APPENDIX C: Profitability Analysis

Summary

C.1 As part of our investigation, we have undertaken an analysis of the financial performance of Google's general search services, which can be one indicator of Google's market power, as set out in our guidance.[1]

C.2 In this Appendix we set out the issues in assessing the profitability of Google's general search services and our findings on the profitability of Google, having considered Google's responses to our financial information requests and publicly available financial information.

C.3 Since our SMS assessment relates to Google's market position in the UK, we are interested in the profitability of Google's UK general search services. However, to help inform this assessment we have started with global figures, recognising that the digital activities we are assessing are global in nature, and because Google did not provide information on the profitability of its general search services at a UK level.[2]

C.4 Our analysis is therefore based on global data from Google supplemented by information we obtained from Google to enable more detailed breakdowns and UK specific analysis where appropriate.

C.5 On the basis of this analysis, our view is that Google is earning profits very significantly above its cost of capital.

C.6 We have found the following:

(a) Google has been highly profitable over the last ten years in absolute terms, and its actual return on capital has been very significantly above its benchmark cost of capital;

(b) our estimate of Google's return on capital from its general search services, including for the UK, is higher than 40%, using a sensitivity based analysis; and

(c) Google's UK general search services have, in 2024, continued to generate profits over and above our estimate of Google's weighted average cost of capital (**WACC**) of [10-15]% based on Google's estimation of WACC for the Alphabet Group.[3]

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[1] See CMA194, paragraph 2.55(e). Digital Markets Competition Regime Guidance
[2] Google's consolidated response to the CMA's RFI.
[3] Google's consolidated response to the CMA's RFI.

C.7 We have also compared Google's recent financial performance with its financial projections relating to future revenues and profitability, and have seen no evidence that these high levels of profitability would not continue.

Contents of this Appendix

C.8 This appendix has the following sections:

(a) Our approach to profitability analysis;

(b) Our assessment of Google's publicly available profitability indicators;

(c) Our analysis of the profitability of Google's general search services; and

(d) Our emerging findings from the profitability analysis we carried out on Google.

C.9 We have conducted a profitability analysis to identify whether Google generates profits at a level that indicates it has substantial market power, either from general search services or indirectly, for example, where its general search services support Google's ability to earn significant profits from other activities.[4]

C.10 We have focused on a few standard reporting metrics to inform our analysis of Google's revenues, costs, and profits. In particular:

(a) We have assessed the amount of profit Google has earned in absolute terms using the metric 'earnings before interest and taxation' (**EBIT**).

(b) We have analysed the level of its profits with reference to the 'return on capital employed' (**ROCE**). This approach compares accounting profit with the size of investment made by firms to achieve those profits.

(c) We have compared our ROCE findings against Google's WACC, which is a widely used benchmark for returns on an investment. The WACC is essentially the minimum return required on an investment or asset to satisfy the owners and creditors.

(d) We have also compared Google's recent financial performance with its financial projections relating to future revenues and profitability.

[4] As identified in CMA194, paragraph 2.55(e), one indicator of a firm with market power would be earnings which are significantly and persistently above normal returns.

Proposed approach to our profitability analysis

C.11 In the following section we set out the business activities we consider to be relevant, the time periods over which we propose to assess profitability, and the ROCE-based approach we are applying.

Business activities

C.12 We are interested in the profitability of Google's general search services in the UK, and asked Google to provide UK-level revenue, profitability and balance sheet asset data, but [✂].[5]

C.13 Google explained that it considers its business as a global entity, [✂],[6] and did not provide:

(a) UK-level profitability data;[7] and

(b) country level or product level asset data.[8]

C.14 We considered requiring that [✂] but decided that this was not necessary for the purpose of our SEMP assessment. Google told us that it [✂], and that [✂].[9] [✂], we have [✂] assumed a similar cost profile for the UK as on a global basis,[10] as explained in more detail below.

C.15 Our analysis is therefore based primarily on global data, supplemented by information we obtained from Google to enable more detailed segmental breakdowns and UK specific analysis where appropriate, due to:

(a) the integrated nature of the products and services Google provides;

(b) the global nature of Google's general search services;

(c) the global nature of its financial reporting, asset base and [✂]; and

(d) the limited availability of UK specific profitability data.

Time period under consideration

C.16 For our SEMP assessment, we are interested in understanding whether Google has been earning consistently high profits in the past and is likely to continue to do so. For that reason, we have aimed to look back over a time period that is

[5] Google's consolidated response to the CMA's RFI. Google's consolidated response to the CMA's RFI.
[6] Google's consolidated response to the CMA's RFI.
[7] Google's consolidated response to the CMA's RFI.
[8] Google's consolidated response to the CMA's RFI.
[9] Google's consolidated response to the CMA's RFI.
[10] [✂].

sufficiently long to provide a representative picture of profitability and that is not unduly distorted by unusual macroeconomic conditions or one-off events.

C.17 We have sought to balance this aim with the constraints faced by Google to provide us with [✂], for example.

C.18 We have therefore assessed Google's overall group-level profitability based on publicly available financial information over a ten-year period. We have also assessed the operating profitability of its general search services over the period 2022 to 2024.

C.19 We have also considered the likely profitability of Google's general search services beyond 2024, including in relation to the UK, to the extent that our review of Google's internal documents suggests that this may be meaningful.

Overarching conceptual approach

Return on capital employed versus cost of capital

C.20 The analysis of profitability as an indicator of market power is based on the premise that under effective competition a firm would generally earn no more than a 'normal' rate of profit over the long run.[11]

C.21 For the purpose of this profitability assessment, we consider a 'normal' level of profit can be defined as the minimum level of profits required to keep the factors of production in their current use in the long run, i.e. the rate of return on capital employed for a particular business activity would be equal to the opportunity cost of capital for that activity.[12]

C.22 The rationale for benchmarking return on capital with the opportunity cost of capital is that, under effective competition, if firms persistently earned in excess of the return required to compensate investors for the risks taken, we would expect these profits to attract entry and/or expansion.[13] This entry/expansion would serve to compete away profits in excess of the cost of capital up until the point where firms cover their total costs, including a market-based cost of capital, and no more. Where firms persistently earn in excess of a normal return, this signals that there may be limitations in the competitive process.

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[11] As identified in CMA194, paragraph 2.55(e), one indicator of a firm with market power would be earnings which are significantly and persistently above normal returns.
[12] CMA194 does not itself define what constitutes a normal rate of profit. For the purpose of the profitability analysis set out in this appendix, we consider that the CMA's definition of 'normal returns' in the Guidelines for market investigations offers a useful reference point. See CC3, paragraph 116. CC3 (Revised), Guidelines for market investigations: Their role, procedures, assessment and remedies
[13] The time period over which this process may take place may differ between different sectors due to the time taken for entry and/or expansion of capacity.

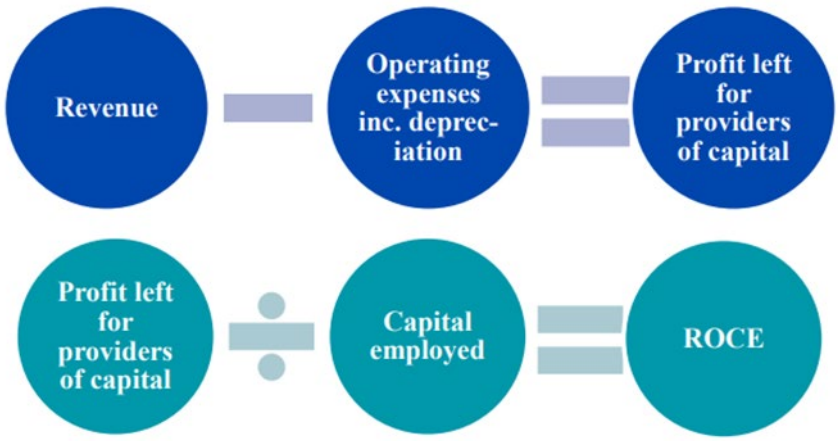
C.23 Return on capital can be based on cash flows (internal rate of return (**IRR**)) or profits (ROCE). These approaches are very similar in substance, with the choice between them determined in part by industry characteristics and in part by data availability.

C.24 We have considered different approaches to assessing Google's profitability and have taken the approach of comparing its ROCE with the cost of capital. Use of ROCE allows us to calculate annual profitability and thus provides insights into trends over time and the drivers of profits which may exist above the 'normal' level.

C.25 We consider that the pattern of ongoing variable capital investments (as opposed to large one-off investments) and the lack of any obvious time period to use as investment entry and exit assumptions means that ROCE is more suitable than IRR for measuring profitability. We would not expect an IRR assessment to produce materially different results to a ROCE assessment.[14]

C.26 Figure C.1 below illustrates how ROCE is calculated.

Figure C.1: The components of ROCE



Source: CMA analysis. Note, profit left for providers of capital can be distributed or reinvested in the business.

C.27 ROCE is the annual return made on the investments needed to run the business, and is calculated by dividing EBIT by the value of capital employed (calculated as total assets minus current liabilities) in the relevant business. The general principle is that all revenues, costs, assets and liabilities necessarily arising from the operation of the business to supply the relevant activities should be included. In practice this means the following items should be excluded:

[14] Provided that analysis is undertaken carefully, with various adjustments made, ROCE assessment is equivalent to an IRR assessment and is also, therefore, conceptually robust. See The Economic Analysis of Accounting Profitability (1987), Jeremy Edwards, J A Kay, Colin P Mayer, for a fuller discussion of the conditions under which the ROCE and IRR approaches are equivalent.

(a) financing costs both of a profit and loss and balance sheet nature (eg cash, interest and sources of finance), regardless of whether they are short- or long-term; and

(b) taxation on income and any associated corporation tax or deferred tax assets and liabilities.

C.28 The ROCE is then benchmarked against the opportunity cost of capital, which is the WACC, over the relevant period(s) of analysis. The WACC is the return on investment that providers of capital– both debt and equity – expect, given the risks associated with the relevant activity.[15]

C.29 A finding that ROCE is higher than the WACC is not in itself an indicator of market power. A firm that innovates and gains a competitive advantage may earn higher ROCE for the period that it is able to sustain that competitive advantage

C.30 For the purpose of our SMS investigation, we do not consider it necessary to define a specific value for the differential between Google's ROCE and WACC that would indicate a level of profits above the 'normal' level. When considering whether the differential is substantial, we will take into consideration the size of this differential and the length of time over which the differential persists.

Economic versus accounting profitability

C.31 When estimating ROCE, our approach is to start with accounting figures from the profit and loss account and balance sheet of the relevant activities, and then make adjustments to arrive at an economically meaningful measure of profitability.

C.32 An important factor to consider when selecting an appropriate measure of profitability in relation to Google's general search services will be data availability. Where possible, the CMA will base its calculations on financial data that can be reconciled to audited financial statements, albeit with appropriate adjustments.

C.33 There is also the need to obtain an appropriate value for capital employed. Obtaining a value for capital employed can present difficulties irrespective of the choice of profitability measurement method; a return on capital approach requires an economically meaningful value for the capital base, which may not accord with the value ascribed in the financial records.

C.34 We may consider adjustments to accounting data produced in line with UK Generally Accepted Accounting Practice (**GAAP**) relating to the difference between historical cost and replacement cost, and relating to the inclusion of certain intangible assets where certain criteria are met. We may also consider

[15] WACC is therefore expected return on equity and expected return on debt, weighted by gearing – the relevant proportions of debt and equity.

adjustments to cost or asset allocations on a case-specific basis to account for the activities which are the subject of the investigation, where a firm undertakes other business activities and/or where there are material intercompany transactions.

Limitations of a ROCE versus WACC framework

C.35 We recognise that economic profitability analysis, based on a ROCE versus WACC framework, requires certain assumptions to be made. The results from economic profitability analysis can be sensitive to ranges around these assumptions, particularly with regard to asset valuations. Where relevant, therefore, we have considered the sensitivity of our analysis to the assumptions we have used.

C.36 We recognise that in digital markets, where there is significant internal investment in assets such as intellectual property (**IP**), R&D and patents, rather than acquisition of technology from third parties, that for some activities the value of those assets may not be fully reflected in the book value of the capital employed, and we have therefore conducted a sensitivity analysis.

CMA assessment of Google's publicly available profitability indicators, including in relation to its general search and search advertising

C.37 In assessing Google's financial performance, we have begun our assessment by considering the profitability of Google and its Google Services reporting segment, which can be directly observed from the financial statements.

C.38 In this section we consider profitability indicators based on publicly available information for Google and its main reporting segments:

(a) we consider Google's overall size and financial position, based on the consolidated financial statements of the Alphabet Group;[16]

(b) we consider Google's segmental reporting structures;

(c) we consider the profitability indicators for Google Services, and additional disaggregated revenue data available within this reporting segment; and

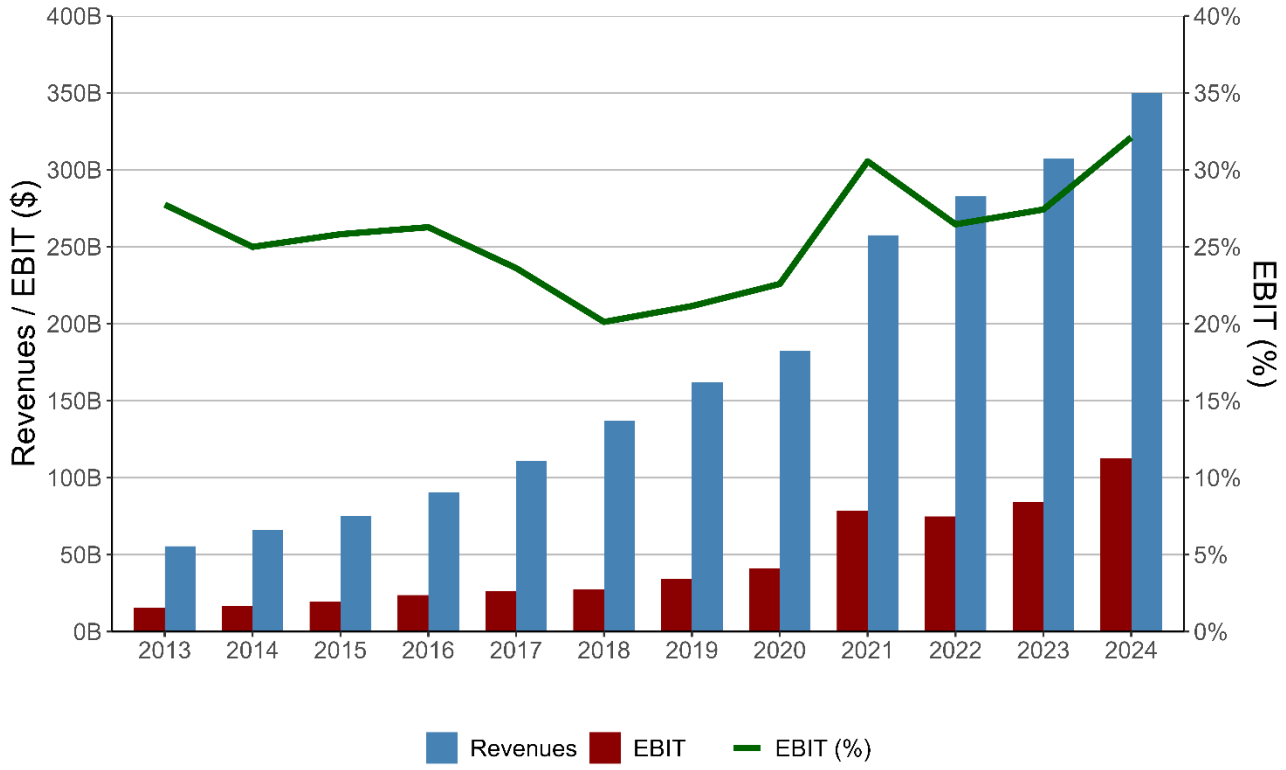
(d) we summarise our findings.

[16] We have considered Google's profitability based on the consolidated financial position of the Alphabet Group (Google's parent company).

Overall size and financial position

C.39 Google has been profitable for at least the last 20 years, since its IPO in 2004,[17] and its revenues have grown significantly in every year since. Figure C.2 demonstrates Google's total group level profitability for the last ten years. The Alphabet Group generated worldwide revenues of $350 billion and global operating income of $112 billion in the financial year ending 31 December 2024.[18] Its percentage profit margins, measured as EBIT as a percentage of revenue, have remained consistently high and its profit margin has been above 25% for the last four years.[19]

Figure C.2: Alphabet Group Revenue and Profit between 2015 and 2024 ($ billion)



Source: CMA analysis of Alphabet Group 10k data[20]

C.40 Google is also highly cash generative. In the financial year ending 31 December, Google generated operating cashflow of $125 billion, and returned almost $70 billion to shareholders through a combination of dividends and share buybacks.[21]

[17] Alphabet Inc and its predecessor Google Inc.
[18] Form 10-K for Alphabet INC filed 02/05/2025, page 53.
[19] EBIT is based on Google's Income from Operations as reported in its Consolidated Statements of Income in published accounts. Form 10-K for Alphabet INC filed 02/05/2025, page 53.
[20] CMA analysis of Alphabet Inc Consolidated Statements of Income on page 53 of Form 10-K for Alphabet INC filed 02/05/2025.
[21] Form 10-K for Alphabet INC filed 02/05/2025.

C.41 Google is not an 'asset-light' business. Its cumulative capital expenditure and R&D expenditure over the last three financial years were $116 billion[22] and $134 billion[23] respectively. In 2024, it reported just under $360 billion of assets (excluding cash, cash equivalents and marketable securities), including $171 billion of tangible assets relating to property and equipment.[24]

Segmental reporting

C.42 Google is an integrated global firm, providing a range of services in addition to its general search services. For segmental reporting purposes, Google's financial statements break down reporting into three main segments:

- Google Services includes products and services such as ads, Android, Chrome, hardware, Google Maps, Google Play, Search, and YouTube.
- Google Cloud includes Google's infrastructure and data analytics platforms, collaboration tools, and other services for enterprise customers.
- Other Bets which Google refer to as a combination of multiple operating segments that are not individually material from a revenue perspective. These businesses are generally not directly related to Google's core businesses.[25]

C.43 In addition, there are certain costs that are not allocated to individual business segments, but are instead recorded as Alphabet-level activities. These costs primarily include certain AI-focused shared R&D activities, including development costs of its general AI models, as well as certain corporate and legal costs.[26]

C.44 On a geographic basis, Google splits its business into three main geographic segments for revenue reporting purposes: US, EMEA, APAC and Other Americas. Google's UK operations are part of the EMEA reporting region, representing Europe, the Middle East and Africa.[27]

C.45 In our assessment of Google's profit margins, we started with information contained within the Alphabet Group financial statements. Using Google's measure of 'cost of revenues' within its 10K report, we calculated that Google generated a gross margin of 58% and an operating margin of 32% in 2024.[28]

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[22] Purchases of property and equipment for the financial years ending 31 December 2022, 31 December 2023 and 31 December 2024. Source: Alphabet plc 10-K 2024 page 56.
[23] Research and Development costs for the financial years ending 31 December 2022, 31 December 2023 and 31 December 2024. Source: Alphabet plc 10-K 2024 page 53.
[24] Form 10-K for Alphabet INC filed 02/05/2025, page 52.
[25] Form 10-K for Alphabet INC filed 02/05/2025, page 88.
[26] Page 88 of Alphabet plc 10-K 2024 explains that certain costs which represent Alphabet-level activities are not allocated to Google's segments.
[27] Form 10-K for Alphabet INC filed 02/05/2025, page 64.
[28] CMA analysis of segmental reporting on page 88 of Form 10-K for Alphabet INC filed 02/05/2025.

Google Services segment

C.46 As described above, Google reports an integrated set of results for the 'Google Services', separate to 'Google Cloud' and 'Other Bets'.[29]

C.47 Google's general search services are part of Google Services, which generated revenues of $305 billion for the financial year ending 31 December 2024.[30]

Figure C.3: Google Segmental Operating income – 2024

Segmental Operating Income	Google Services	Google Cloud	Other Bets	Alphabet level activities[31]	Total Group
Revenue ($ billion)	305	43	2	0	350
Operating income ($ billion)	121	6	(4)	(11)	112
Operating margin (%)	**40%**	**14%**	**n/a**	**n/a**	**32%**

Source: CMA analysis of Alphabet Group 10k data[32]

C.48 Overall, Google Services represents 87% of Google's total group revenue earned in 2024.

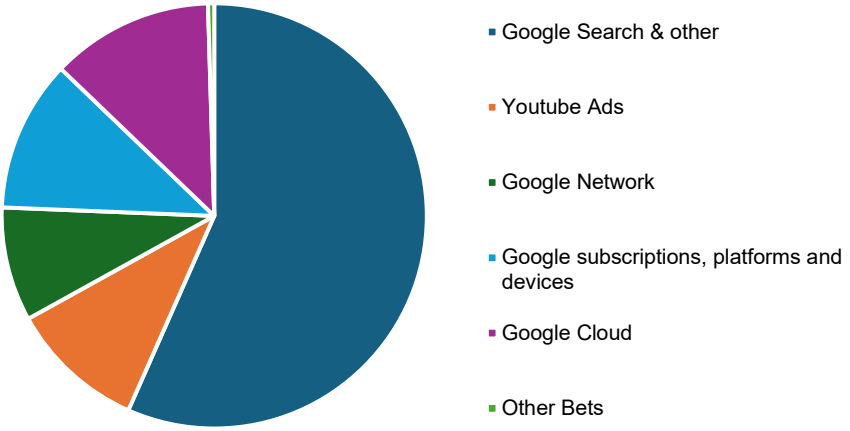
Disaggregated segmental revenues

C.49 In addition to the above segmental reporting, Google also provides limited disaggregated segmental revenue data for certain products and services within Google Services, including 'Google Search & other', which is where Google's general search services revenues are reported. Google describes its 'Google Search & other' segment as including revenues from traffic generated by search distribution partners who use Google Search as their default search in browsers, toolbars, etc. and other Google owned and operated properties like Gmail, Google Maps, and Google Play.

C.50 Based on Google's disaggregated segmental revenue analysis, the 'Google Search & other' segment was the largest contributor to global revenues, with reported revenues of $198 billion for the financial year ending 31 December 2024, and 57% of total group revenues as shown in Figure C.4 below, and has continued to grow as shown in Figure C.5.

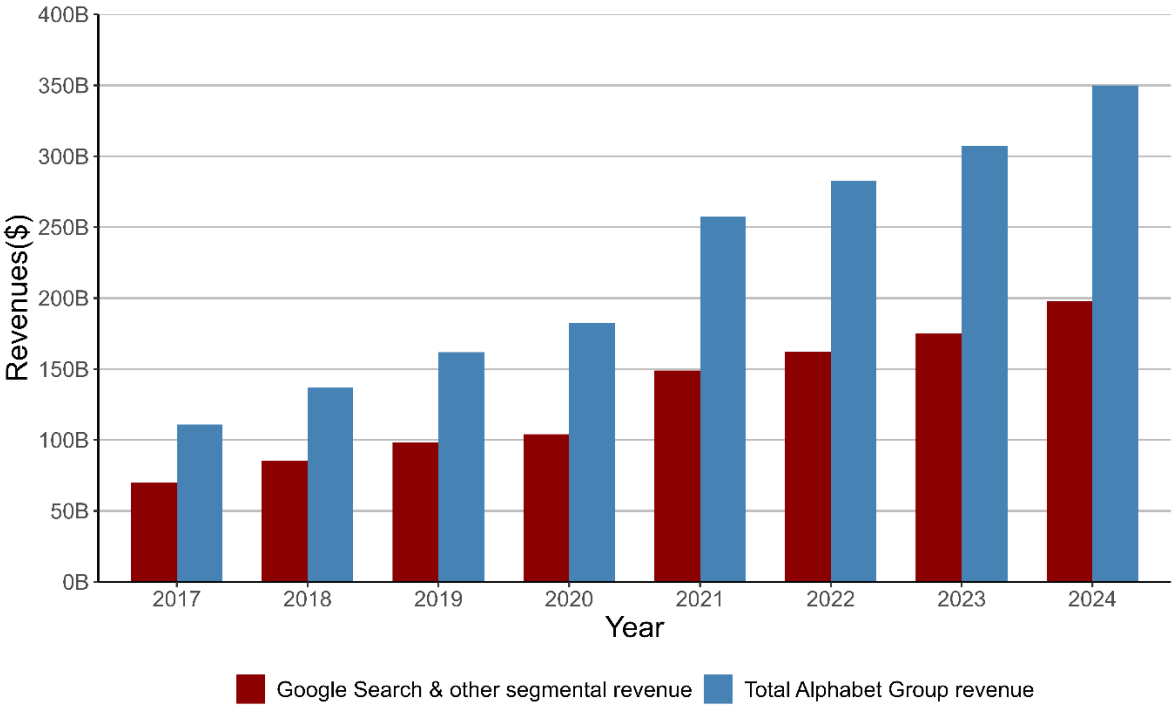
[29] Form 10-K for Alphabet INC filed 02/05/2025, page 30.
[30] Form 10-K for Alphabet INC filed 02/05/2025, page 88.
[31] Revenue figure includes also the separately reported Hedging Gains Revenues.
[32] Segment results on page 88 of Form 10-K for Alphabet INC filed 02/05/2025.

Figure C.4 Alphabet Group disaggregated segmental revenue 2024 (%)



Source: CMA analysis of Alphabet Group 10k data[33]

Figure C.5 Global revenues for the Google Search & other reporting segment and Alphabet Group 2017-2024 ($ billion)



Source: CMA analysis of Alphabet Group 10k data[34]

[33] CMA analysis of segmental revenues excluding hedging gains on page 64 of Form 10-K for Alphabet INC filed 02/05/2025.
[34] CMA analysis of disaggregated segmental reporting on page 64 of Form 10-K for Alphabet INC filed 02/05/2025, page 53 of Form 10-k for Alphabet NC filed 3 February 2020 and page 60 of Form 10-K for Alphabet Inc filed 1 February 2022.

C.51 Google does not publish profitability indicators for its disaggregated reporting segment.

CMA analysis of the profitability of Google's general search services

C.52 In this section, we summarise our analysis of the returns earned by Google in relation to its general search services.

C.53 We have identified three relevant levels within Google's financial reporting hierarchy for assessing the profitability of Google's general search services:

(a) Alphabet Group: We have begun our profitability assessment by considering Google's overall profitability, based on what can be directly observed from its consolidated financial statements and for which balance sheet reporting is available.

(b) Google Services: We have assessed the profitability of the Google Services, because of the high proportion of revenues and profits for this segment which are derived from Google's general search services, the complementarity of some of the other services within this segment to Google's general search services (eg Chrome, Android), and the availability of operating margin data. However, we recognise that this reporting segment includes some other services (such as YouTube) that we do not consider directly relevant to assessing the profitability of Google's general search services.

(c) Google Search and Search Advertising: Google Search and Search Advertising is a product area within the 'Google Search & other' disaggregated revenue reporting segment, and is made up of Google's revenue-generating 'Search Ads' business and its free 'Search Organic' business.[35] We have assessed the profitability of Google's general search services based on financial information for the Search and Search Advertising product area. We asked Google what metrics it uses to measure the profitability of its general search services, and Google told us that it measures profitability across its business using operating income and operating margin as the relevant metrics, as reported in is Form 10-K.[36]

C.54 In this section we set out our analysis of Google's general search services based on information we have obtained from Google.

(a) First we calculate ROCE for the Alphabet Group;

Disaggregated segmental reporting for the Google Search & Other is not available for periods prior to the financial year ending 31 December 2017.

[35] Google's consolidated response to the CMA's RFI.

[36] Google's consolidated response to the CMA's RFI.

(b) Second we calculate ROCE for Google Services;

(c) Third we assess the profitability of the Search & Search Advertising product area.

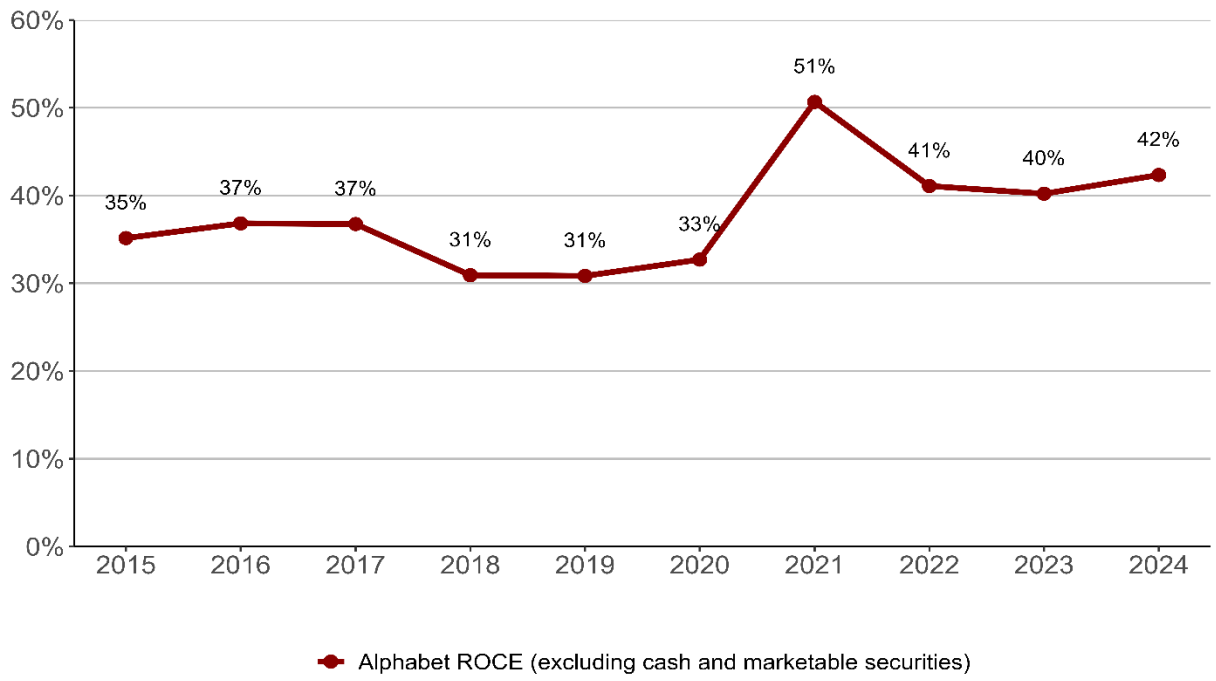
Alphabet Group and Google Services Return on Capital Employed (ROCE)

C.55 In this section we compare the ROCE of the Alphabet Group and Google Services to the benchmark return of the WACC.

Alphabet Group ROCE

C.56 We have considered Google's overall ROCE, measured as EBIT[37] divided by capital employed (calculated as total assets excluding cash and marketable securities minus current liabilities)[38] based on published asset values in the Alphabet Group accounts.

Figure C.6: Alphabet Group return on capital employed 2015 – 2024



Source: CMA analysis of Alphabet Group 10K data[39]

[37] EBIT is based on the Alphabet Group's Income from Operations as reported in its Consolidated Statements of Income in published accounts. Form 10-K for Alphabet INC filed 02/05/2025, page 53.
[38] Capital employed is calculated by reference to Google's Consolidated balance sheets in its published, by deducting Google's reported Total Cash, Cash Equivalent and Marketable Securities from its reported Total Assets. Form 10-K for Alphabet INC filed 02/05/2025, page 52. As is discussed in more detail below, cash and marketable securities have been excluded on the basis that they represent means of funding the capital employed by the business, rather than an operational balance.
[39] Form 10-K for Alphabet INC filed 02/05/2025, pages 52-53.

C.57 Figure C.6 above demonstrates that over the last ten years, we estimate that Google has been able to generate an average ROCE of 38%, and that this has been trending higher in the last few years.

C.58 As described above, we compare ROCE to the benchmark return of the WACC. We have estimated Google's WACC to be around [10-15]%, based on Google's own estimation of WACC for the Alphabet Group.[40]

C.59 On the basis that the actual ROCE for Google's overall business has been around 30-40% or above for at least ten years, we therefore conclude that ROCE is and has been consistently higher than the benchmark WACC.

Google Services ROCE

C.60 We have also considered Google Services ROCE, as Google's general search sits within Google Services. We consider that an analysis of Google Services ROCE should be more reflective of the returns of a standalone general search services business than Google's overall ROCE.

C.61 Based on information provided in Google's 10-K, we have estimated the returns earned by Google Services. Wherever we have had a choice of different assumptions, we have sought to identify conservative assumptions which may if anything understate the ROCE of Google Services.

C.62 We have conservatively estimated the profitability of Google Services as follows:

(a) Revenues and costs were as reported in the filed 10-K form for 2024;

(b) All assets and liabilities on the balance sheet are assumed to relate to Google Services. This resulted in an asset base of $265 billion.[41] This is likely to overstate the Google Services asset base, as Google will also have invested in tangible assets in relation to its cloud segment.

(c) All Alphabet-level costs are assumed to relate to Google Services.

C.63 Google has explained that it does not allocate certain costs to its segments, because they represent Alphabet-level activities, and that these costs primarily include certain AI-focused shared R&D activities, including development costs of its general AI models, as well as certain corporate and legal costs.[42] In taking a conservative approach, we assumed that these are fully allocated to Google Services.

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[40] Google's consolidated response to the CMA's RFI.
[41] CMA analysis of Alphabet Inc Consolidated Financial Statements on page 52 of Form 10-K for Alphabet INC filed 02/05/2025.
[42] Form 10-K for Alphabet INC filed 02/05/2025, page 88.

C.64 This is a conservative assumption for a number of reasons:

(a) some of these costs would relate to overheads serving both the Google Services and Cloud segments;

(b) some of these costs do not relate to Google's operating segments (eg fines and settlements); and

(c) some of these costs relate to restructuring activities that may not be in the ordinary course of business.[43]

C.65 Using this approach, we calculated a ROCE for 2024 Google Services of 42%,[44] consistent with Google's overall ROCE in 2024, and well above our estimated Google WACC of [10-15]%,[45] even after allocating total Alphabet Group assets to this segment.

Search and Search Advertising profitability.

C.66 For the purposes of our analysis of the profits earned from general search services, we are interested in the returns which Google would earn if it operated this business separately. This analysis should be more reflective of the returns of a standalone general search services business than an assessment of Google or Google Services, but requires additional assumptions to be made given that Google does not produce separate accounts for its general search services.

C.67 In this section we first consider revenues and profit margins, and then consider ROCE. Although we are interested in the profitability of general search services in the UK, we conducted our analysis primarily on a global basis, to reflect the fact that [✂]. Our analysis is based on information provided by Google.

Google Search and Search Advertising global revenues and operating profits

C.68 In this section, we consider revenue and profit margins for the Google Search and Search Advertising product area. Our objective is to understand whether Google would still make high profit margins in the UK if it only owned a general search services business.

[43] Google discloses that its Alphabet level costs in 2024 include charges associated with employee severance pays and office space reductions which were not allocated to its segments. Form 10-K for Alphabet INC filed 02/05/2025, page 88
[44] We calculated this by adjusted reported operating profit for Google Services segment for 2024 from $121.3 billion to $110.7 billion, to include reported Alphabet-level costs of $10.5 billion, and divided this by the total asset base of $265.5 billion, which gave us ROCE of 42%.
[45] Google's consolidated response to the CMA's RFI.

C.69 In order to understand the key drivers of profitability in relation to its general search services we asked Google to provide certain information about the share of revenues and operating profits for these activities for the period 2022-2024.

C.70 Google told us that it does not [✂].[46]

C.71 Google told us that, [✂].[47]

C.72 Google also notes [✂].[48]

C.73 Whilst there may be some limitations associated with the data provided by Google, we are nonetheless of the view that it provides a reasonable guide to the scale of the relative profitability of Google's general search and search advertising activities.

C.74 We have found that Google Search and Search Advertising was highly profitable in absolute terms and its operating profit margin is higher than for the rest of the Alphabet Group, as shown in Table C.1 below.

Table C.1: Google Search and Search Advertising revenues and profits

Google Search	*2022*	*2023*	*2024*
Global revenues ($ billion)	[✂]	[✂]	[✂][49]
Global operating profit ($ billion)	[✂]	[✂]	[✂]
Operating margin (%)	[✂]	[✂]	[✂]
UK revenue ($ billion)	**[✂]**	**[✂]**	**[✂]**

Source: CMA analysis [50]

C.75 Google's estimated operating profit margin for Search and Search Advertising for the financial year ending 31 December 2024 was higher than for Google Services and for the Alphabet Group as a whole, which had operating profit margins of 40% and 32% respectively.[51]

C.76 In the UK, Google Search and Search Advertising generated revenues of $[✂] billion (£[£10-20] billion),[52, 53] accounting for [60-70]% of Google's total UK revenues of $[✂] billion (£[10-20] billion).[54]

[46] Google's consolidated response to the CMA's RFI.
[47] Google's consolidated response to the CMA's RFI.
[48] Google's consolidated response to the CMA's RFI. In particular, these costs include costs for Google Search & Other disaggregated reporting segment, for example Shopping, Gmail and Travel.
[49] Revenues for the Search and Search Advertising product area account for a significant majority of the revenues for the Search Ads & other disaggregated reporting segment.
[50] Google's consolidated response to the CMA;s RFI.
[51] CMA analysis of segmental reporting on page 64 of Form 10-K for Alphabet INC filed 02/05/2025.
[52] Google's consolidated response to the CMA's RFI.
[53] [✂].
[54] Google's consolidated response to the CMA's RFI.

C.77 If we assume Google's Search and Search Advertising operating margin in the UK is the same as globally, then, on the above analysis, this would imply UK operating profit in the region of $[✂] (c.£[✂]).[55]

Search and Search Advertising return on capital employed (ROCE)

C.78 In this section, we summarise the analysis we have performed of the returns earned by Google, in relation to its Search and Search Advertising product area.

C.79 Google was founded in 1998 with the intention of creating a search engine for the Internet.[56] It was successful almost from the start and has been highly profitable for a large number of years.

C.80 We have assessed the returns earned by Google and its investors in 2024 from Search by comparing the profits earned from Search and Search Advertising to the investments made in assets acquired to operate Search and Search Advertising.

C.81 We have measured the ROCE Google earns from Search and Search Advertising and compared the size of these returns against Google's group level WACC, based on a breakdown of Google's total costs and assets into those attributable to Search and Search Advertising, and other costs and assets not attributable to search. In some cases, this cannot be done exactly, as both costs and assets are shared across businesses, and so we have made estimates. Our analysis is based on information provided by Google.

C.82 To complete this assessment, we have:

(a) measured the revenues attributable to Google's general search business;

(b) measured the direct costs, and estimated the operating costs attributable to the search business; and

(c) estimated the relevant measure of Google's investment in building up its general search services.

C.83 Wherever we have had a choice of different assumptions, we have sought to identify a conservative approach which may, if anything, understate the ROCE of search. The objective of our analysis is to compare Google's returns from its investments in Search to its WACC, and in doing so we have erred on the side of caution in coming to a lower estimate for the ROCE of the Search and Search Advertising product area.

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[55] CMA analysis using: Google's consolidated response to the CMA's RFI; Google's consolidated response to the CMA'. We have taken into consideration that traffic acquisition costs (TAC) [✂].
[56] www.google.com/search/howsearchworks/our-history [accessed 19 June 2025]

Inputs in assessing the profitability of Google general search services

Revenues and direct costs

C.84 We asked Google to break down its revenues and gross profit into its different businesses, and also geographically. However, in estimating ROCE, we have taken into account that the company operates globally, with many of Google's costs being incurred for the purpose of serving its global general search services, rather than the UK specifically, as well as the fact that Google did not provide UK level profitability data, and based our analysis on its global activities. Our analysis is therefore based on Google's global general search services.

C.85 We have also reviewed data that indicates that Google's revenues in the UK [✂], with [✂] of the revenue in 2024 being derived from Google Search and Search Advertising. Although Google records some costs which are directly attributable to this UK revenue, we have not attempted to estimate ROCE associated with the UK business separately, as it forms part of Google's integrated search business. Direct costs identified by Google include (among others) traffic acquisition costs (TAC), technical infrastructure costs, and engineering costs.[57]

Indirect costs

C.86 Indirect costs are those which are not directly attributable to products but are shared across some or all products and services that Google offers. Indirect costs include R&D, sales and marketing and general and administrative costs.

C.87 Between 2022 and 2024, Google invested approximately $134 billion[58] in R&D. However, Google's submissions show that the proportion of its [✂] than the proportion of [✂] .This was also the case for [✂][59]. Consequently, operating profit margin (as a percentage of revenue) of Google's general search services business, based on Google's estimate of operating expenses for Search and Search Advertising is [✂].

C.88 We note that identifying the revenues and costs associated with a standalone search business requires a number of assumptions, and Google's general search services will have benefitted from some of its investments in associated businesses. We have therefore conducted a sensitivity analysis in relation to the Google ROCE as set out below.

[57] Google's consolidated response to the CMA's RFI.
[58] Form 10-K for Alphabet INC filed 02/05/2025, page 56.
[59] Google's consolidated response to the CMA's RFI.

Asset base

Balance sheet as a starting point

C.89 Google publicly reports a consolidated balance sheet for the total Alphabet Group. Google's public accounts do not include segmental asset balances, and Google has told us that [✂][60], [✂][61]

C.90 In estimating the value of the asset base which directly relates to search, our starting point is therefore the reported assets for the Alphabet Group.

Working capital and tangible assets

C.91 We would expect the capital employed for Google's general search services to include working capital and tangible assets such as buildings, servers and network equipment.

C.92 Our analysis seeks to reflect the operational capital employed by the businesses. We would generally consider relevant tangible and intangible assets, including working capital (which we consider in our estimates of capital employed for our ROCE analysis) to determine this. However, any cash balances or marketable securities represent means of funding the capital employed by the business, rather than an operational balance. We are not aware of any legal or regulatory requirements for a search business to hold amounts of cash or marketable securities, and do not consider cash holdings and marketable securities to be relevant assets to include when estimating capital employed for Google in relation to its general search services.

C.93 Google's tangible assets are largely buildings and physical assets linked to providing Google's digital services, the largest of which is general search services. We have therefore assumed that all assets are shared and therefore necessary to replicate the search function, unless we have evidence that they are clearly separable from general search services such as non-marketable securities. We therefore use as a base case that all of Google's other tangible assets are required to operate general search services. This is a conservative approach and is consistent with our approach to operating costs associated with the technical operations of the search business above.

[60] Google's consolidated response to the CMA's RFI.
[61] Google's consolidated response to the CMA's RFI.

Intangible assets

C.94 We have considered whether we should include intangible assets in our estimate of the capital base. Intangible assets are assets such as goodwill, brand value and in-process research and development assets.

C.95 Our approach for considering intangible assets is based on the following set of criteria that we consider intangible assets should meet to be considered for inclusion in capital employed:

(a) it must comprise a cost that has been incurred primarily to obtain earnings in the future;

(b) this cost must be additional to costs necessarily incurred at the time in running the business; and

(c) it must be identifiable as creating such an asset separate from any arising from the general running of the business.

Goodwill

C.96 Goodwill can be acquired in a business combination. Acquired goodwill is not a separately identified asset but rather is a balancing figure. It is the remaining, unallocated element of an acquisition price once all tangible assets and certain (although not necessarily all) intangible assets have been fair-valued and set against the price paid. In principle, we consider that, when purchasing a business, goodwill may represent the value of intangible assets not capitalised on the businesses' balance sheets.

C.97 Our approach is to recognise those intangible assets that meet our criteria for recognition, regardless of whether they have been separately identified in the companies' balance sheets or are included in a balancing goodwill figure, but to exclude any remaining goodwill. This approach ensures that only intangible assets that meet our criteria for recognition are included in the estimate of the capital employed by Google in relation to its general search services. It also avoids the risk of capitalising any economic profit.

C.98 Based on available balance sheet reporting, we have conservatively included goodwill other than for businesses which are not engaged in activities relating to search.[62]

[62] Based on publicly available information, we have taken a conservative approach excluding only goodwill allocated to the Google Cloud and Other Bets reporting segments.

Brand value

C.99 We recognise that brand value, whether acquired or developed in house, could meet the criterion of comprising a cost that has been incurred primarily to obtain earnings in the future. An acquired brand appears more likely to meet the criterion of being additional to costs necessarily incurred at the time in running the business, whereas operating costs that contribute to developing brand value would be less likely to meet this criterion. We have therefore considered whether there is evidence of a Google brand value asset, and how that may have arisen.

C.100 We recognise that there is significant value in the Google brand. However, within the ROCE-based framework we are applying, our particular focus is on whether there is evidence of an investment in the Google brand asset that falls within the criteria which we have set out above.

C.101 Google does not record an intangible asset relating to brand value in its public accounts, and we have not seen evidence that Google's brand value would fall within our criteria for recognising an intangible asset. In particular we have not seen evidence that Google has incurred brand-related costs in addition to the costs it has necessarily incurred at the time in running its business.

C.102 We would normally expect that much of a firm's advertising spend might be correctly treated as current costs, and have not received specific evidence that Google's Advertising expense meets the criteria that would support capitalisation. We are therefore not aware of any brand asset investments that should be capitalised for the purpose of our ROCE assessment.

Investments in research & development

C.103 As discussed in more detail above (see paragraph C.36C.36), we recognise that in digital markets, where there is significant internal investment in assets such as IP, R&D and patents, rather than acquisition of technology from third parties, the value of those assets may not be fully reflected in the book value of the capital employed.

C.104 We have therefore conducted a high-level sensitivity analysis in relation to the Google ROCE relating to R&D expenditure as set out below.

Summary

C.105 In estimating the value of the asset base which directly relates to Google Search and Search Advertising we used publicly available information from financial statements.

C.106 Our assumption for the asset value of search reflects all of Google's fixed assets (with the exception of goodwill relating to businesses which are not engaged in

activities relating to search) and $14.9 billion assets classified as other non-current assets.

C.107 Taking these together provided us with an asset base for search of $208.1 billion, the majority of which is physical and technical infrastructure.[63,64]

C.108 We have conducted sensitivity analyses in relation to indirect costs and intangible assets as set out below.

Sensitivity Analysis

C.109 We recognise that economic profitability analysis, based on a ROCE versus WACC framework, requires certain assumptions to be made. The results from economic profitability analysis can be sensitive to ranges around these assumptions, particularly with regard to asset valuations.

Sensitivity 1: Investments in research and development

C.110 The first sensitivity analysis we have conducted is to test the sensitivity of our ROCE to changes in intangible assets relating to R&D expenditure.

C.111 Under accounting principles, R&D is typically treated as an expense and accounted for in the firm's profit and loss account. However, there may be circumstances where this expenditure leads to the creation of an asset that will provide future economic benefits and therefore represents capital investment from an economic perspective. In these circumstances, the level of capital employed recorded on a firm's balance sheet may be understated.

C.112 One potential approach to ROCE for a firm investing in long-term assets through R&D is to adjust the capital employed to include that part of the firm's R&D expenditure, ie to assume it creates an intangible asset. Such a change would have two offsetting effects on the calculation of ROCE. In addition to increasing the firm's level of capital employed by moving expenses into its capital base, the firm's EBIT will also increase since it removes some of its operating expenses out of its cost base, which is only partially offset by the effect of amortising that asset. In other words, both profit and capital employed will increase. As a result, while this could change the percentage ROCE, the impact may be relatively limited.

C.113 We have not seen specific evidence that expensed R&D spend meets the criteria that would support capitalisation, and we would normally expect that much of a firm's R&D investment would relate either to expansion into new business

[63] Form 10-K for Alphabet INC filed 02/05/2025.page 42. Google reported Property and equipment of $171 billion, net of depreciation, as at 31 December 2024, of which the majority related to technical infrastructure and to assets not yet in service.
[64] Calculated as the sum of net property and equipment ($171.0 billion), goodwill ($23.5) and operating lease assets ($13.6 billion). Form 10-K for Alphabet INC filed 02/05/2025.page 78

ventures outside the scope of current businesses, or to incremental improvement to products which might be correctly treated as current costs.

C.114 However, we recognise that for the software development costs associated with general search services for example, there may be uncertainty both as to whether a cost might meet the criteria for capitalisation and the value that may apply. We have tested the sensitivity of our ROCE for each additional 10% of Google's annual R&D cost that is amortised rather than being expensed, assuming an amortisation period of up to 5 years.[65]

C.115 Based on this high-level scenario, we have found that even if we capitalised an additional 10-20% of annual R&D expenses[66] over a five-year period, Google's ROCE is only reduced by 1-2%, from 42% to 40%,[67] and remains substantially higher than its estimated WACC even if we apply this form of sensitivity.

C.116 We have not tried to refine these estimates further at this stage. Our intention was to identify whether Google still earns high profit margins if we adjust its intangible asset base to take into consideration the risk that R&D asset investments are understated in its reported balance sheet assets, and found that it does.

Sensitivity 2: Indirect costs

C.117 The second sensitivity analysis we have conducted is to test the sensitivity of our ROCE to changes in indirect cost allocations, by calculating a lower estimate of operating profit, under which a higher proportion of centrally incurred Google Services costs are allocated to Search and Search Advertising, as set out in the table below:

Table C.2 Summary of our approach to revenues and costs

Input	*Base case*[68]	*Lower estimate*
Revenue	Search and Search Advertising revenues, as provided by Google	No change
Direct costs	Search and Search Advertising direct costs, including (among others) TAC, technical infrastructure and engineering costs, as provided by Google	No change
R&D costs	Search and Search Advertising R&D costs, as provided by Google	Revenue based allocation of a share of R&D costs for Google Services[69]

[65] In the absence of more accurate information, our scenario conservatively assumes a five year straight line amortisation period for software development costs, which is not dissimilar to Google's reported depreciation period for servers and network equipment of 6 years. Form 10-K for Alphabet INC filed 02/05/2025.page 62.
[66] Based on publicly reported R&D expenses in the Alphabet Inc. Consolidated Statements of Income on page 52 Form 10-K for Alphabet INC filed 02/05/2025, and page 50 of Form 10-K for Alphabet Inc filed 1 February 2022.
[67] CMA analysis of publicly available data in the Alphabet Inc. Consolidated Statements of Income and Consolidated Balance Sheets on pages 52 and 53 of Form 10-K for Alphabet INC filed 02/05/2025.
[68] [✂].
[69] R&D costs for Google Services were based on [✂].

Other overheads	Other Search and Search Advertising overhead costs, as provided by Google	Revenue based allocation of a share of overheads for Google Services,[70] plus a share of non-allocated Alphabet level costs.[71]

Source: CMA analysis[72]

C.118 The 'Base Case' is based on Google's own estimate of indirect costs relating to Search and Search Advertising. The 'lower estimate' assumes a higher share of overheads incurred within the total Alphabet Group.

C.119 Taking these assumptions together, we expect that our 'lower estimate' will underestimate the profit attributable to Search, potentially significantly, as it assumes that a standalone general search services business would:

(a) incur the same levels of traffic acquisition costs (TAC) as Google; and

(b) incur indirect costs significantly higher than those which Google has indicated are directly related to the provision of general search services.

C.120 Under our lower estimate of indirect costs, we have still found that ROCE is significantly higher than WACC, and higher than the overall Google Services WACC, because [✂].

Our analysis and findings of Google Services segment ROCE in relation to Google Search and Search Advertising ROCE

C.121 Calculating ROCE on the basis of the assumptions above, we have found that the ROCE of a standalone search business would be higher than the ROCE earned by the Alphabet Group in 2024.

C.122 As described above, we have considered the sensitivity of our profitability analysis to the assumptions we have made, including in relation to indirect costs and to intangible assets, and have estimated a range for returns associated with search on that basis, and these do not change our finding that Google's search activities are highly profitable.

C.123 At this stage we do not consider it necessary or proportionate to refine these estimates further since we consider that on any reasonable basis the ROCE for Google's general search services is significantly greater than its WACC.

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[70] Other overhead costs for Google Services were based on [✂].
[71] Based on an adjusted figure for Alphabet level costs for 2024, which excludes $1.0 billion of employee severance and related charges and $0.8 billion of office space reduction charges. See Form 10-K for Alphabet INC filed 02/05/2025, pages 35 and 88.
[72] CMA analysis using: Google's consolidated response to the CMA's RFI; and Google's consolidated response to the CMA's RFI. [✂].

Our estimate of Google's UK general search services profits

C.124 For illustrative purposes we have considered how ROCE would convert into an annual profit number as an estimate of how much profit Google's UK general search services business earned over and above our estimate Google's WACC, based on its own estimate of WACC for the Alphabet Group.

C.125 To calculate our estimate of UK general search services profit above benchmark levels for Google for 2024 we have:

(a) First, taken our 2024 global Search and Search Advertising ROCE calculation, and compared it with an expected investor return of [10-15]% based on Google's own estimated WACC for the Alphabet Group,[73] to estimate the global economic profit from Search and Search advertising; and

(b) Second, used UK total revenue as a percentage of global Search and Search Advertising revenue to estimate an economic profit figure for Google's UK Search and Search advertising activities, applying this ratio to global economic profits.[74]

C.126 As with our analysis of Google's global ROCE for Search and Search Advertising, we have considered a number of scenarios for how to calculate this measure, and our assessment is that they all suggest at least a comparable level of returns.

C.127 Following this approach, we found that Google's UK Search and Search Advertising business earned at least £3-4 billion more profit in 2024 than a return based on its estimate of WACC.[75]

Forecast future performance

C.128 As part of the SMS investigation, we have also compared Google's recent financial performance with its financial projections relating to future revenues and profitability, based on available information, in order to assess whether current trends in revenues and profitability are expected to continue into the future.

C.129 As part of this assessment, we have reviewed search and search advertising revenue projections submitted by Google for the period [✂].:

(a) [✂].[76]

[73] Google's consolidated response to the CMA's RFI.
[74] [✂].
[75] CMA analysis using: Google's consolidated response to the CMA's RFI; and Google's consolidated response to the CMA's RFI.
[76] Google's consolidated response to the CMA's RFI.

(b) [✂].[77]

Conclusion

C.130 Our analysis of Google's financial performance illustrates that it has consistently been highly profitable over the last ten years, including in relation to its general search services.

C.131 We have found through our profitability analysis that the global return on capital employed for Google has been at a level which may be one indicator of substantial market power.

C.132 We have demonstrated this by comparing our estimates of Google's ROCE – its actual profitability – with Google's estimate of the Alphabet Group WACC.

C.133 We have also found that Google has for many years been making operating profit margins from its general search services that are higher than for its overall business:

(a) The Google Search & Other revenue reporting segment was the largest contributor to Google's global revenues, with reported revenues of $198 billion for the financial year ending 31 December 2024.[78]

(b) This segment includes the Google Search and Search Advertising product area, which is made up of Google's revenue-generating 'Search Ads' business and its free 'Search Organic business'.

(c) Google's search and search advertising product area generated global revenues and operating profit of $[✂] billion and $[✂] billion in the financial year ending 31 December 2024, and UK revenues of $[✂] billion (£[10-20] billion). Its global operating profit margin of [✂]% is higher than the 40% for the overall Google Services segment and 32% for the total Alphabet Group.

C.134 Taking into consideration that Google's operating profit margins for its general search services are higher than for its business as a whole, we consider Google's general search services are at least as profitable as the Alphabet Group. We consider that Google is likely to generate a ROCE higher than 40% from search, including for the UK, even when adopting a conservative sensitivity analysis, for example in relation to R&D costs and allocation of Alphabet Group level costs.

C.135 Given the global nature of Google's cost reporting structures, and having seen no evidence that Google's UK general search services have materially higher operating costs [✂], we estimate that Google's UK general search services are

[77] Google's consolidated response to the CMA's RFI.
[78] Form 10-K for Alphabet INC filed 02/05/2025, page 88

generating a ROCE higher than our estimate of Google's weighted average cost of capital.

C.136 We estimate that this high return means that Google was able to earn at least £3-4 billion of profits in 2024 from its UK general search services over and above a return based on Google's estimation of the WACC for the Alphabet Group of [10-15%].[79, 80]

C.137 Based on our review of Google's own financial projections relating to future revenues and profitability (see paragraphs C.128–C.129), we have seen no evidence that these high levels of profitability would not continue.

[79] Google's consolidated response dated to the CMA's RFI.
[80] CMA analysis using: Google's consolidated response to the CMA's RFI; Google's consolidated response to the CMA's RFI.