Google Inc.
Form 10-Q
August 04, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission file number: 000-50726

Google Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0493581**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

1600 Amphitheatre Parkway

Mountain View, CA 94043

(Address of principal executive offices)

(Zip Code)

(650) 253-0000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨

Non-accelerated filer (Do not check if a smaller reporting company) ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

At July 31, 2009, there were 241,971,977 shares of Google s Class A common stock outstanding and 74,599,324 shares of Google s Class B common stock outstanding.

Table of Contents

GOOGLE INC.

INDEX

		Page No.
	PART I. FINANCIAL INFORMATION	
Item 1	Financial Statements	
	Consolidated Balance Sheets December 31, 2008 and June 30, 2009 (unaudited)	3
	Consolidated Statements of Income Three and Six Months Ended June 30, 2008 and 2009 (unaudited)	4
	Consolidated Statements of Cash Flows Six Months Ended June 30, 2008 and 2009 (unaudited)	5
	Notes to Consolidated Financial Statements (unaudited)	6
Item 2	Management s Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3	Quantitative and Qualitative Disclosures About Market Risk	41
Item 4	Controls and Procedures	43
	PART II. OTHER INFORMATION	
Item 1	Legal Proceedings	44
Item 1A	Risk Factors	44
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	56
Item 4	Submission of Matters to a Vote of Security Holders	57
Item 6	Exhibits	58
	Signatures	59
	Exhibit Index	60
	Certifications	

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GOOGLE INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except par value per share)

	As of December 31, 2008	As of June 30, 2009 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 8,656,672	$ 11,911,351
Marketable securities	7,189,099	7,432,655
Accounts receivable, net of allowance of $80,086 and $93,025	2,642,192	2,701,912
Deferred income taxes, net	286,105	575,976
Income taxes receivable, net		145,843
Prepaid revenue share, expenses and other assets	1,404,114	1,067,116
Total current assets	20,178,182	23,834,853
Prepaid revenue share, expenses and other assets, non-current	433,846	406,136
Deferred income taxes, net, non-current		124,647
Non-marketable equity securities	85,160	93,925
Property and equipment, net	5,233,843	5,005,900
Intangible assets, net	996,690	856,386
Goodwill	4,839,854	4,836,913
Total assets	$ 31,767,575	$ 35,158,760
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 178,004	$ 221,914
Accrued compensation and benefits	811,643	589,862
Accrued expenses and other current liabilities	480,263	411,226
Accrued revenue share	532,547	550,199
Deferred revenue	218,084	227,761
Income taxes payable, net	81,549	
Total current liabilities	2,302,090	2,000,962
Deferred revenue, non-current	29,818	31,675
Income taxes payable, net, non-current	890,115	1,232,984
Deferred income taxes, net, non-current	12,515	
Other long-term liabilities	294,175	298,283
Stockholders equity:		
Convertible preferred stock, $0.001 par value, 100,000 shares authorized; no shares issued and outstanding		
Class A and Class B common stock, $0.001 par value: 9,000,000 shares authorized; 315,114 (Class A 240,073, Class B 75,041) and par value of $315 (Class A $240, Class B $75) and 316,422 (Class A 241,785, Class B 74,637) and par value of $316 (Class A $242, Class B $74) shares	315	316

issued and outstanding, excluding 26 and 2 Class A shares subject to repurchase at December 31, 2008 and June 30, 2009		
Additional paid-in capital	14,450,338	15,044,103
Accumulated other comprehensive income	226,579	81,434
Retained earnings	13,561,630	16,469,003
Total stockholders equity	28,238,862	31,594,856
Total liabilities and stockholders equity	$ 31,767,575	$ 35,158,760

See accompanying notes.

Table of Contents

GOOGLE INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Revenues	$ 5,367,212	$ 5,522,897	$ 10,553,255	$ 11,031,887
Costs and expenses:				
Cost of revenues (including stock-based compensation expense of $9,363, $13,592, $18,511 and $26,129)	2,147,575	2,107,971	4,258,111	4,209,475
Research and development (including stock-based compensation expense of $187,281, $182,209, $381,081 and $350,770)	682,210	707,626	1,355,279	1,349,269
Sales and marketing (including stock-based compensation expense of $42,593, $57,294, $85,169 and $116,320)	484,552	469,039	931,450	902,980
General and administrative (including stock-based compensation expense of $33,539, $39,975, $68,794 and $77,334)	474,910	364,367	884,215	812,678
Total costs and expenses	3,789,247	3,649,003	7,429,055	7,274,402
Income from operations	1,577,965	1,873,894	3,124,200	3,757,485
Interest and other income (expense), net	57,923	(17,718)	225,266	(11,508)
Income before income taxes	1,635,888	1,856,176	3,349,466	3,745,977
Provision for income taxes	388,497	371,631	794,989	838,604
Net income	$ 1,247,391	$ 1,484,545	$ 2,554,477	$ 2,907,373
Net income per share of Class A and Class B common stock:				
Basic	$ 3.97	$ 4.70	$ 8.15	$ 9.21
Diluted	$ 3.92	$ 4.66	$ 8.04	$ 9.15

See accompanying notes.

Table of Contents

GOOGLE INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended June 30,	
	2008	2009
	(unaudited)	
Operating activities		
Net income	$ 2,554,477	$ 2,907,373
Adjustments:		
Depreciation and amortization of property and equipment	589,280	632,111
Amortization of intangibles and other	138,851	148,068
Stock-based compensation expense	553,555	570,553
Excess tax benefits from stock-based award activities	(94,979)	(36,359)
Deferred income taxes	(105,890)	(114,431)
Other, net	(24,658)	(23,087)
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(296,376)	(41,728)
Income taxes, net	528,359	(63,518)
Prepaid revenue share, expenses and other assets	(182,803)	87,795
Accounts payable	39,237	41,815
Accrued expenses and other liabilities	(147,251)	(281,167)
Accrued revenue share	(16,450)	19,123
Deferred revenue	10,248	12,136
Net cash provided by operating activities	3,545,600	3,858,684
Investing activities		
Purchases of property and equipment	(1,539,114)	(402,192)
Purchases of marketable securities	(4,921,310)	(10,635,567)
Maturities and sales of marketable securities	7,416,559	10,435,309
Investments in non-marketable equity securities	(9,492)	(28,431)
Acquisitions, net of cash acquired, and purchases of intangible and other assets	(3,312,270)	(5,093)
Net cash used in investing activities	(2,365,627)	(635,974)
Financing activities		
Net proceeds (payments) related to stock-based award activities	(22,746)	9,995
Excess tax benefits from stock-based award activities	94,979	36,359
Net cash provided by financing activities	72,233	46,354
Effect of exchange rate changes on cash and cash equivalents	29,737	(14,385)
Net increase in cash and cash equivalents	1,281,943	3,254,679
Cash and cash equivalents at beginning of year	6,081,593	8,656,672
Cash and cash equivalents at end of period	$ 7,363,536	$ 11,911,351
Supplemental disclosure of cash flow information		
Cash paid for income taxes	$ 378,550	$ 1,013,431

See accompanying notes.

Table of Contents

GOOGLE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Google Inc. and Summary of Significant Accounting Policies

Nature of Operations

We were incorporated in California in September 1998. We were re-incorporated in the State of Delaware in August 2003. We provide highly targeted advertising and global internet search solutions as well as intranet solutions via an enterprise search appliance.

Basis of Consolidation

The Consolidated Financial Statements include the accounts of Google and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Unaudited Interim Financial Information

The accompanying Consolidated Balance Sheet as of June 30, 2009, the Consolidated Statements of Income for the three and six months ended June 30, 2008 and 2009, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2008 and 2009 are unaudited. These unaudited interim Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). In our opinion, the unaudited interim Consolidated Financial Statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of June 30, 2009, our results of operations for the three and six months ended June 30, 2008 and 2009, and our cash flows for the six months ended June 30, 2008 and 2009. The results of operations for the three and six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

These unaudited interim Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related notes included in our 2008 Annual Report on Form 10-K filed on February 13, 2009.

Use of Estimates

The preparation of interim Consolidated Financial Statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates. On an ongoing basis, we evaluate our estimates, including those related to accounts receivable and sales allowances, fair values of financial instruments, fair values of prepaid revenue share, intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of stock-based awards, and income taxes, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Fair Value of Financial Instruments

The carrying amounts of our financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximate fair value because of their generally short maturities.

Subsequent Events

We evaluated subsequent events through August 4, 2009, the date this Quarterly Report on Form 10-Q was filed with the Securities and Exchange Commission (SEC).

Effect of Recent Accounting Pronouncements

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 165, *Subsequent Events* (SFAS 165), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 also requires the disclosure of the date through which an entity has evaluated subsequent events and whether that evaluation date represents the date the financial statements were issued or were available to be issued. We adopted SFAS 165 in the second quarter of 2009 and the adoption did not have any impact on our consolidated financial statements.

Table of Contents

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS 167), which changes the consolidation rules as they relate to variable interest entities. Specifically, SFAS 167 makes significant changes to the model for determining who should consolidate a variable interest entity, and also addresses how often this assessment should be performed. SFAS 167 will be effective for us beginning in the first quarter of 2010. We do not expect the adoption will have a material impact on our consolidated financial statements.

Note 2. Net Income Per Share of Class A and Class B Common Stock

The following table sets forth the computation of basic and diluted net income per share of Class A and Class B common stock (in thousands, except per share amounts):

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2008		2009		2008		2009	
	(unaudited)							
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Basic net income per share:								
Numerator:								
Allocation of undistributed earnings	$ 947,389	$ 300,002	$ 1,133,204	$ 351,341	$ 1,935,792	$ 618,685	$ 2,217,731	$ 689,642
Denominator:								
Weighted-average common shares outstanding	238,481	75,481	241,143	74,763	237,748	75,935	240,731	74,856
Less: Weighted average unvested common shares subject to repurchase or cancellation	(138)	(7)	(5)		(197)	(13)	(11)	
Number of shares used in per share computation	238,343	75,474	241,138	74,763	237,551	75,922	240,720	74,856
Basic net income per share	$ 3.97	$ 3.97	$ 4.70	$ 4.70	$ 8.15	$ 8.15	$ 9.21	$ 9.21
Diluted net income per share:								
Numerator:								
Allocation of undistributed earnings for basic computation	$ 947,389	$ 300,002	$ 1,133,204	$ 351,341	$ 1,935,792	$ 618,685	$ 2,217,731	$ 689,642
Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares	300,002		351,341		618,685		689,642	
Reallocation of undistributed earnings to Class B shares		(2,889)		(2,571)		(5,738)		(4,245)
Allocation of undistributed earnings	$ 1,247,391	$ 297,113	$ 1,484,545	$ 348,770	$ 2,554,477	$ 612,947	$ 2,907,373	$ 685,397
Denominator:								
Number of shares used in basic computation	238,343	75,474	241,138	74,763	237,551	75,922	240,720	74,856
Weighted-average effect of dilutive securities								
Add:								
Conversion of Class B to Class A common shares outstanding	75,474		74,763		75,922		74,856	
Unvested common shares subject to repurchase or cancellation	145	7	5		210	13	11	
Employee stock options including warrants issued under	3,269	268	2,116	72	3,256	299	1,941	82

TSO program (see Note 11)								
Restricted shares and restricted stock units	792		514		769		350	
Number of shares used in per share computation	318,023	75,749	318,536	74,835	317,708	76,234	317,878	74,938
Diluted net income per share	$ 3.92	$ 3.92	$ 4.66	$ 4.66	$ 8.04	$ 8.04	$ 9.15	$ 9.15

Table of Contents

The net income per share amounts were the same for Class A and Class B because the holders of each class are legally entitled to equal per share distributions whether through dividends or in liquidation.

Note 3. Cash and Investments

Cash, cash equivalents and marketable securities consisted of the following (in thousands):

	As of December 31, 2008	As of June 30, 2009 (unaudited)
Cash and cash equivalents:		
Cash	$ 3,330,658	$ 3,564,341
Cash equivalents:		
U.S. government agencies		399,960
Municipal securities	14,250	
Time deposits	3,015,557	4,034,294
Money market mutual funds	2,296,207	3,912,756
Total cash and cash equivalents	8,656,672	11,911,351
Marketable securities:		
U.S. government agencies	3,342,406	3,273,384
Municipal securities	2,721,603	1,996,831
Money market mutual funds	73,034	34,636
Corporate debt securities	907,056	1,664,601
Agency residential mortgage-backed securities		252,232
Commercial mortgage-backed securities		48,324
Marketable equity security	145,000	162,647
Total marketable securities	7,189,099	7,432,655
Total cash, cash equivalents and marketable securities	$ 15,845,771	$ 19,344,006

Table of Contents

The following table summarizes unrealized gains and losses related to our investments in marketable securities designated as available-for-sale (in thousands):

	As of December 31, 2008			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies	$ 3,324,750	$ 17,747	$ (91)	$ 3,342,406
Municipal securities	2,690,270	34,685	(3,352)	2,721,603
Money market mutual funds	73,034			73,034
Corporate debt securities	903,963	3,265	(172)	907,056
Marketable equity security	145,000			145,000
Total	$ 7,137,017	$ 55,697	$ (3,615)	$ 7,189,099

	As of June 30, 2009 (unaudited)			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies	$ 3,264,275	$ 9,109	$	$ 3,273,384
Municipal securities	1,971,519	25,851	(539)	1,996,831
Money market mutual funds	34,636			34,636
Corporate debt securities	1,660,538	4,687	(624)	1,664,601
Agency residential mortgage-backed securities	252,974	376	(1,118)	252,232
Commercial mortgage-backed securities	47,898	426		48,324
Marketable equity security	145,000	17,647		162,647
Total	$ 7,376,840	$ 58,096	$ (2,281)	$ 7,432,655

Time deposits were held by institutions outside the U.S. at December 31, 2008 and June 30, 2009. Gross unrealized gains and losses on cash equivalents were not material at December 31, 2008 and June 30, 2009.

Our corporate debt securities are guaranteed by the full faith and credit of the United States government under the Federal Deposit Insurance Corporation s Temporary Liquidity Guarantee Program (TLGP) or the sovereign guarantee of foreign governments under similar programs to the TLGP.

Our agency residential mortgage-backed securities are specified pools of mortgage pass-through securities that are guaranteed by government-sponsored enterprises. Our commercial mortgage-backed securities are fully defeased securities with underlying collateral loans replaced by U.S. Treasury notes.

We recognized gross realized gains of $8.1 million and $19.6 million on the sale of our marketable securities for the three months ended June 30, 2008 and 2009. We recognized gross realized gains of $58.9 million and $53.9 million for the six months ended June 30, 2008 and 2009. Gross realized losses were not material in all periods presented. Realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of interest and other income (expense), net, in our accompanying Consolidated Statements of Income.

Table of Contents

The following table summarizes the estimated fair value of our investments in marketable securities, excluding the marketable equity security, designated as available-for-sale classified by the contractual maturity date of the security (in thousands):

	As of June 30, 2009 (unaudited)
Due within 1 year	$ 1,766,119
Due within 1 year through 5 years	3,616,321
Due within 5 years through 10 years	669,002
Due after 10 years	1,218,566
Total	$ 7,270,008

In accordance with FASB Staff Position (FSP) FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which amends the recognition guidance for other-than-temporary impairments (OTTI) of debt securities and expands the financial statement disclosure for OTTI on debt and equity securities, the following tables present gross unrealized losses and fair values for those investments that were in an unrealized loss position as of December 31, 2008 and June 30, 2009, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in thousands):

	As of December 31, 2008			
	Less than 12 Months		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government agencies	$ 183,054	$ (91)	$ 183,054	$ (91)
Municipal securities	274,042	(3,352)	274,042	(3,352)
Corporate debt securities	199,828	(172)	199,828	(172)
Total	$ 656,924	$ (3,615)	$ 656,924	$ (3,615)

	As of June 30, 2009			
	Less than 12 Months		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(unaudited)			
Municipal securities	$ 236,590	$ (539)	$ 236,590	$ (539)
Corporate debt securities	325,544	(624)	325,544	(624)
Agency residential mortgage-backed securities	151,614	(1,118)	151,614	(1,118)
Total	$ 713,748	$ (2,281)	$ 713,748	$ (2,281)

As of December 31, 2008 and June 30, 2009, we did not have any investments in marketable securities that were in an unrealized loss position for 12 months or greater.

Table of Contents

Auction Rate Securities

At June 30, 2009, we held $193.7 million of auction rate securities (ARS). The assets underlying these 35 individual investments are primarily student loans which are mostly AAA rated and substantially guaranteed by the U.S. government under the Federal Family Education Loan Program. Historically, these securities have provided liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined intervals every 7 to 49 days. However, these auctions began to fail in the first quarter of 2008. Since these auctions have failed, we have realized higher interest rates for many of these ARS than we would have otherwise. Although we have been receiving interest payments at these generally higher rates, the related principal amounts will not be accessible until a successful auction occurs, a buyer is found outside of the auction process, the issuer calls the security, or the security matures according to contractual terms. Maturity dates for these ARS investments range from 2025 to 2047. Since these auctions have failed, $49.9 million of the related securities were called at par by their issuers.

As a result of the auction failures, these ARS do not have a readily determinable market value. To estimate their fair values at June 30, 2009, we used a discounted cash flow model based on estimated interest rates, timing and amount of cash flows, the credit quality of the underlying securities and illiquidity considerations. Specifically, we estimated the future cash flows of our ARS over the expected workout periods using a projected weighted average interest rate of 5.2% per annum, which is based on the forward swap curve at the end of June 2009 plus any additional basis points currently paid by the issuers assuming these auctions continue to fail. A discount factor was applied over these estimated cash flows of our ARS, which is calculated based on the interpolated forward swap curve adjusted by up to 2,000 basis points to reflect the current market conditions for instruments with similar credit quality at the date of the valuation and additionally adjusted for a liquidity discount of up to 400 basis points to reflect the risk in the marketplace for these investments that has arisen due to the lack of an active market.

At June 30, 2009, the estimated fair values of these ARS were $26.8 million ($15.9 million, net of tax effect) less than their costs. Based on FSP SFAS 115-2, as we have no intent to sell and it is more-likely-than-not that we will not be required to sell these ARS prior to recovery, we concluded the decline in fair values was temporary and recorded the unrealized loss to accumulated other comprehensive income on the accompanying Consolidated Balance Sheet at June 30, 2009.

To the extent we determine that any impairment is other-than-temporary, we would record a charge to earnings. In addition, we have concluded that the auctions for these securities may continue to fail for at least the next 12 months and as a result, they have been classified as non-current assets on the accompanying Consolidated Balance Sheet at June 30, 2009.

Table of Contents

Liquidation of Investment in Non-Marketable Equity Security

We recognized a gain of $9.0 million on the sale of our equity investment in America Online, Inc. to Time Warner Inc. for $283.0 million. We received the related cash proceeds in July 2009.

Note 4. Derivative Financial Instruments

We enter into foreign currency contracts with financial institutions to reduce the risk that our cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. Our program is not designated for trading or speculative purposes.

In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), we recognize derivative instruments as either assets or liabilities on the balance sheet at fair value. Changes in the fair value (i.e., gains or losses) of the derivatives are recorded in the accompanying Consolidated Statements of Income as interest and other income (expense), net, as part of revenues, or to accumulated other comprehensive income (AOCI) on the accompanying Consolidated Balance Sheets.

Cash Flow Hedges

We use options designated as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar. Any gain on the effective portion of a cash flow hedge is initially reported as a component of AOCI and subsequently reclassified to revenues when the hedged revenues are recorded or as interest and other income (expense), net, if the hedged transaction becomes probable of not occurring.

At June 30, 2009, the effective portion of our cash flow hedges before tax effect was $50.0 million, all of which is expected to be reclassified from AOCI to revenues within the next 12 months.

Any gain after a hedge is de-designated because the hedged transaction is no longer probable of occurring or related to an ineffective portion of a hedge is recognized in interest and other income (expense), net, immediately. Further, the change in the time value of the options is excluded from our assessment of hedge effectiveness. The premium paid or time value of an option whose strike price is equal to or greater than the market price on the date of purchase is recorded as an asset. Thereafter, any change to this time value is included in interest and other income (expense), net.

The notional principal of foreign exchange contracts to purchase U.S. dollars with Euros was 1.9 billion (or approximately $2.6 billion) and 2.2 billion (or approximately $2.8 billion) at December 31, 2008 and June 30, 2009; the notional principal of foreign exchange contracts to purchase U.S. dollars with British pounds was £1.1 billion (or approximately $1.8 billion) and £1.1 billion (or approximately $1.6 billion) at December 31, 2008 and June 30, 2009; and the notional principal of foreign exchange contracts to purchase U.S. dollars with Canadian dollars was C$229.7 million (or approximately $202.2 million) and C$276.2 million (or approximately $228.3 million) at December 31, 2008 and June 30, 2009. These foreign exchange options have maturities of 18 months or less. There were no other foreign exchange contracts designated as cash flow hedges.

Other Derivatives

Other derivatives not designated as hedging instruments under SFAS 133 consist of forward contracts that we use to hedge intercompany balances and other monetary assets or liabilities denominated in currencies other than the local currency of a subsidiary. Gains and losses on these contracts as well as the related costs are included in interest and other income (expense), net, along with the gains and losses of the related hedged items. Costs incurred related to these contracts during the three and six months ended June 30, 2008 and 2009 were not material. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $2.6 billion and $2.1 billion at December 31, 2008 and June 30, 2009. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $54.2 million and $158.9 million at December 31, 2008 and June 30, 2009. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 630.5 million (or approximately $897.6 million) and 477.2 million (or approximately $671.4 million) at December 31, 2008 and June 30, 2009. The notional principal of foreign exchange contracts to sell Euros for other currencies was 1.5 million (or approximately $2.2 million) at June 30, 2009.

12

Table of Contents

Effective January 1, 2009, we adopted the disclosure requirements of SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133* (SFAS 161). At December 31, 2008 and June 30, 2009, the fair values of our outstanding derivative instruments are summarized below (in thousands):

		Fair Value of Derivative Instruments	
	Balance Sheet Location	As of December 31, 2008	As of June 30, 2009 (unaudited)
Derivative Assets			
Derivatives designated as hedging instruments under SFAS 133:			
Foreign exchange option contracts	Prepaid revenue share, expenses and other assets, current and non-current	$ 451,723	$ 121,600
Derivatives not designated as hedging instruments under SFAS 133:			
Foreign exchange forward contracts	Prepaid revenue share, expenses and other assets, current	13,270	324
Total		$ 464,993	$ 121,924
Derivative Liabilities			
Derivatives not designated as hedging instruments under SFAS 133:			
Foreign exchange forward contracts	Accrued expenses and other current liabilities	$ 877	$ 204
Total		$ 877	$ 204

Table of Contents

The effect of derivative instruments in cash flow hedging relationship on income and other comprehensive income for the three and six months ended June 30, 2008 and 2009 is summarized below (in thousands):

Derivatives in SFAS 133 Cash Flow Hedging Relationship	Increase (Decrease) in Gains Recognized in AOCI on Derivative Before Tax Effect (Effective Portion)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Foreign exchange option contracts	$ 5,160	$ (164,402)	$ 5,312	$ (26,452)
Total	$ 5,160	$ (164,402)	$ 5,312	$ (26,452)

Derivatives in SFAS 133 Cash Flow Hedging Relationship	Gains Reclassified from AOCI into Income (Effective Portion)				
		Three Months Ended June 30,		Six Months Ended June 30,	
	Location	2008	2009	2008	2009
		(unaudited)			
Foreign exchange option contracts	Revenue	$ 4,760	$ 123,701	$ 4,855	$ 277,786
Total		$ 4,760	$ 123,701	$ 4,855	$ 277,786

Derivatives in SFAS 133 Cash Flow Hedging Relationship	Gains (Losses) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing) from AOCI into Income (Effective Portion) [1]				
		Three Months Ended June 30,		Six Months Ended June 30,	
	Location	2008	2009	2008	2009
		(unaudited)			
Foreign exchange option contracts	Interest and other income (expense), net	$ (27,011)	$ (92,817)	$ (28,639)	$ (192,796)
Total		$ (27,011)	$ (92,817)	$ (28,639)	$ (192,796)

[1] Amount of gains (losses) recognized in income on derivatives includes losses of $27.4 million and $29.0 million related to the amount excluded from the assessment of hedge effectiveness in the three and six months ended June 30, 2008, and $91.8 million and $192.4 million in the three and six months ended June 30, 2009. Gains (losses) related to the ineffectiveness portion of the hedges were not material in all periods presented.

The effect of derivative instruments not designated as hedging instruments on the Consolidated Statements of Income for the three and six months ended June 30, 2008 and 2009 is summarized below (in thousands):

Derivatives Not Designated as Hedging Instruments under SFAS 133	Gains (Losses) Recognized in Income on Derivative			
	Three Months Ended June 30,		Six Months Ended June 30,	
Location	2008	2009	2008	2009
	(unaudited)			
Foreign exchange forward contracts	$ 13,657	$ (146,003)	$ (85,943)	$ (33,386)

	Interest and other income (expense), net			
Total	$ 13,657	$ (146,003)	$ (85,943)	$ (33,386)

Table of Contents

Note 5. Fair Value Measurements

In accordance with SFAS No. 157, *Fair Value Measurement* (SFAS 157), we measure our cash equivalents, marketable securities, ARS and foreign currency derivative contracts at fair value. SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, SFAS 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs which are supported by little or no market activities.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Our cash equivalents and marketable securities are classified within Level 1 or Level 2. This is because our cash equivalents and marketable securities are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Our investments in ARS are classified within Level 3 because they are valued using valuation techniques (see Note 3). Some of the inputs to these models are unobservable in the market and are significant. Our foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

Table of Contents

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

Description	As of December 31, 2008	Fair value measurement at reporting date using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash equivalents:				
Municipal securities	$ 14,250	$	$ 14,250	$
Time deposits	3,015,557		3,015,557	
Money market mutual funds	2,296,207	2,296,207		
Marketable securities:				
U.S. government agencies	3,342,406		3,342,406	
Municipal securities	2,721,603		2,721,603	
Money market mutual funds	73,034		73,034	
Corporate debt securities	907,056		907,056	
Marketable equity security	145,000	145,000		
Foreign currency derivative contracts	464,993		464,993	
Auction rate securities	197,361			197,361
Total	$ 13,177,467	$ 2,441,207	$ 10,538,899	$ 197,361
Liabilities				
Foreign currency derivative contracts	$ 877	$	$ 877	$
Total	$ 877	$	$ 877	$

Description	As of June 30, 2009	Fair value measurement at reporting date using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2) (unaudited)	Significant Unobservable Inputs (Level 3)
Assets				
Cash equivalents:				
U.S. government agencies	$ 399,960	$	$ 399,960	$
Time deposits	4,034,294		4,034,294	
Money market mutual funds	3,912,756	3,912,756		
Marketable securities:				
U.S. government agencies	3,273,384		3,273,384	
Municipal securities	1,996,831		1,996,831	
Money market mutual funds	34,636		34,636	
Corporate debt securities	1,664,601		1,664,601	
Agency residential mortgage-backed securities	252,232		252,232	
Commercial mortgage-backed securities	48,324		48,324	
Marketable equity security	162,647	162,647		
Foreign currency derivative contracts	121,924		121,924	
Auction rate securities	193,725			193,725
Total	$ 16,095,314	$ 4,075,403	$ 11,826,186	$ 193,725
Liabilities				
Foreign currency derivative contracts	$ 204	$	$ 204	$
Total	$ 204	$	$ 204	$

16

Table of Contents

The following tables present reconciliations for our assets measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) as defined in SFAS 157 for the six months ended June 30, 2008 and 2009 (in thousands):

	Level 3 (unaudited)
Balance at December 31, 2007	$
Transfers to Level 3	311,225
Change in unrealized loss included in other comprehensive income	(18,853)
Net settlements	(50,531)
Balance at June 30, 2008	$ 241,841

	Level 3 (unaudited)
Balance at December 31, 2008	$ 197,361
Change in unrealized loss included in other comprehensive income	8,687
Net settlements	(12,323)
Balance at June 30, 2009	$ 193,725

Note 6. Property and Equipment

Property and equipment consisted of the following (in thousands):

	As of December 31, 2008	As of June 30, 2009 (unaudited)
Information technology assets	$ 3,573,499	$ 3,840,838
Construction in progress	1,643,136	1,502,081
Land and buildings	1,725,336	1,898,468
Leasehold improvements	572,908	600,302
Furniture and fixtures	61,462	63,839
Total	7,576,341	7,905,528
Less accumulated depreciation and amortization	2,342,498	2,899,628
Property and equipment, net	$ 5,233,843	$ 5,005,900

Note 7. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended June 30, 2009 were as follows (in thousands, unaudited):

Balance as of December 31, 2008	$ 4,839,854
Goodwill adjustment	(2,941)
Balance as of June 30, 2009	$ 4,836,913

17

Table of Contents

Information regarding our acquisition-related intangible assets that are being amortized is as follows (in thousands):

	As of December 31, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Patents and developed technology	$ 551,332	$ 297,428	$ 253,904
Customer relationships	800,113	153,516	646,597
Tradenames and other	209,492	113,303	96,189
Total	$ 1,560,937	$ 564,247	$ 996,690

	As of June 30, 2009		
	Gross Carrying Amount	Accumulated Amortization (unaudited)	Net Carrying Value
Patents and developed technology	$ 539,952	$ 338,325	$ 201,627
Customer relationships	774,713	197,881	576,832
Tradenames and other	206,207	128,280	77,927
Total	$ 1,520,872	$ 664,486	$ 856,386

Amortization expense of acquisition-related intangible assets for the three and six months ended June 30, 2008 was $80.0 million and $135.0 million and for the three and six months ended June 30, 2009 was $64.5 million and $142.7 million. As of June 30, 2009, expected amortization expense for acquisition-related intangible assets for each of the next five years and thereafter was as follows (in thousands, unaudited):

Remainder of 2009	$ 120,990
2010	218,891
2011	170,495
2012	132,046
2013	105,817
2014	95,852
Thereafter	12,295
	$ 856,386

Note 8. Interest and Other Income (Expense), Net

The components of interest and other income (expense), net, were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
			(unaudited)	
Interest income	$ 88,086	$ 50,017	$ 210,089	$116,109
Realized gains on marketable securities, net	7,252	18,382	53,823	50,146
Foreign exchange losses, net	(42,733)	(83,701)	(41,007)	(174,621)

Other	5,318	(2,416)	2,361	(3,142)
Interest and other income (expense), net	$ 57,923	$ (17,718)	$ 225,266	$(11,508)

Table of Contents

Note 9. Comprehensive Income

The changes in the components of other comprehensive income, net of taxes, were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Net income	$ 1,247,391	$ 1,484,545	$ 2,554,477	$ 2,907,373
Change in unrealized gains (losses) on marketable securities, net of taxes[1]	(23,283)	(2,452)	(33,091)	7,212
Change in cumulative translation adjustment	8,648	85,779	38,434	27,940
Change in unrealized gains on cash flow hedges, net of taxes[2]	400	(170,713)	465	(180,297)
Comprehensive income	$ 1,233,156	$ 1,397,159	$ 2,560,285	$ 2,762,228

(1) Change in unrealized gains (losses) on marketable securities is recorded net of taxes of $16.2 million and $1.7 million for the three months ended June 30, 2008 and 2009, and $23.0 million and $5.0 million for the six months ended June 30, 2008 and 2009.

(2) Change in unrealized gains on cash flow hedges is recorded net of taxes of $0.3 million and $118.6 million for the three months ended June 30, 2008 and 2009, and $0.3 million and $125.3 million for the six months ended June 30, 2008 and 2009.

The components of accumulated other comprehensive income, net of taxes, were as follows (in thousands):

	As of December 31, 2008	As of June 30, 2009 (unaudited)
Unrealized net gains on marketable securities, net of taxes	$ 9,995	$ 17,207
Cumulative translation adjustment	6,677	34,617
Unrealized gains on cash flow hedges, net of taxes	209,907	29,610
Accumulated other comprehensive income	$ 226,579	$ 81,434

Note 10. Contingencies

Legal Matters

Companies have filed trademark infringement and related claims against us over the display of ads in response to user queries that include trademark terms. The outcomes of these lawsuits have differed from jurisdiction to jurisdiction. We currently have three cases pending at the European Court of Justice, which will address questions regarding whether advertisers and search engines can be held liable for use of trademarked terms in keyword advertising. We are litigating, or have recently litigated similar issues in other cases, in the U.S., Australia, Austria, Brazil, Chile, China, France, Germany, Israel, Italy, and Taiwan.

We have also had copyright claims filed against us alleging that features of certain of our products and services, including Google Web Search, Google News, Google Video, Google Image Search, Google Book Search, and YouTube, infringe the rights of others. Adverse results in these lawsuits may include awards of substantial monetary damages, costly royalty or licensing agreements or orders preventing us from offering certain functionalities, and may also result in a change in our business practices, which could result in a loss of revenues for us or otherwise harm our business. In addition, any time one of our products or services links to or

hosts material in which others allegedly own copyrights, we face the risk of being sued for copyright infringement or related claims. Because these products and services comprise the majority of our products and services, our business could be harmed in the event of an adverse result in any of these claims.

We have also had patent lawsuits filed against us alleging that certain of our products and services, including Google Web Search, Google AdWords, Google AdSense, Google Talk, and Google Chrome, infringe patents held by others. In addition, the number of demands for license fees and the dollar amounts associated with each request continue

Table of Contents

to increase. Adverse results in these lawsuits, or our decision to license patents based upon these demands, may result in substantial costs and, in the case of adverse litigation results, could prevent us from offering certain features, functionalities, products, or services, which could result in a loss of revenues for us or otherwise harm our business.

We are also a party to other litigation and subject to claims incident to the ordinary course of business, including intellectual property claims (in addition to the trademark and copyright matters noted above), labor and employment claims and threatened claims, breach of contract claims, tax, and other matters.

Although the results of litigation and claims cannot be predicted with certainty, we believe that the final outcome of the matters discussed above will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows.

EPA Investigation

In February 2009, we learned of a U.S. Environmental Protection Agency (EPA) investigation into an alleged release of refrigerant at one of our smaller data facilities, which we acquired from DoubleClick, and the accuracy of related statements and records. We are cooperating with the EPA and have provided documents and other materials. The EPA investigation could result in fines, civil or criminal penalties, or other administrative action.

We currently believe this matter will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows.

Income Taxes

We are currently under audit by the Internal Revenue Service and various other tax authorities. We have reserved for potential adjustments to our provision for income taxes that may result from examinations by, or any negotiated agreements with, these tax authorities, and we believe that the final outcome of these examinations or agreements will not have a material effect on our results of operations. If events occur which indicate payment of these amounts is unnecessary, the reversal of the liabilities would result in the recognition of tax benefits in the period we determine the liabilities are no longer necessary. If our estimates of the federal, state, and foreign income tax liabilities are less than the ultimate assessment, a further charge to expense would result.

Note 11. Stockholders Equity

The following table presents the weighted-average assumptions used to estimate the fair values of the stock options granted (excluding options granted in connection with the Exchange, see below) in the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Risk-free interest rate	3.0%	2.4%	2.9%	2.1%
Expected volatility	36%	38%	35%	40%
Expected life (in years)	5.3	6.2	5.3	5.7
Dividend yield				
Weighted-average estimated fair value of options granted during the period	$ 197.26	$ 161.84	$ 235.51	$ 130.13

Table of Contents

The following table summarizes the activities for our options for the six months ended June 30, 2009:

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions) (1)
		(unaudited)		
Balance at December 31, 2008	13,971,438	$ 391.40		
Options granted (2)	8,164,343	$ 308.78		
Exercised (3)	(853,262)	$ 120.27		
Canceled/forfeited (2)	(8,161,007)	$ 514.24		
Balance at June 30, 2009	13,121,512	$ 281.55	6.7	$ 1,878.0
Vested and exercisable as of June 30, 2009	4,482,824	$ 220.80	5.7	$ 912.9
Vested and exercisable as of June 30, 2009 and expected to vest thereafter (4)	12,333,395	$ 279.76	6.7	$ 1,787.6

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $421.59 of our Class A common stock on June 30, 2009.
(2) The number of options granted and canceled/forfeited includes options granted and canceled in connection with the Exchange (see below).
(3) Includes options vested during the period that were early exercised.
(4) Options expected to vest reflect an estimated forfeiture rate.

Table of Contents

The following table summarizes additional information regarding outstanding, exercisable, and exercisable and vested stock options at June 30, 2009:

	Options Outstanding					Options Exercisable		Options Exercisable and Vested	
Range of Exercise Prices	Total Number of Shares	Unvested Options Granted and Exercised Subsequent to March 21, 2002	Number of Shares	Weighted-Average Remaining Life (Years) (unaudited)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 0.30 $94.80	818,895	1,723	817,172	4.3	$ 22.09	773,015	$ 20.65	705,649	$ 21.87
$117.84 $198.41	1,405,330		1,405,330	3.8	$ 177.08	1,402,418	$ 177.05	1,400,310	$ 176.47
$205.96 $298.91	1,260,246		1,260,246	4.7	$ 274.89	1,212,682	$ 274.34	1,210,941	$ 273.76
$300.97 $399.00	9,110,469		9,110,469	7.8	$ 310.13	1,052,078	$ 315.53	986,446	$ 312.04
$401.78 $499.07	208,708		208,708	3.2	$ 439.39	168,351	$ 439.60	82,281	$ 434.81
$500.00 $594.05	312,898		312,898	4.5	$ 532.95	196,705	$ 527.91	94,613	$ 535.51
$615.95 $699.35	4,692		4,692	5.0	$ 644.34	3,065	$ 640.83	2,360	$ 640.83
$707.00 $732.94	274		274	2.6	$ 726.49	224	$ 729.98	224	$ 729.05
$ 0.30 $732.94	13,121,512	1,723	13,119,789	6.7	$ 281.55	4,808,538	$ 230.61	4,482,824	$ 220.80

Options outstanding at June 30, 2009 in the above tables include 1,723 options granted and exercised subsequent to March 21, 2002 that were unvested at June 30, 2009, in accordance with Emerging Issues Task Force Issue No. 00-23, *Issues Related to Accounting for Stock Compensation Under APB Opinion No. 25 and FASB Interpretation No. 44*. However, the computation of the weighted-average exercise prices, weighted-average remaining contractual term and aggregate intrinsic value does not consider these unvested shares. Further, the above tables include 1.5 million warrants held by selected financial institutions that were options purchased from employees under our Transferable Stock Option (TSO) program.

The total grant date fair value of stock options vested during the three and six months ended June 30, 2009 was $30.3 million and $142.6 million. The total grant date fair value of stock options vested during the three and six months ended June 30, 2008 was $159.0 million and $320.0 million. The aggregate intrinsic value of all options and warrants exercised during the three and six months ended June 30, 2009 was $104.4 million and $211.3 million. The aggregate intrinsic value of all options exercised during the three and six months ended June 30, 2008 was $131.5 million and $359.8 million. These amounts do not include the aggregate sales price of options sold under our TSO program.

During the six months ended June 30, 2009, the number of shares underlying TSOs sold to selected financial institutions under the TSO program was 324,768 at a total value of $46.6 million, or an average of $143.55 per share, including an average premium of $38.26 per share. The premium is calculated as the difference between (a) the sale price of the TSO and (b) the intrinsic value of the TSO, which we define as the excess, if any, of the price of our Class A common stock at the time of the sale over the exercise price of the TSO. At June 30, 2009, the number of options eligible for participation under the TSO program was approximately 10 million.

In March 2009, we completed an offer to exchange certain employee stock options issued under Google s 2004 Stock Plan (the Exchange). Certain previously granted options were exchanged for new options with a lower exercise price granted on a one-for-one basis. Options for an aggregate of approximately 7.6 million shares of Google s Class A common stock were exchanged. Options granted pursuant to the Exchange have an exercise price of $308.57 per share, the closing price of Google s Class A common stock as reported by The Nasdaq Global Select Market on March 6, 2009. Options granted pursuant to the Exchange have a new vesting schedule determined by adding 12 months to each vesting date under the exchanged options original vesting schedule. In addition, new options will vest no sooner than six months

22

Table of Contents

after the date of the Exchange. The Exchange resulted in a modification charge of approximately $360 million which is being recognized over the vesting periods of the new options. These vesting periods range from six months to five years. We recorded approximately $42 million and $53 million of the modification charge in the three and six months ended June 30, 2009.

As of June 30, 2009, there was $1,205.9 million of unrecognized compensation cost related to outstanding employee stock options. This amount is expected to be recognized over a weighted average period of 3.4 years. To the extent the forfeiture rate is different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

The following table summarizes the activities for our unvested restricted stock units and restricted shares for the six months ended June 30, 2009:

	Unvested Restricted Stock Units and Restricted Shares	
	Number of Shares	Weighted-Average Grant-Date Fair Value
	(unaudited)	
Unvested at December 31, 2008	3,268,089	$ 514.56
Granted	786,761	$ 359.26
Vested	(693,305)	$ 486.91
Forfeited	(223,973)	$ 470.22
Unvested at June 30, 2009	3,137,572	$ 485.21
Expected to vest after June 30, 2009 (1)	2,843,268	$ 485.21

(1) Restricted stock units and restricted shares expected to vest reflect an estimated forfeiture rate.

As of June 30, 2009, there was $1,215.3 million of unrecognized compensation cost related to employee unvested restricted stock units and restricted shares. This amount is expected to be recognized over a weighted average period of 2.7 years. To the extent the actual forfeiture rate is different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

Note 12. Income Taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109), and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination. Our total unrecognized tax benefits as of December 31, 2008 and June 30, 2009 were $721.1 million and $1,048.3 million. Also, our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were $561.3 million and $715.5 million as of December 31, 2008 and June 30, 2009. The increase in our unrecognized tax benefits during the six months ended June 30, 2009 was primarily related to uncertain tax positions relating to our international structure.

Note 13. Information about Geographic Areas

Our chief operating decision-makers (i.e., our chief executive officer, his direct reports and our presidents) review financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region for purposes of allocating resources and evaluating financial performance. There are no segment managers who are held accountable by our chief operating decision-makers, or anyone else, for operations, operating results and planning for levels or components below the consolidated unit level. Accordingly, we consider ourselves to be in a single reporting segment and operating unit structure.

23

Table of Contents

Revenues by geography are based on the billing addresses of our advertisers. The following table sets forth revenues and long-lived assets by geographic area (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Revenues:				
United States	$ 2,567,024	$ 2,609,129	$ 5,102,498	$ 5,236,190
United Kingdom	773,958	715,000	1,576,931	1,448,408
Rest of the world	2,026,230	2,198,768	3,873,826	4,347,289
Total revenues	$ 5,367,212	$ 5,522,897	$ 10,553,255	$ 11,031,887

Table of Contents

	As of December 31, 2008	As of June 30, 2009 (unaudited)
Long-lived assets:		
United States	$ 9,782,825	$ 9,482,048
International	1,806,568	1,841,859
Total long-lived assets	$ 11,589,393	$ 11,323,907

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements include, among other things, statements concerning our expectations:

regarding the growth and growth rate of our operations, business, revenues, or operating margins;

that seasonal fluctuations in internet usage and traditional retail seasonality are likely to affect our business;

that growth in advertising revenues from our web sites will continue to exceed that from our Google Network members web sites;

regarding our future stock-based compensation charges;

that we will continue to pay most of the Google AdSense fees we receive from advertisers to our Google Network members;

that we will continue to take steps to improve the relevance of the ads we deliver;

that we may continue to take steps to reduce the number of accidental clicks;

that we will continue to make investments and acquisitions;

that our cost of revenues and traffic acquisition costs may increase in dollars and as a percentage of revenues;

that our research and development and sales and marketing expenses may increase in dollars and as a percentage of revenues;

regarding the increase of costs related to hedging activities under our foreign exchange risk management program;

regarding fluctuations in paid clicks and cost-per-click;

regarding the sufficiency of our existing cash, cash equivalents, marketable securities, and cash generated from operations;

regarding fluctuations in our effective tax rate;

regarding fluctuations in our capital expenditures;

regarding continued investments in international markets;

regarding the impact on our business, consolidated financial position, results of operations, or cash flows of the EPA s investigation;

Table of Contents

as well as other statements regarding our future operations, financial condition and prospects, and business strategies. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report, and in particular, the risks discussed under the heading Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

The following discussion and analysis of our financial condition and results of operations should be read together with our Consolidated Financial Statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

Overview

Google is a global technology leader focused on improving the ways people connect with information. Our innovations in web search and advertising have made our web site a top internet property and our brand one of the most recognized in the world. Our mission is to organize the world s information and make it universally accessible and useful. We serve three primary constituencies:

Users. We provide users with products and services that enable people to more quickly and easily find, create and organize information that is useful to them.

Advertisers. We provide advertisers with cost-effective ways to deliver online ads, as well as offline ads on television, to customers across Google sites and through the Google Network, which is the network of online and offline third parties that use our advertising programs to deliver relevant ads with their search results and content.

Google Network Members and Other Content Providers. We provide the online and offline members of our Google Network with our Google AdSense programs. These include programs through which we distribute our advertisers AdWords ads for display on the web sites of our Google Network members as well as programs to deliver ads on television broadcasts. We share most of the fees these ads generate with our Google Network members, thereby creating an important revenue stream for them. In addition, we have entered into arrangements with other content providers under which we distribute or license their video and other content, and we may display ads next to or as part of this content on the pages of our web sites and our Google Network members web sites. We share most of the fees these ads generate with these content providers and our Google Network members, thereby creating an important revenue stream for these partners.

How We Generate Revenues

Advertising revenues made up 97% of our revenues for the three and six months ended June 30, 2008 and 2009. We derive most of our additional revenues from offering internet ad serving and management services to advertisers and ad agencies and the license of our enterprise products, search solutions, and web search technology.

Google AdWords is our automated online program that enables advertisers to place targeted text-based and display ads on our web sites and our Google Network members web sites. Most of our AdWords customers pay us on a cost-per-click basis, which means that an advertiser pays us only when a user clicks on one of its ads. We also offer AdWords on a cost-per-impression basis that enables advertisers to pay us based on the number of times their ads appear on our web sites and our Google Network members web sites as specified by the advertiser. For advertisers using our AdWords cost-per-click pricing, we recognize as revenue the fees charged advertisers each time a user clicks on one of the ads that appears next to the search results on our web sites or next to the search results or content on our Google Network members web sites. For advertisers using our AdWords cost-per-impression pricing, we recognize as revenue the fees charged advertisers each time their ads are displayed on our web sites or the Google Network members web sites. Our AdWords agreements are generally terminable at any time by our advertisers.

Google AdSense refers to the online programs through which we distribute our advertisers AdWords ads for display on the web sites of our Google Network members as well as programs to deliver ads on television. Our AdSense programs include AdSense for search and AdSense for content.

Table of Contents

AdSense for search is our online service for distributing relevant ads from our advertisers for display with search results on our Google Network members sites. To use AdSense for search, most of our AdSense for search partners add Google search functionality to their web pages in the form of customizable Google search boxes. When visitors of these web sites search either the web site or the internet using these customizable search boxes, we display relevant ads on the search results pages, targeted to match user search queries. Ads shown through AdSense for search are text ads.

AdSense for content is our online service for distributing ads from our advertisers that are relevant to content on our Google Network members web sites. Under this program, we use automated technology to analyze the meaning of the content on the web page and serve relevant ads based on the meaning of such content. For example, a web page on an automotive blog that contains an entry about vintage cars might display ads for vintage car parts or vintage car shows. These ads are displayed in spaces that our AdSense for content partners have set aside on their web sites. AdSense for content allows a variety of ad types to be shown, including text ads, image ads, Google Video Ads, link units (which are sets of clickable links to topic pages related to page content), themed units (which are regular text ads with graphic treatments that change seasonally and by geography), and gadget ads (which are customized mini-sites that run as ads on AdSense publisher web sites).

For our online AdSense program, our advertisers pay us a fee each time a user clicks on one of our advertisers ads displayed on our Google Network members web sites or, for those advertisers who choose our cost-per-impression pricing, as their ads are displayed. To date, we have paid most of these advertiser fees to our Google Network members, and we expect to continue doing so for the foreseeable future. We recognize these advertiser fees as revenue and the portion of the advertiser fee we pay to our Google Network members as traffic acquisition costs under cost of revenues. In some cases, we guarantee our Google Network members minimum revenue share payments based on their achieving defined performance terms, such as number of search queries or advertisements displayed. Google Network members do not pay any fees associated with the use of our AdSense program on their web sites.

Our agreements with Google Network members consist largely of uniform online click-wrap agreements that members enter into by interacting with our registration web sites. The standard agreements have no stated term and are terminable at will. Agreements with our larger members are individually negotiated. Both the standard agreements and the negotiated agreements contain provisions requiring us to share with the Google Network member most of the advertiser fees generated by users clicking on ads on the Google Network member s web site or, for advertisers who choose our cost-per-impression pricing, as the ads are displayed on the Google Network member s web site.

Google TV Ads enables advertisers, operators, and programmers to buy, schedule, deliver and measure ads on television. We recognize as revenue the fees charged advertisers each time an ad is displayed on television.

DoubleClick provides us with a platform for delivering display advertising. DoubleClick offers online ad serving and management services to advertisers, ad agencies and web site publishers. Fees derived from hosted or web-based applications are recognized as licensing and other revenues in the period the advertising impressions are delivered.

We have entered into arrangements with certain content providers under which we distribute or license their video and other content. Our agreements with content providers are typically standard agreements with no stated term and are terminable at will. Agreements with our larger members are individually negotiated. Both the standard agreements and the negotiated agreements contain provisions requiring us to pay the content providers for the content we license. In a number of these arrangements, we display ads on the pages of our web sites and our Google Network members web sites from which the content is viewed and share most of the fees these ads generate with the content providers and Google Network members. We recognize these advertiser fees as revenue. We recognize the portion of the advertiser fees we pay to our content providers as content acquisition costs under cost of revenues and the portion we pay to our Google Network members as traffic acquisition costs. In some cases, we guarantee our content providers minimum revenue share or other payments.

We believe the factors that influence the success of our advertising programs include the following:

- The relevance, objectivity, and quality of our search results and the relevance and quality of ads displayed with each search results page.

The number of searches initiated at our web sites and our Google Network members web sites and the underlying purpose of these searches (for instance, whether they are for academic research, to find a news article, or to find a product or service).

The number and prominence of ads displayed on our web sites and our Google Network members web sites.

Table of Contents

The number of visits to, and the content of, our Google Network members web sites and certain of our web sites and the relevance and quality of the ads we display next to this content.

The advertisers return on investment from advertising campaigns on our web sites or our Google Network members web sites compared to other forms of advertising.

The total advertising spending budgets of each advertiser.

The number of advertisers and the breadth of items advertised.

The amount we ultimately pay our Google Network members, distribution partners, and our content providers for traffic, access points, and content compared to the amount of revenue we generate.

Trends in Our Business

Our business has grown rapidly since inception, resulting in substantially increased revenues, and we expect that our business will continue to grow. However, our revenue growth rate has generally declined over time, and we expect it will continue to do so as a result of a number of factors including increasing competition, the difficulty of maintaining growth rates as our revenues increase to higher levels and increasing maturity of the online advertising market in certain countries. In addition, the continuing weak economic conditions have adversely impacted our revenue growth rate and may result in fewer commercial queries by our users and may cause advertisers to reduce the amount they spend on online advertising, including the amount they are willing to pay for each click or impression, which could negatively affect the growth rate of our revenues.

The main focus of our advertising programs is to provide relevant and useful advertising to our users, reflecting our commitment to constantly improve their overall web experience. As a result, we expect to continue to take steps to improve the relevance of the ads displayed on our web sites and our Google Network members web sites. These steps include not displaying ads that generate low click-through rates or that send users to irrelevant or otherwise low quality sites and terminating our relationships with those Google Network members whose web sites do not meet our quality requirements. We may also continue to take steps to reduce the number of accidental clicks by our users. These steps could negatively affect the growth rate of our revenues.

Both seasonal fluctuations in internet usage and traditional retail seasonality have affected, and are likely to continue to affect, our business. Internet usage generally slows during the summer months, and commercial queries typically increase significantly in the fourth quarter of each year. These seasonal trends have caused, and will likely continue to cause, fluctuations in our quarterly results, including fluctuations in sequential revenues, as well as paid click and average cost-per-click growth rates.

The operating margin we realize on revenues generated from ads placed on our Google Network members web sites through our AdSense program is significantly lower than the operating margin we realize from revenues generated from ads placed on our web sites because most of the advertiser fees from ads served on Google Network members web sites are shared with our Google Network members. For the past five years, growth in advertising revenues from our web sites has generally exceeded that from our Google Network members web sites. This trend has had a positive impact on our operating margins, and we expect that this will continue for the foreseeable future, although the relative rate of growth in revenues from our web sites compared to the rate of growth in revenues from our Google Network members web sites may vary over time.

We continue to invest in building the necessary employee and systems infrastructures required to manage our growth and develop and promote our products and services, and this may cause our operating margins to decrease. We have generally experienced and expect to continue to experience growth in our operations as we build our research and development programs, expand our base of users, advertisers, Google Network members, and content providers, and increase our presence in international markets. Also, we have acquired and expect to continue to acquire businesses and other assets from time to time. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other functional areas, our technologies and our product offerings. Our full-time employee headcount was 19,604 at June 30, 2008 and 19,786 at June 30, 2009. We have recently made efforts to improve the discipline of our hiring process and to focus on better managing our expense growth. However, we expect to continue to invest in our business, and this may cause our operating margins to decrease.

We expect our cost of revenues to increase in dollars and may increase as a percentage of revenues in future periods, primarily as a result of forecasted increases in traffic acquisition costs, data center costs and credit card and other transaction fees, as well as content acquisition costs. In particular, traffic acquisition costs as a percentage of

Table of Contents

advertising revenues may increase in the future if we are unable to continue to improve the monetization or generation of revenues from traffic on our web sites and our Google Network members web sites, particularly with those members to whom we have guaranteed minimum revenue share payments.

Our international revenues have grown as a percentage of our total revenues from 52% in the three months ended June 30, 2008 to 53% in the three months ended June 30, 2009. This increase in the portion of our revenues derived from international markets results largely from increased acceptance of our advertising programs, and our continued progress in developing localized versions of our products in these international markets. The increase in the proportion of international revenues derived from international markets increases our exposure to fluctuations in foreign currency to U.S. dollar exchange rates. For example, in the second quarter of 2009, the general strengthening of the U.S. dollar relative to foreign currencies (primarily the British pound and the Euro) as compared to the second quarter of 2008 had an unfavorable impact on our revenues. We have a foreign exchange risk management program that is designed to reduce our exposure to fluctuations in foreign currencies; however, this program will not fully offset the effect of fluctuations on our revenues and earnings.

Results of Operations

The following table presents our historical operating results as a percentage of revenues for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Consolidated Statements of Income Data:				
Revenues	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of revenues	40.0	38.2	40.4	38.2
Research and development	12.7	12.8	12.8	12.2
Sales and marketing	9.0	8.5	8.8	8.2
General and administrative	8.9	6.6	8.4	7.3
Total costs and expenses	70.6	66.1	70.4	65.9
Income from operations	29.4	33.9	29.6	34.1
Interest and other income (expense), net	1.1	(0.3)	2.1	(0.1)
Income before income taxes	30.5	33.6	31.7	34.0
Provision for income taxes	7.3	6.7	7.5	7.6
Net income	23.2%	26.9%	24.2%	26.4%

Revenues

The following table presents our revenues, by revenue source, for the periods presented (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Advertising revenues:				
Google web sites	$ 3,530.1	$ 3,652.6	$ 6,930.6	$ 7,345.5
Google Network web sites	1,655.3	1,683.5	3,341.4	3,321.5
Total advertising revenues	5,185.4	5,336.1	10,272.0	10,667.0

Licensing and other revenues	181.8	186.8	281.3	364.9
Revenues	$ 5,367.2	$ 5,522.9	$ 10,553.3	$ 11,031.9

Table of Contents

The following table presents our revenues, by revenue source, as a percentage of total revenues for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Advertising revenues:				
Google web sites	66%	66%	66%	67%
Google Network web sites	31	31	31	30
Total advertising revenues	97	97	97	97
Google web sites as % of advertising revenues	68	68	67	69
Google Network web sites as % of advertising revenues	32	32	33	31
Licensing and other revenues	3%	3%	3%	3%

The growth in our advertising revenues from the three months ended June 30, 2008 to the three months ended June 30, 2009, and from the six months ended June 30, 2008 to the six months ended June 30, 2009 resulted from an increase in the number of paid clicks generated through our advertising programs as well as hedging gains recognized from our foreign currency risk management program, partially offset by a decrease in the average cost-per-click paid by our advertisers. The increase in the number of paid clicks generated through our advertising programs was due to an increase in aggregate traffic, certain monetization improvements, and the continued global expansion of our products, our advertiser base, and our user base. The decrease in the average cost-per-click paid by our advertisers was primarily the result of the general strengthening of the U.S. dollar relative to foreign currencies (primarily the British pound and the Euro), as well as changes in geographical mix due to traffic growth in emerging markets compared to more mature markets. In addition, the decrease in the average cost-per-click was due to how we believe advertisers managed their advertising costs in response to continuing weak economic conditions. Specifically, we believe that as a result of the general economic downturn, advertisers, in aggregate, have lowered their bids for keywords in response to a decrease in the sales they are able to make per paid click.

From the three months ended June 30, 2008 to the three months ended June 30, 2009, advertising revenue growth for Google web sites and Google Network members sites resulted primarily from an increase in aggregate traffic, certain monetization improvements, and the continued global expansion of our products, our advertiser base and our user base. From the six months ended June 30, 2008 to the six months ended June 30, 2009, advertising revenue growth for Google web sites resulted primarily from an increase in aggregate traffic, certain monetization improvements, and the continued global expansion of our products, our advertiser base and our user base. From the six months ended June 30, 2008 to the six months ended June 30, 2009, revenues generated from Google Network members sites were relatively unchanged.

Improvements in our ability to ultimately monetize increased traffic primarily relate to enhancing the end user experience, including providing end users with ads that are more relevant to their search queries or to the content on the Google Network members web sites they visit. These improvements have included, for instance, continued enhancements to the web search results page, a reduction in minimum cost-per-click to show more good quality ads, a change to the formula used to determine which ads appear at the top of our search results pages, and a change to the clickable area around our AdSense for content text-based ads to only the title and URL to reduce the number of accidental clicks. In addition, these improvements have included certain changes to further enhance the accuracy of our quality scoring, which is our measurement of an ad s click-through rate and other relevancy factors.

Aggregate paid clicks on Google web sites and our Google Network members web sites increased 15% from the three months ended June 30, 2008 to the three months ended June 30, 2009 and 16% from the six months ended June 30, 2008 to the six months ended June 30, 2009 and decreased 2% from the three months ended March 31, 2009 to the three months ended June 30, 2009. Average cost-per-click on Google web sites and our Google Network members web sites decreased 13% from the three and six months ended June 30, 2008 to the three and six months ended June 30, 2009 and increased 5% from the three months ended March 31, 2009 to the three months ended June 30, 2009. The rate of change in aggregate paid clicks and average cost-per-click, and their correlation with the rate of change in revenues, has fluctuated or may in the future fluctuate because of various factors including the revenue growth rates on our web sites compared to those of our Google Network members, advertiser competition for keywords, changes in foreign currency exchange rates, seasonality, the fees advertisers are willing to pay based on how they manage their advertising costs, and the recent economic downturn. In addition, traffic growth in emerging markets compared to more

31

Table of Contents

mature markets and across various advertising verticals also contributes to these fluctuations. Changes in aggregate paid clicks and average cost-per-click may not be indicative of our performance or advertiser experiences in any specific geographic market, vertical, or industry.

Revenues by Geography

Domestic and international revenues as a percentage of consolidated revenues, determined based on the billing addresses of our advertisers are set forth below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
United States	48%	47%	48%	48%
United Kingdom	14%	13%	15%	13%
Rest of the world	38%	40%	37%	39%

The growth in international revenues (other than the United Kingdom) as a percentage of consolidated revenues from the three and six months ended June 30, 2008 to the three and six months ended June 30, 2009 resulted largely from increased acceptance of our advertising programs and our continued progress in developing localized versions of our products for these international markets, as well as hedging gains recognized under our foreign exchange risk management program, partially offset by the effect of the general economic downturn and a general strengthening of the U.S dollar compared to foreign currencies (primarily the Euro). The decrease in revenues from the United Kingdom as a percentage of consolidated revenues from the three and six months ended June 30, 2008 to the three and six months ended June 30, 2009 resulted largely from the effect of the general economic downturn and a general strengthening of the U.S. dollar compared to the British pound, partially offset by hedging gains recognized to revenues under our foreign exchange risk management program during these periods.

The general strengthening of the U.S. dollar relative to foreign currencies (primarily the British pound and the Euro) from the three months ended June 30, 2008 to the three months ended June 30, 2009 had an unfavorable impact on our international revenues (international revenues increased $113.6 million during this period). Had foreign exchange rates remained constant in these periods, our total revenues would have been approximately $497 million, or 9.0%, higher in the three months ended June 30, 2009. This is before consideration of hedging gains recognized to revenues of $123.7 million and $4.8 million in the three months ended June 30, 2009 and June 30, 2008.

The general strengthening of the U.S. dollar relative to foreign currencies (primarily the British pound and the Euro) from the six months ended June 30, 2008 to the six months ended June 30, 2009 had an unfavorable impact on our international revenues (international revenues increased $344.9 million during this period). Had foreign exchange rates remained constant in these periods, our total revenues would have been approximately $926 million, or 8.4%, higher in the six months ended June 30, 2009. This is before consideration of hedging gains recognized to revenues of $277.8 million and $4.9 million in the six months ended June 30, 2009 and June 30, 2008.

Although we expect to continue to make investments in international markets, they may not result in an increase in our international revenues as a percentage of total revenues in the remainder of 2009 or thereafter. See Note 13 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information about geographic areas.

Costs and Expenses

Cost of Revenues.

Cost of revenues consists primarily of traffic acquisition costs. Traffic acquisition costs consist of amounts ultimately paid to our Google Network members under AdSense arrangements and to certain other partners (our distribution partners) who distribute our toolbar and other products (collectively referred to as access points) or otherwise direct search queries to our web site (collectively referred to as distribution arrangements). These amounts are primarily based on the revenue share arrangements with our Google Network members and distribution partners.

Certain AdSense agreements obligate us to make guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. These fees may be paid in advance or in arrears and are non-refundable but are subject to adjustment based on the achievement of the defined performance terms. In addition, the arrangements are terminable at will, although under the terms of certain contracts we or our Google Network members may be subject to penalties in the

Table of Contents

event of early termination. To the extent we expect revenues generated under an arrangement to exceed the guaranteed minimum revenue share payments, we recognize traffic acquisition costs on a contractual revenue share basis or on a basis proportionate to forecasted revenues, whichever is greater. Otherwise, we recognize the guaranteed revenue share payments as traffic acquisition costs on a straight-line basis over the term of the related agreements. For other AdSense agreements under which we only pay on a contractual revenue share basis, we recognize the revenue share obligations as traffic acquisition costs at the same time the related revenue is recognized. Also, concurrent with the commencement of a small number of AdSense and other agreements, we have purchased certain items from, or provided other consideration to, our Google Network members and partners. We have determined that certain of these amounts are prepaid traffic acquisition costs and are amortized on a straight-line basis over the terms of the related agreements.

In addition, certain distribution arrangements require us to pay our partners based on a fee per access point delivered and not exclusively or at all based on revenue share. The fees are non-refundable. Further, the arrangements are terminable at will, although under the terms of certain contracts, we or our distribution partners may be subject to penalties in the event of early termination. We recognize fees under these arrangements over the estimated useful lives of the access points (two years) to the extent we can reasonably estimate those lives and they are longer than one year, or based on any contractual revenue share, if greater. Otherwise, the fees are charged to expense as incurred. The estimated useful life of the access points is based on the historical average period of time they generate traffic and revenues.

Cost of revenues also includes the expenses associated with the operation of our data centers, including depreciation, labor, energy and bandwidth costs, credit card and other transaction fees related to processing customer transactions, amortization of acquired intangible assets as well as content acquisition costs. We have entered into arrangements with certain content providers under which we distribute or license their video and other content. In a number of these arrangements we display ads on the pages of our web sites and our Google Network members web sites from which the content is viewed and share most of the fees these ads generate with the content providers and the Google Network members. To the extent we are obligated to make guaranteed minimum revenue share or other payments to our content providers, we recognize content acquisition costs equal to the greater of the following three amounts: the contractual revenue share amount, if any, an amount that is based on the number of times the content is displayed, or an amount calculated on a straight-line basis over the terms of the agreements. The following tables present our cost of revenues and cost of revenues as a percentage of revenues, and our traffic acquisition costs and traffic acquisition costs as a percentage of advertising revenues for the periods presented (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Cost of revenues	$ 2,147.6	$ 2,108.0	$ 4,258.1	$ 4,209.5
Cost of revenues as a percentage of revenues	40.0%	38.2%	40.4%	38.2%

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Traffic acquisition costs related to AdSense arrangements	$ 1,319.5	$ 1,235.3	$ 2,662.7	$ 2,464.4
Traffic acquisition costs related to distribution arrangements	154.5	218.0	297.7	424.9
Traffic acquisition costs	$ 1,474.0	$ 1,453.3	$ 2,960.4	$ 2,889.3
Traffic acquisition costs as a percentage of advertising revenues	28.4%	27.2%	28.8%	27.1%

Cost of revenues decreased $39.6 million from the three months ended June 30, 2008 to the three months ended June 30, 2009. Over the same period there was a decrease in traffic acquisition costs of $20.7 million primarily as a result of more revenues realized from Google Network members to whom we pay lower revenue share and less revenues realized from those members to whom we pay more revenue share, partially offset by more traffic acquisition costs recognized due to more distribution fees paid and more traffic directed to our web sites under our distribution agreements. In addition, there was also a decrease in the amortization of intangible assets of $12.4 million as certain intangible assets have been fully amortized. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to an increase in the proportion of advertising revenues from our web sites compared to our Google Network members web sites, as well as an increase in hedging gains recognized to revenues under our foreign exchange risk management program.

33

Table of Contents

Cost of revenues decreased $48.6 million from the six months ended June 30, 2008 to the six months ended June 30, 2009. Over the same period there was a decrease in traffic acquisition costs of $71.1 million primarily as a result of lower revenues generated through our AdSense program as well as more revenues realized from Google Network members to whom we pay lower revenue share and less revenues realized from those members to whom we pay more revenue share. This decrease was partially offset by more traffic acquisition costs recognized due to more distribution fees paid and more traffic directed to our web sites under our distribution agreements. The decrease in cost of revenues was partially offset by an increase in data center costs of $35.0 million primarily resulting from the depreciation of additional information technology assets and data center buildings. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to an increase in the proportion of advertising revenues from our web sites compared to our Google Network members web sites, as well as an increase in hedging gains recognized to revenues under our foreign exchange risk management program.

We expect cost of revenues to increase in dollar amount and may increase as a percentage of revenues in the remainder of 2009 and in future periods, primarily as a result of forecasted increases in traffic acquisition costs, data center costs, credit card and other transaction fees, content acquisition and other costs. Traffic acquisition costs as a percentage of advertising revenues may fluctuate in the future based on a number of factors, including the following:

- The relative growth rates of revenues from our web sites and from our Google Network members web sites.
- Whether we are able to enter into more AdSense arrangements that provide for lower revenue share obligations or whether increased competition for arrangements with existing and potential Google Network members results in less favorable revenue share arrangements, including arrangements with guaranteed minimum payments.
- Whether we are able to continue to improve the monetization of traffic on our web sites and our Google Network members web sites, particularly with those members to whom we have guaranteed minimum revenue share payments.
- The relative growth rates of expenses associated with distribution arrangements and the related revenues generated, including whether we share with certain existing and new distribution partners proportionately more of the aggregate advertising fees that we earn from paid clicks derived from search queries these partners direct to our web sites.

Research and Development.

The following table presents our research and development expenses, and research and development expenses as a percentage of revenues for the periods presented (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Research and development expenses	$ 682.2	$ 707.6	$ 1,355.3	$ 1,349.3
Research and development expenses as a percentage of revenues	12.7%	12.8%	12.8%	12.2%

Research and development expenses consist primarily of compensation and related costs for personnel responsible for the research and development of new products and services, as well as significant improvements to existing products and services. We expense research and development costs as they are incurred.

Research and development expenses increased $25.4 million from the three months ended June 30, 2008 to the three months ended June 30, 2009. This increase was primarily due to an increase in labor related costs of $51.8 million substantially as a result of an 8% increase in research and development headcount. This increase was partially offset by a decrease in consulting services of $24.4 million.

Research and development expenses decreased $6.0 million from the six months ended June 30, 2008 to the six months ended June 30, 2009. This decrease was primarily due to a decrease in stock-based compensation expense of $30.3 million as a result of certain acquisition related equity awards which fully vested during the second quarter of 2008. This decrease was partially offset by an increase in labor and facilities related costs of $37.7 million primarily due to an 8% increase in headcount.

Table of Contents

We expect that research and development expenses may increase in dollar amount and as a percentage of revenues in the remainder of 2009 and future periods because we expect to continue to invest in building the necessary employee and systems infrastructures required to support the development of new, and improve existing, products and services.

Sales and Marketing.

The following table presents our sales and marketing expenses, and sales and marketing expenses as a percentage of revenues for the periods presented (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30.	
	2008	2009	2008	2009
	(unaudited)			
Sales and marketing expenses	$ 484.6	$ 469.0	$ 931.5	$ 903.0
Sales and marketing expenses as a percentage of revenues	9.0%	8.5%	8.8%	8.2%

Sales and marketing expenses consist primarily of compensation and related costs for personnel engaged in customer service and sales and sales support functions, as well as advertising and promotional expenditures.

Sales and marketing expenses decreased $15.6 million from the three months ended June 30, 2008 to the three months ended June 30, 2009 primarily due to a decrease in travel and related expenses of $13.3 million and a decrease in conference fees of $10.1 million, partially offset by an increase in advertising and promotional expenses of $11.9 million.

Sales and marketing expenses decreased $ 28.5 million from the six months ended June 30, 2008 to the six months ended June 30, 2009 primarily due to a decrease in travel and related expenses of $21.2 million.

We anticipate that sales and marketing expenses may increase in dollar amount and as a percentage of revenues in the remainder of 2009 and future periods as we expand our business on a worldwide basis.

General and Administrative.

The following table presents our general and administrative expenses, and general and administrative expenses as a percentage of revenues for the periods presented (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
General and administrative expenses	$ 474.9	$ 364.4	$ 884.2	$ 812.7
General and administrative expenses as a percentage of revenues	8.9%	6.6%	8.4%	7.3%

General and administrative expenses consist primarily of compensation and related costs for personnel and facilities related to our finance, human resources, facilities, information technology and legal organizations, and fees for professional services. Professional services are principally comprised of outside legal, audit, information technology consulting and outsourcing services.

General and administrative expenses decreased $110.5 million from the three months ended June 30, 2008 to the three months ended June 30, 2009. This decrease was primarily related to a decrease in professional services of $66.4 million, the majority of which were related to a decrease in legal costs and consulting services. In addition, there was a decrease in bad debt expense of $13.2 million.

General and administrative expenses decreased $71.5 million from the six months ended June 30, 2008 to the six months ended June 30, 2009. This decrease was primarily related to a decrease in professional services of $51.3 million, the majority of which was related to consulting services. In addition, there was a decrease in travel and related expenses of $10.3 million.

35

Table of Contents

Stock-Based Compensation.

The following table presents our stock-based compensation, and stock-based compensation as a percentage of revenues for the periods presented (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Stock-based compensation	$ 272.8	$ 293.1	$ 553.6	$ 570.6
Stock-based compensation as a percentage of revenues	5.1%	5.3%	5.2%	5.2%

In March 2009, we completed an offer to exchange certain employee stock options issued under Google s 2004 Stock Plan (the Exchange). Certain previously granted options were exchanged for new stock options with a lower exercise price granted on a one-for-one basis. Options for an aggregate of approximately 7.6 million shares of Google s Class A common stock were exchanged. Options granted pursuant to the Exchange have an exercise price of $308.57 per share, the closing price of Google s Class A common stock as reported by The Nasdaq Global Select Market on March 6, 2009. Options granted pursuant to the Exchange have a new vesting schedule determined by adding 12 months to each vesting date under the exchanged options original vesting schedule. In addition, new options will vest no sooner than six months after the date of the Exchange. The Exchange resulted in a modification charge of approximately $360 million which is being recognized over the vesting periods of the new options. These vesting periods range from six months to approximately five years. We recorded approximately $42 million and $53 million of the modification charge in the three and six months ended June 30, 2009.

Stock-based compensation increased $20.3 million and $17.0 million from the three and six months ended June 30, 2008 to the three and six months ended June 30, 2009, largely due to the modification charge recognized in the three and six months ended June 30, 2009. The increase was partially offset by lower stock-based compensation expense as a result of a significant amount of equity awards which fully vested during 2008 as well as an adjustment made to the overall estimated forfeiture rate during the three months ended June 30, 2009.

We expect stock-based compensation to be approximately $1.1 billion in 2009 and $1.9 billion thereafter. These amounts do not include stock-based compensation related to stock awards that have been and may be granted to employees and directors subsequent to June 30, 2009 and stock awards that have been or may be granted to non-employees. In addition, to the extent forfeiture rates are different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

Interest and Other Income (Expense), Net

Interest and other income (expense), net, decreased $75.6 million from the three months ended June 30, 2008 to the three months ended June 30, 2009. This decrease was primarily a result of an increase in net foreign exchange related costs of $41.0 million as a result of the increased hedging activities related to exposures in foreign currency and a decrease in interest income of $38.1 million due to lower yields on our cash and investment balances. These decreases were partially offset by an increase in net realized gains on sales of marketable securities of $11.1 million as well as a $9.0 million gain recognized on the sale of our equity investment in America Online, Inc. to Time Warner Inc. for $283.0 million. We received the related cash proceeds in July 2009.

Interest and other income (expense), net, decreased $236.8 million from the six months ended June 30, 2008 to the six months ended June 30, 2009. This decrease was primarily a result of an increase in net foreign exchange related costs of $133.6 million as a result of the increased hedging activities related to exposures in foreign currency and a decrease in interest income of $94.0 million due to lower yields on our cash and investment balances.

The costs of our foreign exchange hedging activities that we recognized to interest and other income (expense), net are primarily a function of the notional amount of the option and forward contracts and their related duration, the volatility of the foreign exchange rates as well as the movement of the foreign exchange rates relative to the strike prices of the contracts.

As we expand our international business, we believe costs related to hedging activities under our foreign exchange risk management program may increase in dollar amount in the remainder of 2009 and future periods.

Table of Contents

Provision for Income Taxes

The following table presents our provision for income taxes, and effective tax rate for the periods presented (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
	(unaudited)			
Provision for income taxes	$ 388.5	$ 371.6	$ 795.0	$ 838.6
Effective tax rate	23.7%	20.0%	23.7%	22.4%

Our provision for income taxes and effective tax rate decreased from the three months ended June 30, 2008 to the three months ended June 30, 2009, primarily because proportionately more of our annual earnings in 2009 compared to 2008 are expected to be realized in countries where we have lower statutory tax rates.

Our provision for income taxes increased from the six months ended June 30, 2008 to the six months ended June 30, 2009, primarily as a result of increases in federal and state income taxes, driven by higher taxable income period over period. Our effective tax rate decreased from the six months ended June 30, 2008 to the six months ended June 30, 2009, primarily because proportionately more of our annual earnings in 2009 compared to 2008 are expected to be realized in countries where we have lower statutory tax rates partially offset by certain discrete items.

Our effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected to the extent earnings are lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates. Our effective tax rate could also fluctuate due to the net gains and losses recognized by legal entities on certain hedges and related hedged intercompany and other transactions under our foreign exchange risk management program, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Liquidity and Capital Resources

In summary, our cash flows were as follows (in millions):

	Six Months Ended June 30,	
	2008	2009
	(unaudited)	
Net cash provided by operating activities	$ 3,545.6	$ 3,858.7
Net cash used in investing activities	(2,365.6)	(636.0)
Net cash provided by financing activities	72.2	46.4

At June 30, 2009, we had $19.3 billion of cash, cash equivalents and marketable securities. Cash equivalents and marketable securities are comprised of highly liquid debt instruments of the U.S. government and its agencies, municipalities in the U.S., time deposits, money market mutual funds, mortgage-backed securities and U.S. corporate securities. See Note 3 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for a further discussion on the composition of our cash, cash equivalents and marketable securities.

Our principal sources of liquidity are our cash, cash equivalents and marketable securities, as well as the cash flow that we generate from our operations. At December 31, 2008 and June 30, 2009, we had unused letters of credit of $109.9 million and $95.5 million. We believe that our existing cash, cash equivalents, marketable securities and cash generated from operations will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months. Our liquidity could be negatively affected by a decrease in demand for our products and services, including the impact of changes in customer buying or advertiser spending behavior that may result from the continuing weak economic conditions. Also, if the banking system or the financial markets continue to deteriorate or remain volatile, our investment portfolio may be impacted and the value and liquidity of

our investments could be adversely affected. In addition, we may make acquisitions or license products and technologies complementary to our business and may need to raise additional capital through future debt or equity financing to provide for greater flexibility to fund any such acquisitions and licensing activities. Additional financing may not be available at all or on terms favorable to us.

Table of Contents

Cash provided by operating activities consisted of net income adjusted for certain non-cash items including depreciation, amortization, stock-based compensation expense, excess tax benefits from stock-based award activities, deferred income taxes, and the effect of changes in working capital and other activities. Cash provided by operating activities in the six months ended June 30, 2009 was $3,858.7 million and consisted of net income of $2,907.4 million, adjustments for non-cash items of $1,176.8 million and cash used in working capital and other activities of $225.5 million. Adjustments for non-cash items primarily consisted of $632.1 million of depreciation and amortization expense on property and equipment, $570.6 million of stock-based compensation expense and $148.1 million of amortization of intangibles and other, partially offset by $114.4 million of deferred income taxes and $36.4 million of excess tax benefits from stock-based award activities. In addition, the decrease in cash from changes in working capital activities primarily consisted of a decrease of $281.2 million in accrued expenses and other liabilities primarily as a result of employee bonuses for the year ended December 31, 2008 paid in the first quarter of 2009, a net decrease of $63.5 million of income taxes payable and deferred income taxes (which includes the same $36.4 million of excess tax benefits from stock-based awards included under adjustments for non-cash items), an increase of $41.7 million in accounts receivable due to the growth in fees billed to our advertisers, partially offset by a decrease of $87.8 million in prepaid revenue share, expenses and other assets primarily due to a decrease in the value of derivative assets, an increase in accounts payable of $41.8 million, and to a lesser extent, by an increase in accrued revenue share of $19.1 million. The decrease in income taxes payable and deferred income taxes was primarily a result of more estimated income taxes paid during the first half of 2009 for the year ending December 31, 2009, partially offset by additional tax obligations accrued.

Cash provided by operating activities in the six months ended June 30, 2008 was $3,545.6 million and consisted of net income of $2,554.5 million, adjustments for non-cash items of $1,056.2 million and cash used in working capital and other activities of $65.1 million. Adjustments for non-cash items primarily consisted of $589.3 million of depreciation and amortization expense on property and equipment, $553.6 million of stock-based compensation expense and $138.9 million of amortization of intangibles and other, partially offset by $105.9 million of deferred income taxes and $95.0 million of excess tax benefits from stock-based award activities. In addition, changes in working capital activities primarily consisted of an increase of $296.4 million in accounts receivable due to the growth in fees billed to our advertisers, an increase of $182.8 million in prepaid revenue share, expenses and other assets, and a decrease of $147.3 million in accrued expenses and other liabilities primarily as a result of employee bonuses for the year ended December 31, 2007 paid in the first quarter of 2008, partially offset by a net increase in income taxes payable and deferred income taxes of $528.4 million, which includes the same $95.0 million of excess tax benefits from stock-based awards included under adjustments for non-cash items, and to a lesser extent, by an increase in accounts payable of $39.2 million. The increase in income taxes payable and deferred income taxes was primarily a result of additional tax obligations accrued.

As we expand our business internationally, we have offered payment terms to certain advertisers that are standard in their locales, but longer than terms we would generally offer to our domestic advertisers. This may increase our working capital requirements and may have a negative effect on cash provided by our operating activities.

Cash used in investing activities in the six months ended June 30, 2009 of $636.0 million was attributable to purchases of marketable securities of $10,635.6 million and capital expenditures of $402.2 million, partially offset by the net proceeds received from the sales and maturities of marketable securities of $10,435.3 million. Cash used in investing activities in the six months ended June 30, 2008 of $2,365.6 million was attributable to purchases of marketable securities of $4,921.3 million and cash consideration used in acquisitions and other investments of $3,321.8 million, primarily related to the DoubleClick acquisition, and capital expenditures of $1,539.1 million, partially offset by net proceeds received from the sales and maturities of marketable securities of $7,416.6 million.

Capital expenditures are mainly for the purchase of information technology assets. In order to manage expected increases in internet traffic, advertising transactions and new products and services, and to support our overall global business expansion, we will make significant investments in data center operations, technology, corporate facilities and information technology infrastructure in the remainder of 2009 and thereafter. However, the amount of our capital expenditures has fluctuated and may continue to fluctuate on a quarterly basis.

In addition, we expect to spend a significant amount of cash on acquisitions and other investments from time to time. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other functional areas, our technologies and our product offerings. In connection with certain acquisitions, we are obligated to make additional cash payments if certain criteria are met. As of June 30, 2009, our remaining contingent obligations related to these acquisitions was approximately $36 million, which if the criteria are met, would be recorded as part of the purchase. Since these contingent payments are based on the achievement of performance targets, actual payments may be substantially lower.

38

Table of Contents

Cash provided by financing activities in the six months ended June 30, 2009 of $46.4 million was primarily due to excess tax benefits of $36.4 million from stock-based award activities during the period which represents a portion of the $108.0 million reduction to income taxes payable that we recorded in the first half of 2009 related to the total direct tax benefit realized from the exercise, sale or vesting of these awards, as well as net proceeds related to stock-based award activities of $10.0 million. Net proceeds result when the cash we receive upon the exercise of stock options exceeds the tax withholding payments we make on behalf of our employees upon the net settlement of their vested restricted stock units. Cash provided by financing activities in the six months ended June 30, 2008 of $72.2 million was primarily due to excess tax benefits of $95.0 million from stock-based award activities during the period which represents a portion of the $150.2 million reduction to income taxes payable that we recorded in the first half of 2008 related to the total direct tax benefit realized from the exercise, sale or vesting of these awards, as well as net payments related to stock-based award activities of $22.7 million.

Table of Contents

Contractual Obligations

We are obligated under certain agreements to make non-cancelable guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. At December 31, 2008 and June 30, 2009, our aggregate outstanding non-cancelable guaranteed minimum revenue share commitments totaled $1,030.3 million and $536.4 million through 2012.

In addition, we recorded additional long-term taxes payable of $344.9 million in the six months ended June 30, 2009 as FIN 48 specifies that tax positions for which the timing of the ultimate resolution is uncertain should be recognized as long-term liabilities. At this time, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing of tax audit outcomes.

Critical Accounting Policies and Estimates

We prepare our Consolidated Financial Statements in accordance with accounting principles generally accepted in the U.S. In doing so, we have to make estimates and assumptions that affect our reported amounts of assets, liabilities, revenues and expenses, as well as related disclosure of contingent assets and liabilities. In some cases, we could reasonably have used different accounting policies and estimates. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations will be affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies and estimates, which we discuss further below. We have reviewed our critical accounting policies and estimates with the audit committee of our board of directors.

Income Taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes.

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

Our effective tax rates have differed from the statutory rate primarily due to the tax impact of foreign operations, research and experimentation tax credits, state taxes, and certain benefits realized related to stock option activities. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Stock-Based Compensation

We account for stock-based compensation in accordance with SFAS No. 123R, *Share-Based Payment* (SFAS 123R). Under the provisions of SFAS 123R, stock-based compensation cost is estimated at the grant date based on the award s fair value as calculated by the Black-Scholes-Merton (BSM) option-pricing model and is recognized as expense over the requisite service period. The BSM model requires various highly judgmental assumptions including expected volatility and option life. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on historical experience. Further, to the extent our actual forfeiture rate is different from our estimate, stock-based compensation expense is adjusted accordingly.

Traffic Acquisition Costs

We are obligated under certain agreements to make non-cancelable guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or

Table of Contents

advertisements displayed. To the extent we expect revenues generated under such an arrangement to exceed the guaranteed minimum revenue share payments, we recognize traffic acquisition costs on a contractual revenue share basis or on a basis proportionate to forecasted revenues, whichever is greater. If our estimate of revenues under such an arrangement is subsequently revised downward, then the amount of traffic acquisition costs we would recognize thereafter would be proportionately greater. Otherwise, we recognize the guaranteed revenue share payments as traffic acquisition costs on a straight-line basis over the term of the related agreements.

Impairment of Marketable and Non-Marketable Securities

We periodically review our marketable securities, as well as our non-marketable equity securities for impairment. If we conclude that any of these investments are impaired, we determine whether such impairment is other-than-temporary as defined under FSP FAS 115-1 and FAS 124-1*, The Meaning of Other Than-Temporary Impairment and Its Application to Certain Investments*, and FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other Than-Temporary Impairments* . Factors we consider to make such determination include the duration and severity of the impairment, the reason for the decline in value and the potential recovery period, and our intent and ability to hold an investment. If any impairment is considered other-than-temporary, we will write down the asset to its fair value and take a corresponding charge to our Consolidated Statement of Income.

Effect of Recent Accounting Pronouncements

In May 2009, the FASB issued Statement of SFAS 165, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 also requires the disclosure of the date through which an entity has evaluated subsequent events and whether that evaluation date represents the date the financial statements were issued or were available to be issued. We adopted SFAS 165 in the second quarter of 2009 and the adoption did not have any impact on our consolidated financial statements.

In June 2009, the FASB issued SFAS 167, which changes the consolidation rules as they relate to variable interest entities. Specifically, SFAS 167 makes significant changes to the model for determining who should consolidate a variable interest entity, and also addresses how often this assessment should be performed. SFAS 167 will be effective for us beginning in the first quarter of 2010. We do not expect the adoption will have a material impact on our consolidated financial statements.

Available Information

Our web site is located at www.google.com, and our investor relations web site is located at http://investor.google.com. The following filings are available through our investor relations web site after we file them with the Securities and Exchange Commission (SEC): Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and our Proxy Statements for our annual stockholder s meetings (for the last two years). We also provide a link to the section of the SEC s web site at www.sec.gov that has all of our public filings. Our Quarterly Reports, Annual Reports, and Proxy Statements for the last two years are also available for download free of charge on our investor relations web site. Further, a copy of this Quarterly Report on Form 10-Q is located at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at www.sec.gov.

We webcast our earnings calls and certain events we participate in or host with members of the investment community on our investor relations web site. Additionally, we provide notifications of news or announcements regarding our financial performance, including SEC filings, investor events, press and earnings releases, and blogs as part of our investor relations web site. The contents of these web sites are not intended to be incorporated by reference into this Quarterly Report on Form 10-Q or in any other report or document we file and any reference to these web sites are intended to be inactive textual references only.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in currency exchange rates and interest rates.

Foreign Exchange Risk

Economic Exposure

We transact business in various foreign currencies and have significant international revenues as well as costs denominated in foreign currencies. This exposes us to foreign currency risk. We purchase foreign exchange option

Table of Contents

contracts to reduce the volatility of cash flows primarily related to forecasted revenues denominated in certain foreign currencies. The objective of the foreign exchange contracts is to better ensure that the U.S. dollar-equivalent cash flows are not adversely affected by changes in the U.S. dollar/foreign currency exchange rate. In accordance with SFAS 133, these contracts are designated as cash flow hedges. The gain on the effective portion of a cash flow hedge is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into revenues when the hedged revenues are recorded or as interest and other income (expense), net, if the hedged transaction becomes probable of not occurring. Any gain after a hedge is de-designated because the hedged transaction is no longer probable of occurring or related to an ineffective portion of a hedge is recognized as interest and other income (expense), net, immediately.

At December 31, 2008, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 1.9 billion (or approximately $2.6 billion) and $152.0 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £1.1 billion (or approximately $1.8 billion) and $277.9 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$229.7 million (or approximately $202.2 million) and $21.8 million. At June 30, 2009, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 2.2 billion (or approximately $2.8 billion) and $66.5 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £1.1 billion (or approximately $1.6 billion) and $47.5 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$276.2 million (or approximately $228.3 million) and $7.6 million. These foreign exchange options have maturities of 18 months or less. There are no other foreign exchange contracts designated as cash flow hedges. However, we may enter into similar contracts in other foreign currencies in the future.

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that changes in exchange rates of 20% for our foreign currencies instruments could be experienced in the near term.

If the U.S. dollar weakened by 20%, the amount recorded in accumulated other comprehensive income before tax effect would have been approximately $38 million lower at June 30, 2009, and the total amount of expense recorded as interest and other income (expense), net, would have been approximately $75 million higher in the three months ended June 30, 2009. If the U.S. dollar strengthened by 20%, the amount recorded in accumulated other comprehensive income before tax effect would have been approximately $644 million higher at June 30, 2009, and the total amount of expense recorded as interest and other income (expense), net, would have been approximately $51 million higher in the three months ended June 30, 2009.

Transaction Exposure

Our exposure to foreign currency transaction gains and losses is the result of certain net receivables due from our foreign subsidiaries and customers being denominated in currencies other than the functional currency of the subsidiary, primarily the Euro, the British pound and the Japanese yen. Our foreign subsidiaries conduct their businesses in local currency. We have entered into foreign exchange contracts to offset the foreign exchange risk on certain monetary assets and liabilities denominated in currencies other than the local currency of the subsidiary. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $2.6 billion and $2.1 billion at December 31, 2008 and June 30, 2009. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $54.2 million and $158.9 million at December 31, 2008 and June 30, 2009. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 630.5 million (or approximately $897.6 million) and 477.2 million (or approximately $671.4 million) at December 31, 2008 and June 30, 2009. The notional principal of foreign exchange contracts to sell Euros for other currencies was 1.5 million (or approximately $2.2 million) at June 30, 2009.

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that adverse changes in exchange rates of 20% for all currencies could be experienced in the near term. These changes would have resulted in an adverse impact on income before income taxes of approximately $16 million and $4 million at December 31, 2008 and June 30, 2009. The adverse impact at December 31, 2008 and June 30, 2009 is after consideration of the offsetting effect of approximately $555 million and $551 million from forward exchange contracts in place for the months of December 2008 and June 2009. These reasonably possible adverse changes in exchange rates of 20% were applied to total monetary assets denominated in currencies other than the local currencies at the balance sheet dates to compute the adverse impact these changes would have had on our income before taxes in the near term.

Table of Contents

Interest Rate Risk

We invest our excess cash primarily in highly liquid debt instruments of the U.S. government and its agencies, municipalities in the U.S., time deposits, money market mutual funds, mortgage-backed securities and corporate securities. By policy, we limit the amount of credit exposure to any one issuer.

Investments in both fixed rate and floating rate interest earning securities carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than predicted if interest rates fall. Due in part to these factors, our income from investments may decrease in the future.

We considered the historical volatility of short term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term. A hypothetical 1.00% (100 basis-point) increase in interest rates would have resulted in a decrease in the fair values of our marketable securities of approximately $83 million and $69 million at December 31, 2008 and June 30, 2009.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting.

We regularly review our system of internal control over financial reporting to ensure we maintain an effective internal control environment. As we grow geographically and with new product offerings, we continue to create new processes and controls as well as improve our existing environment to increase efficiencies. Improvements may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in a variety of claims, suits, investigations and proceedings arising from the ordinary course of our business, including actions with respect to intellectual property claims, breach of contract claims, labor and employment claims, tax and other matters. Although claims, suits, investigations and proceedings are inherently uncertain and their results cannot be predicted with certainty, we believe that the resolution of our current pending matters will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flow. Regardless of the outcome, litigation can have an adverse impact on us because of defense costs, diversion of management resources and other factors. In addition, it is possible that an unfavorable resolution of one or more such proceedings could in the future materially and adversely affect our financial position, results of operations or cash flows in a particular period. See the risk factors *Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our products, services, and brand* and *We are, and may in the future be, subject to intellectual property rights claims, which are costly to defend, could require us to pay damages and could limit our ability to use certain technologies in the future* in the Risks Related to Our Business and Industry section of Part II, Item 1A of this Quarterly Report on Form 10-Q.

EPA Investigation

In February 2009, we learned of a U.S. Environmental Protection Agency (EPA) investigation into an alleged release of refrigerant at one of our smaller data facilities, which we acquired from DoubleClick, and the accuracy of related statements and records. We are cooperating with the EPA and have provided documents and other materials. The EPA investigation could result in fines, civil or criminal penalties, or other administrative action.

While we currently believe this matter will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows, we have noted it in accord with Securities and Exchange Commission regulations that call for disclosure of certain environmental proceedings that may result in monetary sanctions of $100,000 or more.

ITEM 1A. RISK FACTORS

Risks Related to Our Business and Industry

We face significant competition from web search providers, internet advertising companies, online service and content providers, and traditional media companies.

We face significant competition in every aspect of our business. This includes competition from web search providers, internet advertising companies, companies that provide products and services online, and companies that provide online content. Our competitors include companies ranging from large and established companies to emerging start-ups. Established companies have longer operating histories and more established relationships with customers and end users, and they can use their experience and resources against us in a variety of competitive ways, including by making acquisitions, investing aggressively in research and development, and competing aggressively for advertisers and web sites. Emerging start-ups may be able to innovate and provide products and services faster than we can.

In certain markets outside the U.S., other web search, advertising services, and internet companies have greater brand recognition, more users, and more search traffic than we have. Even in countries where we have a significant user following, we may not be as successful in generating advertising revenues due to slower market development, our inability to provide attractive local advertising services, or other factors. To compete more effectively, we need to better understand our international users and their preferences, improve our brand recognition, enhance our selling efforts internationally, and build stronger relationships with advertisers. If we fail to do so, our global expansion efforts may be more costly and less profitable than we expect.

In addition to competition from internet advertising companies, internet advertising companies such as Google face substantial competition from companies that offer traditional media advertising services. Most large advertisers allocate only a small portion of their overall advertising budgets to internet advertising, and we expect that large advertisers will continue to focus most of their advertising efforts on traditional media. If we fail to convince these companies to spend a portion of their advertising budgets with

us, or if our existing advertisers reduce the amount they spend on our programs, our operating results will be harmed.

Table of Contents

We expect our revenue growth rate to decline and anticipate downward pressure on our operating margin in the future.

We believe our revenue growth rate will generally decline as a result of a number of factors including increasing competition, the inevitable decline in growth rates as our revenues increase to higher levels, the increasing maturity of the online advertising market and, more recently, the significant global economic crisis. We believe our operating margin will experience downward pressure as a result of increasing competition and increased expenditures for many aspects of our business. Our operating margin will also experience downward pressure if a greater percentage of our revenues comes from ads placed on our Google Network members web sites compared to revenues generated through ads placed on our own web sites or if we spend a proportionately larger amount to promote the distribution of certain products, including Google Toolbar. The margin on revenues we generate from our Google Network members is significantly less than the margin on revenues we generate from advertising on our web sites. Additionally, the margin we earn on revenues generated from our Google Network members could decrease in the future if we pay an even larger percentage of advertising fees to our Google Network members.

Our operating results may fluctuate, which makes our results difficult to predict and could cause our results to fall short of expectations.

Our operating results may fluctuate as a result of a number of factors, many outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. Our quarterly, year-to-date, and annual expenses as a percentage of our revenues may differ significantly from our historical or projected rates. Our operating results in future quarters may fall below expectations. Any of these events could cause our stock price to fall. Each of the risk factors listed in this Item 1A and the following factors may affect our operating results:

- Our ability to continue to attract users to our web sites and satisfy existing users on our web sites.
- Our ability to monetize (or generate revenues from) traffic on our web sites and our Google Network members web sites.
- Our ability to attract advertisers to our AdWords program.
- Our ability to attract web sites to our AdSense program.
- The mix in our revenues between those generated on our web sites and those generated through our Google Network.
- The amount of revenues and expenses generated and incurred in currencies other than U.S. dollars, and our ability to manage the resulting risk through our foreign exchange risk management program.
- The amount and timing of operating costs and capital expenditures related to the maintenance and expansion of our businesses, operations, and infrastructure.
- Our focus on long-term goals over short-term results.
- The results of our investments in risky projects.

Our ability to keep our web sites operational at a reasonable cost and without service interruptions.

Our ability to achieve revenue goals for partners to whom we guarantee minimum payments or pay distribution fees.

Our ability to generate significant revenues from services in which we have invested considerable time and resources, such as YouTube and Google Checkout.

Because our business is changing and evolving, our historical operating results may not be useful to you in predicting our future operating results. In addition, advertising spending has historically been cyclical in nature, reflecting overall economic conditions as well as budgeting and buying patterns. For example, in 1999, advertisers spent heavily on internet advertising. This was followed by a lengthy downturn in ad spending on the web. Also, user traffic tends to be seasonal. Our rapid growth has tended to mask the cyclicality and seasonality of our business. As our growth rate has slowed, the cyclicality and seasonality in our business has become more pronounced and caused our operating results to fluctuate.

Table of Contents

If we do not continue to innovate and provide products and services that are useful to users, we may not remain competitive, and our revenues and operating results could suffer.

Our success depends on providing products and services that make using the internet a more useful and enjoyable experience for our users. Our competitors are constantly developing innovations in web search, online advertising, and web based products and services. As a result, we must continue to invest significant resources in research and development in order to enhance our web search technology and our existing products and services and introduce new products and services that people can easily and effectively use. If we are unable to provide quality products and services, then our users may become dissatisfied and move to a competitor s products and services. In addition, these new products and services may present new and difficult technology challenges, and we may be subject to claims if users of these offerings experience service disruptions or failures or other quality issues. Our operating results would also suffer if our innovations are not responsive to the needs of our users, advertisers, and Google Network members, are not appropriately timed with market opportunities or are not effectively brought to market. As search technology continues to develop, our competitors may be able to offer search results that are, or that are seen to be, substantially similar to or better than ours. This may force us to compete in different ways and expend significant resources in order to remain competitive.

We generate our revenues almost entirely from advertising, and the reduction in spending by or loss of advertisers could seriously harm our business.

We generated 97% of our revenues in both 2008 and the first six months of 2009 from our advertisers. Our advertisers can generally terminate their contracts with us at any time. Advertisers will not continue to do business with us if their investment in advertising with us does not generate sales leads, and ultimately customers, or if we do not deliver their advertisements in an appropriate and effective manner. In addition, expenditures by advertisers tend to be cyclical, reflecting overall economic conditions and budgeting and buying patterns. If we are unable to remain competitive and provide value to our advertisers, they may stop placing ads with us, which would negatively harm our revenues and business.

The effects of the recent global economic crisis may impact our business, operating results, or financial condition.

The recent global economic crisis has caused disruptions and extreme volatility in global financial markets and increased rates of default and bankruptcy, and has impacted levels of consumer spending. These macroeconomic developments have negatively affected and may continue to affect our business, operating results, or financial condition in a number of ways. For example, current or potential customers may delay or decrease spending with us, may have difficulty paying us, or may delay paying us for previously purchased products and services. This may also require us to increase our bad debt reserve and may affect how we recognize accounts receivables. In addition, if consumer spending continues to decrease, this may result in fewer clicks on our advertisers ads displayed on our web sites and our Google Network members web sites. Finally, if the banking system or the financial markets continue to deteriorate or remain volatile, our investment portfolio may be impacted and the values and liquidity of our investments could be adversely affected. Continuing poor economic conditions will likely continue these trends.

We rely on our Google Network members for a significant portion of our revenues, and we benefit from our association with them. The loss of these members could adversely affect our business.

We provide advertising, web search, and other services to our Google Network members, which accounted for 31% of our revenues in 2008 and 30% of our revenues in the six months ended June 30, 2009. Some of the participants in this network may compete with us in one or more areas. They may decide in the future to terminate their agreements with us. If our Google Network members decide to use a competitor s or their own web search or advertising services, our revenues would decline. Our agreements with a few of the largest Google Network members account for a significant portion of revenues derived from our AdSense program. If our relationship with one or more large Google Network members were terminated or renegotiated on terms less favorable to us, our business could be adversely affected.

Also, certain of our key Google Network members operate high-profile web sites, and we derive tangible and intangible benefits from this affiliation. If one or more of these key relationships is terminated or not renewed, and is not replaced with a comparable relationship, our business would be adversely affected.

Table of Contents

Our business and operations are experiencing rapid growth. If we fail to effectively manage our growth, our business and operating results could be harmed.

We have experienced rapid growth in our headcount and operations, which has placed, and will continue to place, significant demands on our management, operational, and financial infrastructure. If we do not effectively manage our growth, the quality of our products and services could suffer, which could negatively affect our brand and operating results. Our expansion and growth in international markets heighten these risks as a result of the particular challenges of supporting a rapidly growing business in an environment of multiple languages, cultures, customs, legal systems, alternative dispute systems, regulatory systems, and commercial infrastructures. To effectively manage this growth, we will need to continue to improve our operational, financial and management controls, and our reporting systems and procedures. These systems enhancements and improvements will require significant capital expenditures and management resources. Failure to implement these improvements could hurt our ability to manage our growth and our financial position.

Our business depends on a strong brand, and failing to maintain and enhance our brand would hurt our ability to expand our base of users, advertisers, and Google Network members.

The brand identity that we have developed has significantly contributed to the success of our business. Maintaining and enhancing the Google brand is critical to expanding our base of users, advertisers, Google Network members, and other partners. We believe that the importance of brand recognition will increase due to the relatively low barriers to entry in the internet market. If we fail to maintain and enhance the Google brand, or if we incur excessive expenses in this effort, our business, operating results, and financial condition will be materially and adversely affected. Maintaining and enhancing our brand will depend largely on our ability to be a technology leader and continue to provide high-quality products and services, which we may not do successfully.

Acquisitions could result in operating difficulties, dilution, and other harmful consequences.

We have acquired a number of businesses in the past, including our acquisitions of DoubleClick and Postini. We expect to continue to evaluate and enter into discussions regarding a wide array of potential strategic transactions. These transactions could be material to our financial condition and results of operations. The process of integrating an acquired company, business, or technology has created, and will continue to create unforeseen operating difficulties and expenditures. The areas where we face risks include:

- Implementation or remediation of controls, procedures, and policies at the acquired company.
- Diversion of management time and focus from operating our business to acquisition integration challenges.
- Coordination of product, engineering, and sales and marketing functions.
- Transition of operations, users, and customers onto our existing platforms.
- Cultural challenges associated with integrating employees from the acquired company into our organization.
- Retention of employees from the businesses we acquire.
- Integration of the acquired company s accounting, management information, human resource, and other administrative systems.

Liability for activities of the acquired company before the acquisition, including patent and trademark infringement claims, violations of laws, commercial disputes, tax liabilities, and other known and unknown liabilities.

Litigation or other claims in connection with the acquired company, including claims from terminated employees, customers, former stockholders, or other third parties.

In the case of foreign acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political, and regulatory risks associated with specific countries.

Failure to successfully further develop the acquired technology.

Our failure to address these risks or other problems encountered in connection with our past or future acquisitions and strategic investments could cause us to fail to realize the anticipated benefits of such acquisitions or investments, incur unanticipated liabilities and harm our business generally.

Table of Contents

Future acquisitions or dispositions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses, or write-offs of goodwill, any of which could harm our financial condition. Also, the anticipated benefit of many of our acquisitions may not materialize. For example, we have yet to realize significant revenue benefits from our acquisition of YouTube.

Our international operations are subject to increased risks which could harm our business, operating results, and financial condition.

International revenues accounted for approximately 51% of our total revenues in 2008 and approximately 52% of our total revenues in the first six months of 2009. More than half of our user traffic came from outside the U.S. in the first six months of 2009. We have limited experience with operations outside the U.S. and our ability to manage our business and conduct our operations internationally requires considerable management attention and resources and is subject to a number of risks, including the following:

- Challenges caused by distance, language, and cultural differences and by doing business with foreign agencies and governments.
- Longer payment cycles in some countries.
- Uncertainty regarding liability for services and content.
- Credit risk and higher levels of payment fraud.
- Currency exchange rate fluctuations and our ability to manage these fluctuations under our foreign exchange risk management program.
- Foreign exchange controls that might prevent us from repatriating cash earned in countries outside the U.S.
- Import and export requirements that may prevent us from shipping products or providing services to a particular market and may increase our operating costs.
- Potentially adverse tax consequences.
- Higher costs associated with doing business internationally.
- Different employee/employer relationships and the existence of workers councils and labor unions.

In addition, compliance with complex foreign and U.S. laws and regulations that apply to our international operations increases our cost of doing business in international jurisdictions and could expose us or our employees to fines and penalties. These numerous and sometimes conflicting laws and regulations include import and export requirements, content requirements, trade restrictions, tax laws, sanctions, internal and disclosure control rules, data privacy requirements, labor relations laws, U.S. laws such as the Foreign Corrupt Practices Act, and local laws prohibiting corrupt payments to governmental officials. Violations of these laws and regulations could result in fines, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our

business, and damage to our reputation. Although we have implemented policies and procedures designed to ensure compliance with these laws, there can be no assurance that our employees, contractors, or agents will not violate our policies. Any such violations could include prohibitions on our ability to offer our products and services to one or more countries, and could also materially damage our reputation, our brand, our international expansion efforts, our ability to attract and retain employees, our business, and our operating results.

Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our products, services, and brand.

Our patents, trademarks, trade secrets, copyrights, and other intellectual property rights are important assets for us. Various events outside of our control pose a threat to our intellectual property rights as well as to our products and services. For example, effective intellectual property protection may not be available in every country in which our products and services are distributed or made available through the internet. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant impairment of our intellectual property rights could harm our business or our ability to compete. Also, protecting our intellectual property rights is costly and time consuming. Any increase in the unauthorized use of our intellectual property could make it more expensive to do business and harm our operating results.

Table of Contents

Although we seek to obtain patent protection for our innovations, it is possible we may not be able to protect some of these innovations. Changes in patent law, such as changes in the law regarding patentable subject matter, can also impact our ability to obtain patent protection for our innovations. In addition, given the costs of obtaining patent protection, we may choose not to protect certain innovations that later turn out to be important. Furthermore, there is always the possibility, despite our efforts, that the scope of the protection gained will be insufficient or that an issued patent may be deemed invalid or unenforceable.

We also face risks associated with our trademarks. For example, there is a risk that the word Google could become so commonly used that it becomes synonymous with the word search. If this happens, we could lose protection for this trademark, which could result in other people using the word Google to refer to their own products, thus diminishing our brand.

We also seek to maintain certain intellectual property as trade secrets. The secrecy could be compromised by outside parties, or by our employees, which would cause us to lose the competitive advantage resulting from these trade secrets.

We are, and may in the future be, subject to intellectual property rights claims, which are costly to defend, could require us to pay damages, and could limit our ability to use certain technologies in the future.

Companies in the internet, technology, and media industries own large numbers of patents, copyrights, trademarks. and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. As we have grown, the intellectual property rights claims against us have increased and may continue to increase. Our products, services, and technologies may not be able to withstand any third-party claims and regardless of the merits of the claim, intellectual property claims are often time-consuming and expensive to litigate or settle. In addition, to the extent claims against us are successful, we may have to pay substantial monetary damages or discontinue any of our services or practices that are found to be in violation of another party s rights.

We also may have to seek a license to continue such practices, which may significantly increase our operating expenses. In addition, many of our agreements with our Google Network members and other partners require us to indemnify these members for certain third-party intellectual property infringement claims, which would increase our costs as a result of defending such claims and may require that we pay damages if there were an adverse ruling in any such claims.

Companies have filed trademark infringement and related claims against us over the display of ads in response to user queries that include trademark terms. The outcomes of these lawsuits have differed from jurisdiction to jurisdiction. We currently have three cases pending at the European Court of Justice, which will address questions regarding whether advertisers and search engines can be held liable for use of trademarked terms in keyword advertising. We are litigating, or have recently litigated similar issues in other cases, in the U.S., Australia, Austria, Brazil, Chile, China, France, Germany, Israel, Italy, and Taiwan.

We have also had copyright claims filed against us by companies alleging that features of certain of our products and services, including Google Web Search, Google News, Google Video, Google Image Search, Google Book Search, and YouTube, infringe the rights of others. In the U.S. we announced a settlement with the Authors Guild and the Association of American Publishers; however, this class action settlement is subject to approval by the U.S. District Court for the Southern District of New York, and we may be subject to additional claims with respect to Google Book Search both in the U.S. and in other parts of the world. Adverse results in these lawsuits may include awards of substantial monetary damages, costly royalty or licensing agreements, or orders preventing us from offering certain functionalities, and may also result in a change in our business practices, which could result in a loss of revenues for us or otherwise harm our business. In addition, any time one of our products or services links to or hosts material in which others allegedly own copyrights, we face the risk of being sued for copyright infringement or related claims. Because these products and services comprise the majority of our products and services, the risk of harm from such lawsuits could be substantial.

We have also had patent lawsuits filed against us alleging that certain of our products and services, including Google Web Search, Google AdWords, Google AdSense, Google Talk, and Google Chrome, infringe patents held by others. In addition, the number of demands for license fees and the dollar amounts associated with each request continue to increase. Adverse results in these lawsuits, or our decision to license patents based upon these demands, may result in substantial costs and, in the case of adverse litigation rulings, could prevent us from offering certain features, functionalities, products, or services, which could result in a loss of revenues for us or otherwise harm our business.

49

Table of Contents

Privacy concerns relating to our technology could damage our reputation and deter current and potential users from using our products and services.

From time to time, concerns have been expressed about whether our products and services compromise the privacy of users and others. Concerns about our practices with regard to the collection, use, disclosure, or security of personal information or other privacy-related matters, even if unfounded, could damage our reputation and operating results. While we strive to comply with all applicable data protection laws and regulations, as well as our own posted privacy policies, any failure or perceived failure to comply may result in proceedings or actions against us by government entities or others, which could potentially have an adverse effect on our business.

In addition, as nearly all of our products and services are web based, the amount of data we store for our users on our servers (including personal information) has been increasing. Any systems failure or compromise of our security that results in the release of our users data could seriously limit the adoption of our products and services as well as harm our reputation and brand and, therefore, our business. We may also need to expend significant resources to protect against security breaches. The risk that these types of events could seriously harm our business is likely to increase as we expand the number of web based products and services we offer as well as increase the number of countries where we operate.

Regulatory authorities around the world are considering a number of legislative proposals concerning data protection. In addition, the interpretation and application of data protection laws in Europe and elsewhere are still uncertain and in flux. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could have an adverse effect on our business. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

A variety of new and existing U.S. and foreign laws could subject us to claims or otherwise harm our business.

We are subject to a variety of laws in the U.S. and abroad that are costly to comply with, can result in negative publicity and diversion of management time and effort, and can subject us to claims or other remedies. Many of these laws were adopted prior to the advent of the internet and related technologies and, as a result, do not contemplate or address the unique issues of the internet and related technologies. The laws that do reference the internet are being interpreted by the courts, but their applicability and scope remain uncertain. For example, the laws relating to the liability of providers of online services are currently unsettled both within the U.S. and abroad. Claims have been threatened and filed under both U.S. and foreign law for defamation, libel, slander, invasion of privacy and other tort claims, unlawful activity, copyright and trademark infringement, or other theories based on the nature and content of the materials searched and the ads posted by our users, our products and services, or content generated by our users.

In addition, the Digital Millennium Copyright Act has provisions that limit, but do not necessarily eliminate, our liability for listing or linking to third-party web sites that include materials that infringe copyrights or other rights, so long as we comply with the statutory requirements of this act. The Child Online Protection Act and the Children s Online Privacy Protection Act restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from minors. In the area of data protection, many states have passed laws requiring notification to users when there is a security breach for personal data, such as California s Information Practices Act. We face similar risks and costs as our products and services are offered in international markets and may be subject to additional regulations.

We are subject to increased regulatory scrutiny that may negatively impact our business.

The growth of our company and our expansion into a variety of new fields implicate a variety of new regulatory issues and may subject us to increased regulatory scrutiny, particularly in the U.S. and Europe. Moreover, our competitors have employed and will likely continue to employ significant resources to shape the legal and regulatory regimes in countries where we have significant operations. Legislators and regulators may make legal and regulatory changes, or interpret and apply existing laws, in ways that make our products and services less useful to our users, require us to incur substantial costs, or change our business practices. These changes or increased costs could negatively impact our business.

Table of Contents

More individuals are using non-PC devices to access the internet. If users of these devices do not widely adopt versions of our web search technology, products, or operating systems developed for these devices, our business could be adversely affected.

The number of people who access the internet through devices other than personal computers, including mobile telephones, personal digital assistants (PDAs), smart phones, handheld computers, and video game consoles, as well as television set-top devices, has increased dramatically in the past few years. The lower resolution, functionality, and memory associated with alternative devices make the use of our products and services through such devices more difficult and the versions of our products and services developed for these devices may not be compelling to users, manufacturers, or distributors of alternative devices. Each manufacturer or distributor may establish unique technical standards for its devices, and our products and services may not work or be viewable on these devices as a result. As we have limited experience to date in operating versions of our products and services, including Google Mobile and Android, developed or optimized for users of alternative devices and as new devices and new platforms are continually being released, it is difficult to predict the problems we may encounter in developing versions of our products and services for use on these alternative devices and we may need to devote significant resources to the creation, support, and maintenance of such devices. If we are unable to attract and retain a substantial number of alternative device manufacturers, distributors, and users to our products and services or if we are slow to develop products and technologies that are more compatible with non-PC devices, we will fail to capture a significant share of an increasingly important portion of the market for online services, which could adversely affect our business.

Our business may be adversely affected by malicious applications that interfere with, or exploit security flaws in, our products and services.

Our business may be adversely affected by malicious applications that make changes to our users computers and interfere with the Google experience. These applications have in the past attempted, and may in the future attempt, to change our users internet experience, including hijacking queries to Google.com, altering or replacing Google search results, or otherwise interfering with our ability to connect with our users. The interference often occurs without disclosure to or consent from users, resulting in a negative experience that users may associate with Google. These applications may be difficult or impossible to uninstall or disable, may reinstall themselves and may circumvent other applications efforts to block or remove them. In addition, we offer a number of products and services that our users download to their computers or that they rely on to store information and transmit information to others over the internet. These products and services are subject to attack by viruses, worms, and other malicious software programs, which could jeopardize the security of information stored in a user s computer or in our computer systems and networks. The ability to reach users and provide them with a superior experience is critical to our success. If our efforts to combat these malicious applications are unsuccessful, or if our products and services have actual or perceived vulnerabilities, our reputation may be harmed and our user traffic could decline, which would damage our business.

Proprietary document formats may limit the effectiveness of our search technology by preventing our technology from accessing the content of documents in such formats, which could limit the effectiveness of our products and services.

A large amount of information on the internet is provided in proprietary document formats such as Microsoft Word. These proprietary document formats may limit the effectiveness of our search technology by preventing our technology from accessing the content of such documents. The providers of the software application used to create these documents could engineer the document format to prevent or interfere with our ability to access the document contents with our search technology. This would mean that the document contents would not be included in our search results even if the contents were directly relevant to a search. The software providers may also seek to require us to pay them royalties in exchange for giving us the ability to search documents in their format. If a software provider also competes with us in the search business, it may give its search technologies, or the technologies of our competitors, a preferential ability to search documents in its proprietary format. Any of these results could harm our brand and our operating results.

New technologies could block our ads, which would harm our business.

Technologies have been developed that can block the display of our ads. Most of our revenues are derived from fees paid to us by advertisers in connection with the display of ads on web pages. As a result, ad-blocking technology could adversely affect our operating results.

Table of Contents

If we fail to detect click fraud or other invalid clicks, we could face additional litigation as well as lose the confidence of our advertisers, which would cause our business to suffer.

We are exposed to the risk of fraudulent clicks and other invalid clicks on our ads from a variety of potential sources. We have regularly refunded fees that our advertisers have paid to us that were later attributed to click fraud and other invalid clicks, and we expect to do so in the future. Invalid clicks are clicks that we have determined are not intended by the user to link to the underlying content, such as inadvertent clicks on the same ad twice and clicks resulting from click fraud. Click fraud occurs when a user intentionally clicks on a Google AdWords ad displayed on a web site for a reason other than to view the underlying content. If we are unable to stop these invalid clicks, these refunds may increase. If we find new evidence of past invalid clicks we may issue refunds retroactively of amounts previously paid to our Google Network members. This would negatively affect our profitability, and these invalid clicks could hurt our brand. If invalid clicks are not detected, the affected advertisers may experience a reduced return on their investment in our advertising programs because the invalid clicks will not lead to potential revenues for the advertisers. This could lead the advertisers to become dissatisfied with our advertising programs, which has led to litigation alleging click fraud and could lead to further litigation, as well as to a loss of advertisers and revenues.

Interruption or failure of our information technology and communications systems could hurt our ability to effectively provide our products and services, which could damage our reputation and harm our operating results.

The availability of our products and services depends on the continuing operation of our information technology and communications systems. Our systems are vulnerable to damage or interruption from earthquakes, terrorist attacks, floods, fires, power loss, telecommunications failures, computer viruses, computer denial of service attacks, or other attempts to harm our systems. Some of our data centers are located in areas with a high risk of major earthquakes. Our data centers are also subject to break-ins, sabotage, and intentional acts of vandalism, and to potential disruptions if the operators of these facilities have financial difficulties. Some of our systems are not fully redundant, and our disaster recovery planning cannot account for all eventualities. The occurrence of a natural disaster, a decision to close a facility we are using without adequate notice for financial reasons, or other unanticipated problems at our data centers could result in lengthy interruptions in our service. In addition, our products and services are highly technical and complex and may contain errors or vulnerabilities. Any errors or vulnerabilities in our products and services, or damage to or failure of our systems could result in interruptions in our services, which could reduce our revenues and profits, and damage our brand.

Index spammers could harm the integrity of our web search results, which could damage our reputation and cause our users to be dissatisfied with our products and services.

There is an ongoing and increasing effort by index spammers to develop ways to manipulate our web search results. For example, because our web search technology ranks a web page s relevance based in part on the importance of the web sites that link to it, people have attempted to link a group of web sites together to manipulate web search results. We take this problem very seriously because providing relevant information to users is critical to our success. If our efforts to combat these and other types of index spamming are unsuccessful, our reputation for delivering relevant information could be diminished. This could result in a decline in user traffic, which would damage our business.

If we were to lose the services of Eric, Larry, Sergey, or other members of our senior management team, we may not be able to execute our business strategy.

Our future success depends in a large part upon the continued service of key members of our senior management team. In particular, our CEO, Eric Schmidt, and our founders, Larry Page and Sergey Brin, are critical to the overall management of Google as well as the development of our technology, our culture, and our strategic direction. All of our executive officers and key employees are at-will employees, and we do not maintain any key-person life insurance policies. The loss of any of our management or key personnel could seriously harm our business.

We rely on highly skilled personnel and, if we are unable to retain or motivate key personnel, hire qualified personnel, or maintain our corporate culture, we may not be able to grow effectively.

Our performance largely depends on the talents and efforts of highly skilled individuals. Our future success depends on our continuing ability to identify, hire, develop, motivate, and retain highly skilled personnel for all areas of our organization. Competition in our industry for qualified employees is intense, and certain of our competitors have directly targeted our employees. In addition, our compensation arrangements, such as our equity award programs, may not always be successful in attracting new

employees and retaining and motivating our existing employees. Our continued ability to compete effectively depends on our ability to attract new employees and to retain and motivate our existing employees.

Table of Contents

In addition, we believe that our corporate culture fosters innovation, creativity, and teamwork. As our organization grows, and we are required to implement more complex organizational management structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

We may have difficulty scaling and adapting our existing architecture to accommodate increased traffic and technology advances or changing business requirements, which could lead to the loss of users, advertisers, and Google Network members, and cause us to incur expenses to make architectural changes.

To be successful, our network infrastructure has to perform well and be reliable. The greater the user traffic and the greater the complexity of our products and services, the more computing power we will need. We have spent and expect to continue to spend substantial amounts on the purchase and lease of data centers and equipment and the upgrade of our technology and network infrastructure to handle increased traffic on our web sites and to roll out new products and services. This expansion is expensive and complex and could result in inefficiencies or operational failures. If we do not expand successfully, or if we experience inefficiencies and operational failures, the quality of our products and services and our users experience could decline. This could damage our reputation and lead us to lose current and potential users, advertisers, and Google Network members. Cost increases, loss of traffic, or failure to accommodate new technologies or changing business requirements could harm our operating results and financial condition.

We rely on bandwidth providers, data centers, and others in providing products and services to our users, and any failure or interruption in the services and products provided by these third parties could damage our reputation and harm our ability to operate our business.

We rely on vendors, including data center and bandwidth providers, in providing products and services to our users. Any disruption in the network access or colocation services provided by these providers or any failure of these providers to handle current or higher volumes of use could significantly harm our business. Any financial or other difficulties our providers face may have negative effects on our business. We exercise little control over these vendors, which increases our vulnerability to problems with the services they provide. We license technology and related databases to facilitate aspects of our data center and connectivity operations including internet traffic management services. We have experienced and expect to continue to experience interruptions and delays in service and availability for such elements. Any errors, failures, interruptions, or delays in connection with these technologies and information services could harm our relationship with users, adversely affect our brand, and expose us to liabilities.

Our business depends on continued and unimpeded access to the internet by us and our users. Internet access providers may be able to block, degrade, or charge for access to certain of our products and services, which could lead to additional expenses and the loss of users and advertisers.

Our products and services depend on the ability of our users to access the internet, and certain of our products require significant bandwidth to work effectively. Currently, this access is provided by companies that have significant and increasing market power in the broadband and internet access marketplace, including incumbent telephone companies, cable companies, and mobile communications companies. Some of these providers have stated that they may take measures that could degrade, disrupt, or increase the cost of user access to certain of our products by restricting or prohibiting the use of their infrastructure to support or facilitate our offerings, or by charging increased fees to us or our users to provide our offerings. These activities may be permitted in the U.S. after recent regulatory changes, including recent decisions by the U.S. Supreme Court and Federal Communications Commission. While interference with access to our popular products and services seems unlikely, such carrier interference could result in a loss of existing users and advertisers and increased costs, and could impair our ability to attract new users and advertisers, thereby harming our revenues and growth.

Table of Contents

To the extent our revenues are paid in foreign currencies, and currency exchange rates become unfavorable, we may lose some of the economic value of the revenues in U.S. dollar terms.

As we expand our international operations, more of our customers may pay us in foreign currencies. Since we conduct business in currencies other than U.S. dollars but report our financial results in U.S. dollars, we face exposure to fluctuations in currency exchange rates. For instance, if currency exchange rates were to change unfavorably, the U.S. dollar equivalent of our operating income recorded in foreign currencies would be diminished. Hedging strategies, such as forward contracts, options, and foreign exchange swaps that we have implemented or may implement to mitigate this risk may not reduce or completely offset our exposure to foreign exchange fluctuations. Additionally, hedging programs expose us to risks that could adversely affect our financial results, including the following:

- We have limited experience in implementing or operating hedging programs. Hedging programs are inherently risky and we could lose money as a result of poor trades.
- We may be unable to hedge currency risk for some transactions or match the accounting for the hedge with the exposure because of a high level of uncertainty or the inability to reasonably estimate our foreign exchange exposures.
- We may be unable to acquire foreign exchange hedging instruments in some of the geographic areas where we do business, or, where these derivatives are available, we may not be able to acquire enough of them to fully offset our exposure.
- We may determine that the cost of acquiring a foreign exchange hedging instrument outweighs the benefit we expect to derive from the derivative, in which case we would not purchase the derivative and would be exposed to unfavorable changes in currency exchange rates.
- To the extent we recognize a gain on a hedge transaction in one of our subsidiaries that is subject to a high statutory tax rate, and a loss on the related hedged transaction that is subject to a lower rate, our effective tax rate would be higher.
- Significant fluctuations in foreign exchange rates could greatly increase our hedging costs.

Payments to certain of our Google Network members have exceeded the related fees we receive from our advertisers.

We are obligated under certain agreements to make non-cancelable guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. In these agreements, we promise to make these minimum payments to the Google Network member for a pre-negotiated period of time. At June 30, 2009, our aggregate outstanding non-cancelable guaranteed minimum revenue share commitments totaled $536.4 million through 2012 compared to $1.03 billion at December 31, 2008. It is difficult to forecast with certainty the fees that we will earn under agreements with guarantees, and sometimes the fees we earn fall short of the guaranteed minimum payment amounts.

We rely on outside providers for our worldwide billing, collection, payment processing, and payroll. If these outside service providers are not able to fulfill their service obligations, our business and operations could be disrupted, and our operating results could be harmed.

Outside providers perform various functions for us, such as worldwide billing, collection, payment processing, and payroll. These functions are critical to our operations and involve sensitive interactions between us and our advertisers, Google Network members, and employees. Although we have implemented service level agreements and have established monitoring controls, if we do not successfully manage our service providers or if the service providers do not perform satisfactorily to agreed-upon service levels, our operations could be disrupted resulting in advertiser, partner, or employee dissatisfaction. In addition, our business,

reputation, and operating results could be adversely affected.

Table of Contents

We may have exposure to greater than anticipated tax liabilities.

Our future income taxes could be adversely affected by earnings being lower than anticipated in jurisdictions where we have lower statutory tax rates and higher than anticipated in jurisdictions where we have higher statutory tax rates, by changes in the valuation of our deferred tax assets and liabilities, as a result of gains on our foreign exchange risk management program, or changes in tax laws, regulations, accounting principles, or interpretations thereof. Our determination of our tax liability is always subject to review by applicable tax authorities. Any adverse outcome of such a review could have a negative effect on our operating results and financial condition. In addition, the determination of our worldwide provision for income taxes and other tax liabilities requires significant judgment, and there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

Risks Related to Ownership of Our Common Stock

The trading price for our Class A common stock has been and may continue to be volatile.

The trading price of our Class A common stock has been volatile since our initial public offering and will likely continue to be volatile. The trading price of our Class A common stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include:

- Quarterly variations in our results of operations or those of our competitors.
- Announcements by us or our competitors of acquisitions, new products, significant contracts, commercial relationships, or capital commitments.
- Recommendations by securities analysts or changes in earnings estimates.
- Announcements about our earnings that are not in line with analyst expectations, the risk of which is enhanced because it is our policy not to give guidance on earnings.
- Announcements by our competitors of their earnings that are not in line with analyst expectations.
- The volume of shares of Class A common stock available for public sale.
- Sales of stock by us or by our stockholders.
- Short sales, hedging, and other derivative transactions on shares of our Class A common stock (including derivative transactions under our TSO program).

In addition, the stock market in general, and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our Class A common stock, regardless of our actual operating performance. In the past, following periods of volatility in the overall market and the market price of a company s securities, securities class-action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management s attention and resources.

We do not intend to pay dividends on our common stock.

We have never declared or paid any cash dividend on our capital stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future.

The concentration of our capital stock ownership with our founders, executive officers, and our directors and their affiliates will limit our stockholders ability to influence corporate matters.

Our Class B common stock has 10 votes per share and our Class A common stock has one vote per share. As of June 30, 2009, our founders, executive officers, and directors (and their affiliates) together owned shares of Class A common stock, Class B common stock, and other equity interests representing approximately 71% of the voting power of our outstanding capital stock. In particular, as of June 30, 2009, our two founders and our CEO, Larry, Sergey, and Eric, owned approximately 90% of our outstanding Class B common stock, representing approximately 68% of the voting power of our outstanding capital stock. Larry, Sergey, and Eric therefore have significant influence over management and affairs and over all matters requiring stockholder approval, including the election of directors and significant corporate transactions, such as a merger or other sale of our company or its assets, for the foreseeable future. This concentrated control limits our stockholders ability to influence corporate matters and, as a result, we may take actions that our stockholders do not view as beneficial. As a result, the market price of our Class A common stock could be adversely affected.

Table of Contents

Provisions in our charter documents and under Delaware law could discourage a takeover that stockholders may consider favorable.

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. These provisions include the following:

- Our certificate of incorporation provides for a dual class common stock structure. As a result of this structure our founders, executives, and employees have significant influence over all matters requiring stockholder approval, including the election of directors and significant corporate transactions, such as a merger or other sale of our company or its assets. This concentrated control could discourage others from initiating any potential merger, takeover, or other change of control transaction that other stockholders may view as beneficial.

- Our board of directors has the right to elect directors to fill a vacancy created by the expansion of the board of directors or the resignation, death, or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors.

- Our stockholders may not act by written consent. As a result, a holder, or holders, controlling a majority of our capital stock would not be able to take certain actions without holding a stockholders meeting.

- Our certificate of incorporation prohibits cumulative voting in the election of directors. This limits the ability of minority stockholders to elect director candidates.

- Stockholders must provide advance notice to nominate individuals for election to the board of directors or to propose matters that can be acted upon at a stockholders meeting. These provisions may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer s own slate of directors or otherwise attempting to obtain control of our company.

- Our board of directors may issue, without stockholder approval, shares of undesignated preferred stock. The ability to issue undesignated preferred stock makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

As a Delaware corporation, we are also subject to certain Delaware anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Results of Google s Transferable Stock Option Program

Under our TSO program, which we launched in April 2007, eligible employees are able to sell vested stock options to participating financial institutions in an online auction as an alternative to exercising options in the traditional method and then selling the underlying shares. The following table provides information with respect to sales by our employees of TSOs during the three months ended June 30, 2009:

Period (1)	Aggregate Amounts			Weighted-Average Per Share Amounts		
	Number of Shares Underlying TSOs Sold	Sale Price of TSOs Sold (in thousands)	TSO Premium (2) (in thousands)	Exercise Price of TSOs Sold	Sale Price of TSOs Sold	TSO Premium (2)
April 1-30	72,766	$ 11,732	$ 2,632	$ 274.95	$ 161.23	$ 36.17
May 1-31	102,763	16,904	3,122	280.95	164.49	30.39
June 1-30						
Total (except weighted-average amounts)	175,529	$ 28,636	$ 5,754	$ 278.46	$ 163.14	$ 32.78

(1) The TSO program is generally active during regular trading hours for The Nasdaq Stock Market when Google s trading window is open. However, we have the right to suspend the TSO program at any time for any reason, including for maintenance and other technical reasons.

(2) TSO premium is calculated as the difference between (a) the sale price of the TSO and (b) the intrinsic value of the TSO, which we define as the excess, if any, of the price of our Class A common stock at the time of the sale over the exercise price of the TSO.

Table of Contents

In April 2009, we amended our TSO program to allow participation by executive officers (other than Eric Schmidt, Sergey Brin, and Larry Page) in our TSO program. During the three months ended June 30, 2009, none of our executive officers sold TSOs.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our 2009 Annual Stockholders Meeting on May 7, 2009 at our corporate headquarters at 1600 Amphitheatre Parkway, Mountain View, California 94043. The following proposals were submitted to the stockholders:

The election of ten directors to serve for the ensuing year or until their successors are duly elected and qualified.

The ratification of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2009.

The approval of an amendment to our 2004 Stock Plan to increase the number of authorized shares of Class A common stock issuable under the 2004 Stock Plan from 28,931,660 to 37,431,660 shares.

To consider a stockholder proposal to request that management institute policies to help protect freedom of access to the internet.

To consider a stockholder proposal to adopt principles for health care reform.

Holders of our Class A common stock are entitled to one vote per share and holders of our Class B common stock are entitled to ten votes per share and vote together as a single class on all matters (including the election of directors) submitted to a vote of stockholders, unless otherwise required by law. The holders of our common stock voted as follows:

Board of Director Election Results

	Votes For	Votes Against
Eric Schmidt	799,301,145	61,260,551
Larry Page	799,451,579	61,110,117
Sergey Brin	799,461,404	61,100,292
Shirley M. Tilghman	798,510,611	62,051,085
L. John Doerr	799,814,572	60,747,124
John L. Hennessy	779,661,373	80,900,323
Arthur D. Levinson	762,697,880	97,863,816
Ann Mather	797,876,020	62,685,676
Paul S. Otellini	762,859,262	97,702,434
K. Ram Shriram	799,872,518	60,689,178

The ten nominees who received the highest number of votes (all of the above individuals) were elected to the Board of Directors, and will serve as directors until our next annual meeting or until their respective successors are elected and qualified.

Ratification of Ernst & Young LLP as Google s Independent Registered Public Accounting Firm

The results of the voting included 859,877,038 votes for, 451,155 votes against, 233,503 votes abstained, and zero votes were non-votes. The appointment was ratified.

Approval of Amendment to Google s 2004 Stock Plan

The results of the voting included 682,316,062 votes for, 141,473,404 votes against, 502,035 votes abstained, and 36,270,195 votes were non-votes. The amendment was approved.

Table of Contents

Stockholder Proposal Relating to the Request that Management Institute Policies to Help Protect Freedom of Access to the Internet

The results of the voting included 9,357,871 votes for, 493,724,296 votes against, 321,209,449 votes abstained, and 36,270,080 votes were non-votes. The stockholder proposal was not approved.

Stockholder Proposal Relating to Adopting Principles for Health Care Reform

The results of the voting included 6,716,611 votes for, 780,495,806 votes against, 37,079,199 votes abstained, and 36,270,080 votes were non-votes. The stockholder proposal was not approved.

ITEM 6. EXHIBITS

Exhibit Number		Description
10.08	♥	Google Inc. 2004 Stock Plan, as amended. Incorporated by reference to Exhibit 10.08 of Google s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 11, 2009
31.01	*	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02	*	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01		Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	**	XBRL Instance Document
101.SCH	**	XBRL Taxonomy Extension Schema Document
101.CAL	**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	**	XBRL Taxonomy Extension Presentation Linkbase Document

♥ Indicates management compensatory plan, contract or arrangement.

* Filed herewith.

Furnished herewith.

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GOOGLE INC.

Date: August 4, 2009

By: /s/ PATRICK PICHETTE
Patrick Pichette
Senior Vice President and Chief Financial Officer
(Principal Financial Officer and duly authorized signatory)

Table of Contents

EXHIBIT INDEX

Exhibit Number		Description
10.08	♥	Google Inc. 2004 Stock Plan, as amended. Incorporated by reference to Exhibit 10.08 of Google s Current Report on Form 8-K filed with the Securities and Exchange Commission on May 11, 2009
31.01	*	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02	*	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01		Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	**	XBRL Instance Document
101.SCH	**	XBRL Taxonomy Extension Schema Document
101.CAL	**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	**	XBRL Taxonomy Extension Presentation Linkbase Document

♥ Indicates management compensatory plan, contract or arrangement.

* Filed herewith.

Furnished herewith.

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.