/Sunday Alamba)

As far as unpleasant surprises go, Google hit Wall Street with a double whammy Thursday.

The Internet search leader that prides itself on organizing the world's information lost control of its own data when a contractor released its third-quarter earnings report more than three hours before the numbers were supposed to come out.

As if that wasn't jarring enough, the results alarmed investors because the company's earnings and revenue fell well below analyst projections. The disappointment triggered an 8 percent drop in Google's stock price that erased about $20 billion in shareholder wealth.

"This is a monumental failure of epic proportions," said Michael Robinson, an executive vice president for the Levick Strategic Communications, which specializes in financial crisis management. "This was bad news compounded by bad process. It came out in the worst way possible."

Google Inc. blamed printer R.R. Donnelley & Sons Co. for filing the company's quarterly statement with the Securities and Exchange Commission more than three hours ahead of schedule.

"We are fully engaged in an investigation to determine how this event took place and are pursuing our first obligation, which is to serve our valued customer," R.R. Donnelley said in a statement.

The embarrassing mix-up prompted Google CEO Larry Page to preface his review of the quarter with an apology during a conference call with analysts.

"I am sorry for the scramble earlier today," Page said, still sounding hoarse from a mysterious throat ailment. The problem left Page unable to speak during the summer, causing him to skip Google's second-quarter earnings call three months ago.

Page went on to paint a bright picture, not only of the most recent quarter, but for the next few years. "Every day, I wake up and I am delighted about our opportunities to keep growing," he said.

The pep talk didn't immediately resonate with investors.

Google's stock initially plunged more than 9 percent after the early release of the results. Trading was then suspended to allow more time for the information to be digested. After a nearly three-hour break, investors decided the results weren't quite as bad as they initially appeared, and the shares recovered slightly.

Even so, the stock wound up dropping $60.49, or 8 percent, to close at $695.

In this Wednesday, Oct. 17, 2012, file photo, people attend a workshop, "New York Get Your Business Online," at Google offices in New York. Google Inc.'s stock plunged suddenly on Thursday, Oct. 18, 2012, after a contractor prematurely released the search company's third-quarter earnings report. (AP

Photo/Mark Lennihan, File)

The sell-off reflects a reversal of the optimistic sentiment that had propelled Google's stock to an all-time high earlier this month. The stock had surged 27 percent in the three months before Thursday's unsettling developments.

Google earned $2.18 billion, or $6.53 per share, during the three months ending in September. That compared with net income of $2.73 billion, or $8.33 per share, last year.

The earnings would have been $9.03 per share, if not for Google's accounting costs for employee stock compensation and the Motorola charges. Analysts polled by FactSet were expecting $10.63 per share, on average.

Revenue climbed 45 percent from last year to $14.1 billion. Excluding compensation for websites that generate traffic for Google's ads, revenue was $11.33 billion. Analysts were expecting $11.86 billion

Most of the trouble appeared to be concentrated in Motorola Mobility, a troubled cellphone maker that Google bought for $12.4 billion in May. Analysts have been fretting that Motorola Mobility would turn into a financial albatross, and some of those fears appeared to be realized in the latest quarter spanning from July through September.

The device maker suffered an operating loss of $527 million, more than tripling from the same time last year when it was still an independent company.

Google is trying to improve Motorola Mobility's performance by laying off about 20 percent of its workforce—about 4,000 employees—and closing one-third of its 90 plants and office. Those cost-cutting measures resulted in $349 million in charges during the quarter. But it still could take a few years for Google to turn around Motorola Mobility, Chief Financial Officer Patrick Pichette said on the conference call.

The stronger dollar also hurt Google, just as it has many other U.S. companies that do a lot of business in other countries. That's because overseas sales are now translating into fewer dollars than a year ago, resulting in less revenue. Excluding Motorola Mobility, Google said its revenue for the latest quarter would have been $557 million, or 5 percent higher, if currencies had remained at the same levels as a year ago.

But there were also some worrisome signs in Google's main business of selling online advertising.

Google's ad revenue rose 16 percent from the same time last year, the slowest pace in three years. The company's ad revenue had climbed by at least 21 percent in each of the previous 10 quarters.

Advertising accounts for 77 percent of Google's revenue. The rest comes from Motorola Mobility and other products, such as Google's recently released Nexus 7 tablet computer.

As has been the case for the past year, the average prices companies pay Google for ads appearing alongside search results also fell. The year-over-year decline for advertiser's "cost-per-click" on Google's ads declined 15 percent from the same time last year.

The decelerating growth in ad revenue is likely being driven by the growing use of smartphones and tablet computers to access the Internet.

The ads are more difficult to see on smartphones, in particular, so marketers aren't willing to pay as much for those commercial messages as they do for ads that are seen by people on personal computers. And people relying on mobile devices tend to use specially designed applications that so far haven't been set up to show as many ads as can be seen in Web browsers. People using mobile apps also have less reason to conduct searches on Google, depriving the company of opportunities to show ads.

"I am not at all worried about this because I think we are better positioned than most companies," Page assured analysts.

Google is reaping more revenue from the rapidly growing mobile market, largely because of its Android software than now powers more than 500 million smartphones and tablet computers. The company gives away Android to device makers, but the software is fruitful for Google because it's designed to drive up more traffic to its search engine and other services that show ads.

Page said the mobile market is now generating about $8 billion in annual revenue, including sales of applications, video, books and music in its Play store. Not all of those, sales, though, are recorded in Google's books because most of the money goes to developers, studios and publishers. A year ago, Google said the mobile market was generating about $2.5 billion in annual revenue, but that figure consisted entirely of ads, so it's not an apples-to-apples comparison to the $8 billion.