Google Inc.
Form 10-Q
October 29, 2010
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 September 30, 2010

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, including 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 Website, 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.

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 October 25, 2010, there were 248,407,078 shares of Google s Class A common stock outstanding and 71,368,036 shares of Google s Class B common stock outstanding.

GOOGLE INC.

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GOOGLE INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except share and par value amounts which are reflected in thousands, and par value per share amounts)

	As of December 31, 2009	As of September 30, 2010 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 10,198	$ 11,257
Marketable securities	14,287	22,123
Total cash, cash equivalents, and marketable securities (including securities loaned of $0 and $3,652)	24,485	33,380
Accounts receivable, net of allowance of $79 and $65	3,178	3,616
Receivable under reverse repurchase agreements	0	875
Deferred income taxes, net	644	138
Income taxes receivable, net	23	228
Prepaid revenue share, expenses and other assets	837	1,210
Total current assets	29,167	39,447
Prepaid revenue share, expenses and other assets, non-current	415	406
Deferred income taxes, net, non-current	263	406
Non-marketable equity securities	129	485
Property and equipment, net	4,845	5,506
Intangible assets, net	775	993
Goodwill	4,903	6,099
Total assets	$ 40,497	$ 53,342
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 216	$ 528
Short-term debt	0	2,122
Accrued compensation and benefits	982	1,104
Accrued expenses and other current liabilities	570	841
Accrued revenue share	694	752
Securities lending payable	0	2,861
Deferred revenue	285	322
Total current liabilities	2,747	8,530
Deferred revenue, non-current	42	33
Income taxes payable, non-current	1,392	1,098

Other long-term liabilities		312		391
Stockholders equity:				
Convertible preferred stock, $0.001 par value per share, 100,000 shares authorized; no shares issued and outstanding		0		0
Class A and Class B common stock and additional paid-in capital, $0.001 par value per share: 9,000,000 shares authorized; 317,772 (Class A 243,611, Class B 74,161) and par value of $318 (Class A $244, Class B $74) and 319,234 (Class A 247,489, Class B 71,745) and par value of $319 (Class A $247, Class B $72) shares issued and outstanding		15,817		17,435
Accumulated other comprehensive income		105		531
Retained earnings		20,082		25,324
Total stockholders equity		36,004		43,290
Total liabilities and stockholders equity	$	40,497	$	53,342

See accompanying notes.

Table of Contents

GOOGLE INC.

CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Revenues	$ 5,945	$ 7,286	$ 16,977	$ 20,881
Costs and expenses:				
Cost of revenues (including stock-based compensation expense of $15, $8, $41 and $22)	2,226	2,552	6,436	7,471
Research and development (including stock-based compensation expense of $196, $244, $546 and $637)	758	994	2,107	2,711
Sales and marketing (including stock-based compensation expense of $62, $75, $179 and $185)	498	661	1,401	1,897
General and administrative (including stock-based compensation expense of $45, $53, $122 and $136)	389	532	1,202	1,403
Total costs and expenses	3,871	4,739	11,146	13,482
Income from operations	2,074	2,547	5,831	7,399
Interest and other income (expense), net	(7)	167	(19)	255
Income before income taxes	2,067	2,714	5,812	7,654
Provision for income taxes	428	547	1,266	1,692
Net income	$ 1,639	$ 2,167	$ 4,546	$ 5,962
Net income per share of Class A and Class B common stock:				
Basic	$ 5.18	$ 6.80	$ 14.39	$ 18.73
Diluted	$ 5.13	$ 6.72	$ 14.27	$ 18.49

See accompanying notes.

Table of Contents

GOOGLE INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2010
	(unaudited)	
Operating activities		
Net income	$ 4,546	$ 5,962
Adjustments:		
Depreciation and amortization of property and equipment	943	787
Amortization of intangibles and other assets	216	228
Stock-based compensation expense	888	980
Excess tax benefits from stock-based award activities	(64)	(43)
Deferred income taxes	(288)	23
Other	(26)	(7)
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(127)	(456)
Income taxes, net	97	(295)
Prepaid revenue share, expenses and other assets	313	(355)
Accounts payable	9	314
Accrued expenses and other liabilities	(14)	316
Accrued revenue share	57	69
Deferred revenue	35	32
Net cash provided by operating activities	6,585	7,555
Investing activities		
Purchases of property and equipment	(589)	(1,473)
Purchases of marketable securities	(19,587)	(37,589)
Maturities and sales of marketable securities	17,016	30,369
Investments in non-marketable equity securities	(46)	(265)
Cash collateral received from securities lending	0	2,861
Investments in reverse repurchase agreements	0	(875)
Acquisitions, net of cash acquired, and purchases of intangible and other assets	(40)	(859)
Net cash used in investing activities	(3,246)	(7,831)
Financing activities		
Net proceeds (payments) related to stock-based award activities	11	(65)
Excess tax benefits from stock-based award activities	64	43
Repurchase of common stock in connection with acquisitions	0	(801)
Issuance of short-term debt, maturities of 3 months or less, net	0	737
Issuance of short-term debt, maturities longer than 3 months	0	1,384
Net cash provided by financing activities	75	1,298
Effect of exchange rate changes on cash and cash equivalents	16	37

Net increase in cash and cash equivalents		3,430		1,059
Cash and cash equivalents at beginning of year		8,657		10,198
Cash and cash equivalents at end of period	$	12,087	$	11,257
Supplemental disclosures of cash flow information				
Cash paid for income taxes	$	1,453	$	1,954
Non-cash financing activity:				
Fair value of common stock issued and vested options assumed in connection with acquisitions	$	0	$	750

See accompanying notes.

5

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 hosted applications.

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 September 30, 2010, the Consolidated Statements of Income for the three and nine months ended September 30, 2009 and 2010, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and 2010 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 September 30, 2010, our results of operations for the three and nine months ended September 30, 2009 and 2010, and our cash flows for the nine months ended September 30, 2009 and 2010. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the year ending December 31, 2010.

These unaudited interim Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related notes included in our 2009 Annual Report on Form 10-K filed on February 12, 2010.

Use of Estimates

The preparation of interim Consolidated Financial Statements in conformity with 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 the accounts receivable and sales allowances, fair values of financial instruments, intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of stock-based awards, income taxes, and contingent liabilities, 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.

Table of Contents

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 millions, except share amounts which are reflected in thousands and per share amounts):

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2009		2010		2009		2010	
	(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	$ 1,253	$ 386	$ 1,677	$ 490	$ 3,470	$ 1,076	$ 4,596	$ 1,366
Denominator								
Weighted-average common shares outstanding	241,914	74,583	246,521	72,096	241,116	74,774	245,341	72,946
Less: Weighted-average unvested common shares subject to repurchase or cancellation	0	0	0	0	(7)	0	0	0
Number of shares used in per share computation	241,914	74,583	246,521	72,096	241,109	74,774	245,341	72,946
Basic net income per share	$ 5.18	$ 5.18	$ 6.80	$ 6.80	$ 14.39	$ 14.39	$ 18.73	$ 18.73
Diluted net income per share:								
Numerator								
Allocation of undistributed earnings for basic computation	$ 1,253	$ 386	$ 1,677	$ 490	$ 3,470	$ 1,076	$ 4,596	$ 1,366
Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares	386	0	490	0	1,076	0	1,366	0
Reallocation of undistributed earnings to Class B shares	0	(3)	0	(5)	0	(7)	0	(16)
Allocation of undistributed earnings	$ 1,639	$ 383	$ 2,167	$ 485	$ 4,546	$ 1,069	$ 5,962	$ 1,350
Denominator								
Number of shares used in basic computation	241,914	74,583	246,521	72,096	241,109	74,774	245,341	72,946
Weighted-average effect of dilutive securities								
Add:								
Conversion of Class B to Class A common shares outstanding	74,583	0	72,096	0	74,774	0	72,946	0
Unvested common shares subject to repurchase or cancellation	0	0	0	0	7	0	0	0
Employee stock options, including warrants issued under Transferable Stock Option program	2,583	75	2,904	59	2,155	84	3,219	70
Restricted shares and restricted stock units	666	0	856	0	456	0	984	0
Number of shares used in per share computation	319,746	74,658	322,377	72,155	318,501	74,858	322,490	73,016
Diluted net income per share	$ 5.13	$ 5.13	$ 6.72	$ 6.72	$ 14.27	$ 14.27	$ 18.49	$ 18.49

The net income per share amounts are 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.

Table of Contents

Note 3. Cash and Investments

Cash, cash equivalents, and marketable securities consist of the following (in millions):

	As of December 31, 2009	As of September 30, 2010 (unaudited)
Cash and cash equivalents:		
Cash	$ 4,303	$ 4,046
Cash equivalents:		
Time deposits	3,740	1,041
Money market and other funds[1]	2,153	5,635
U.S. government agencies	2	0
U.S. government notes	0	500
Corporate debt securities	0	35
Total cash and cash equivalents	10,198	11,257

	As of December 31, 2009	As of September 30, 2010 (unaudited)
Marketable securities:		
Time deposits	1,250	257
Money market mutual funds	28	3
U.S. government agencies	3,703	1,969
U.S. government notes	2,492	3,831
Foreign government bonds	37	1,288
Municipal securities	2,130	2,349
Corporate debt securities	2,822	6,403
Agency residential mortgage-backed securities	1,578	5,739
Commercial mortgage-backed securities	48	46
Marketable equity security	199	238
Total marketable securities	14,287	22,123
Total cash, cash equivalents and marketable securities	$ 24,485	$ 33,380

(1) The balance at September 30, 2010 includes $2.0 billion of cash collateral received in connection with our securities lending program, which was invested in reverse repurchase agreements maturing within three months. See below for further discussion on this program. No similar amounts were outstanding as of December 31, 2009.

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

As of December 31, 2009

	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Time deposits	$ 1,250	$ 0	$ 0	$ 1,250
Money market mutual funds	28	0	0	28
U.S. government agencies	3,700	5	(2)	3,703
U.S. government notes	2,520	0	(28)	2,492
Foreign government bonds	37	0	0	37
Municipal securities	2,100	30	0	2,130
Corporate debt securities	2,826	13	(17)	2,822
Agency residential mortgage-backed securities	1,585	5	(12)	1,578
Commercial mortgage-backed securities	47	1	0	48
Marketable equity security	145	54	0	199
Total	$ 14,238	$ 108	$ (59)	$ 14,287

Table of Contents

	As of September 30, 2010			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(unaudited)			
Time deposits	$ 257	$ 0	$ 0	$ 257
Money market mutual funds	3	0	0	3
U.S. government agencies	1,962	7	0	1,969
U.S. government notes	3,725	106	0	3,831
Foreign government bonds	1,243	46	(1)	1,288
Municipal securities	2,324	26	(1)	2,349
Corporate debt securities	6,136	273	(6)	6,403
Agency residential mortgage-backed securities	5,687	63	(11)	5,739
Commercial mortgage-backed securities	46	0	0	46
Marketable equity security	145	93	0	238
Total	$ 21,528	$ 614	$ (19)	$ 22,123

Gross unrealized gains and losses on cash equivalents were not material at December 31, 2009 and September 30, 2010.

Foreign government bonds consist of USD and non-USD denominated bonds issued by foreign governments.

Corporate debt securities consist of investment grade securities, high-yield securities, foreign corporate bonds that are guaranteed by sovereign governments, and emerging market bonds.

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

Marketable equity security consists of our investment in Clearwire Corporation.

We recognized gross realized gains of $26 million and $67 million for the three months ended September 30, 2009 and 2010. We recognized gross realized gains of $79 million and $148 million for the nine months ended September 30, 2009 and 2010. Gross realized losses were not material for the three and nine months ended September 30, 2009. We recognized gross realized losses of $5 million and $18 million for the three and nine months ended September 30, 2010. We determine realized gains and losses on the sale of marketable securities on a specific identification method, and we reflect such gains and losses as a component of interest and other income (expense), net, in the accompanying Consolidated Statements of Income.

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

	As of September 30, 2010 (unaudited)
Due in 1 year	$ 2,056
Due in 1 year through 5 years	6,601
Due in 5 years through 10 years	5,618
Due after 10 years	7,610
Total	$ 21,885

9

The following tables present fair values and gross unrealized losses for those investments that were in an unrealized loss position as of December 31, 2009 and September 30, 2010, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in millions):

	As of December 31, 2009	
	Less than 12 Months	
Security Description	Fair Value	Unrealized Loss
U.S. government agencies	$ 1,273	$ (2)
U.S. government notes	2,492	(28)
Corporate debt securities	1,175	(17)
Agency residential mortgage-backed securities	1,040	(12)
Total	$ 5,980	$ (59)

	As of September 30, 2010	
	Less than 12 Months	
Security Description	Fair Value	Unrealized Loss
	(unaudited)	
Municipal securities	$ 457	$ (1)
Corporate debt securities	439	(6)
Foreign government bonds	29	(1)
Agency residential mortgage-backed securities	1,829	(11)
Total	$ 2,754	$ (19)

As of December 31, 2009, we did not have any investments in marketable securities that were in an unrealized loss position for a period of 12 months or greater. As of September 30, 2010, our investments in marketable securities that were in an unrealized loss position for a period of 12 months or greater was not material.

Auction Rate Securities

At September 30, 2010, we held $156 million of auction rate securities (ARS). The assets underlying these 31 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, $91 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 September 30, 2010, 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 1.7% per annum, which is based on the forward swap curve at the end of September 2010 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 1,700 basis points to reflect the current market conditions for instruments with similar credit quality at the date of the valuation and further adjusted by up to 400 basis points to reflect a discount for the liquidity risk associated with these investments due to the lack of an active market.

At September 30, 2010, the estimated fair value of these ARS was $24 million less than their costs. As we have no intent to sell these ARS and it is more likely than not that we will not be required to sell these ARS prior to recovery of our entire cost basis, we concluded the decline in the fair value was temporary and recorded the unrealized loss to accumulated other comprehensive income on the accompanying Consolidated Balance Sheet at September 30, 2010.

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, we classified them as non-current assets on the accompanying Consolidated Balance Sheet at September 30, 2010.

Securities Lending Program

From time to time, we enter into securities lending agreements with financial institutions to enhance investment income. We loan selected securities which are secured by collateral in the form of cash or securities. Cash collateral is invested in reverse repurchase agreements. We classify loaned securities as cash equivalents or marketable securities on the accompanying Consolidated Balance Sheets. We record the cash collateral as an asset with a corresponding liability. We classify reverse repurchase agreements maturing within three months as cash equivalents and those longer than three months as receivable under reverse repurchase agreements on the accompanying Consolidated Balance Sheets. For lending agreements collateralized by securities, we do not record an asset or liability as we are not permitted to sell or repledge the associated collateral.

Note 4. Short-Term Debt

On July 15, 2010, we announced a debt financing program of up to $3.0 billion through the issuance of commercial paper. Net proceeds from the commercial paper program are used for general corporate purposes. As of September 30, 2010, we had $2.1 billion of commercial paper outstanding recorded as short-term debt, with a weighted-average interest rate of 0.3% that matures at various dates through September 2011. The estimated fair value of the commercial paper approximates its carrying value. In conjunction with this program, we established a $3.0 billion revolving credit facility expiring on June 30, 2013. Interest rate for the credit facility is determined based on a formula using certain market rates. As of September 30, 2010, we were in compliance with the financial covenant in the credit facility. No amounts were outstanding under the credit facility as of September 30, 2010.

Note 5. 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.

We recognize derivative instruments as either assets or liabilities on the accompanying Consolidated Balance Sheets at fair value. We record changes in the fair value (i.e., gains or losses) of the derivatives 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. We initially report any gain on the effective portion of a cash flow hedge as a component of AOCI and subsequently reclassify 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 September 30, 2010, the effective portion of our cash flow hedges before tax effect was $73 million, of which $51 million is expected to be reclassified from AOCI to revenues within the next 12 months.

We recognize any gain after a hedge is de-designated or related to an ineffective portion of a hedge in interest and other income (expense), net, immediately. Further, we exclude the change in the time value of the options from our assessment of hedge effectiveness. We record 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 as an asset. Thereafter, we recognize any change to this time value in interest and other income (expense), net.

The notional principal of foreign exchange contracts to purchase U.S. dollars with Euros was 1.6 billion (or approximately $2.2 billion) and 2.7 billion (or approximately $3.6 billion) at December 31, 2009 and September 30, 2010; the notional principal of foreign exchange contracts to purchase U.S. dollars with British pounds was £809 million (or approximately $1.3 billion) and £1.5 billion (or approximately $2.2 billion) at December 31, 2009 and September 30, 2010; and the notional principal of foreign exchange contracts to purchase U.S. dollars with Canadian dollars was C$306 million (or approximately $268 million) and C$383 million (or approximately $356 million) at December 31, 2009 and September 30, 2010. These foreign exchange options have maturities of 36 months or less. We have not designated any other foreign exchange contracts as cash flow hedges.

Table of Contents

Fair Value Hedges

In November 2009, we began using forward contracts designated as fair value hedges to hedge foreign currency risks for our investments denominated in currencies other than the U.S. dollar. Gains and losses on these contracts are recognized in interest and other income (expense), net, along with the offsetting losses and gains of the related hedged items. We exclude changes in the time value for forward contracts from the assessment of hedge effectiveness and recognize them in interest and other income (expense), net. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $37 million and $694 million at December 31, 2009 and September 30, 2010.

Other Derivatives

Other derivatives not designated as hedging instruments consist primarily 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. We recognize gains and losses on these contracts as well as the related costs in interest and other income (expense), net, along with the gains and losses of the related hedged items. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $2.4 billion and $3.6 billion at December 31, 2009 and September 30, 2010. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $115 million and $69 million at December 31, 2009 and September 30, 2010. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 618 million (or approximately $889 million) and 746 million (or approximately $1.0 billion) at December 31, 2009 and September 30, 2010. The notional principal of foreign exchange contracts to sell Euros for other foreign currencies was 8 million (or approximately $11 million) at December 31, 2009.

At December 31, 2009 and September 30, 2010, the fair values of our outstanding derivative instruments are summarized below (in millions):

		Fair Value of Derivative Instruments	
	Balance Sheet Location	As of December 31, 2009	As of September 30, 2010 (unaudited)
Derivative Assets			
Derivatives designated as hedging instruments:			
Foreign exchange option contracts	Prepaid revenue share, expenses and other assets, current and non-current	$ 104	$ 209
Foreign exchange forward contracts	Prepaid revenue share, expenses and other assets, current	1	0
Derivatives not designated as hedging instruments:			
Foreign exchange forward contracts	Prepaid revenue share, expenses and other assets, current	0	7
Total		$ 105	$ 216
Derivative Liabilities			
Derivatives designated as hedging instruments:			
Foreign exchange forward contracts	Accrued expenses and other current liabilities	$ 0	$ 28
Derivatives not designated as hedging instruments:			
Foreign exchange forward contracts	Accrued expenses and other current liabilities	0	2
Total		$ 0	$ 30

Table of Contents

The effect of derivative instruments in cash flow hedging relationship on income and other comprehensive income for the three and nine months ended September 30, 2009 and 2010 is summarized below (in millions):

Derivatives in Cash Flow Hedging Relationship	Increase (Decrease) in Gains Recognized in AOCI on Derivative Before Tax Effect (Effective Portion)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Foreign exchange option contracts	$ 20	$ (194)	$ (6)	$ 236

Derivatives in Cash Flow Hedging Relationship		Gains Reclassified from AOCI into Income (Effective Portion)			
		Three Months Ended September 30,		Nine Months Ended September 30,	
	Location	2009	2010	2009	2010
		(unaudited)			
Foreign exchange option contracts	Revenues	$ 39	$ 89	$ 317	$ 178

Derivatives in Cash Flow Hedging Relationship		Gains (Losses) Recognized in Income on Derivative (Amount Excluded from Effectiveness Testing and Ineffective Portion)[1]			
		Three Months Ended September 30,		Nine Months Ended September 30,	
	Location	2009	2010	2009	2010
		(unaudited)			
Foreign exchange option contracts	Interest and other income (expense), net	$ (67)	$ (60)	$ (260)	$ (258)

(1) Gains (losses) related to the ineffective portion of the hedges were not material in all periods presented.

The effect of derivative instruments in fair value hedging relationship on income for the three and nine months ended September 30, 2010 is summarized below (in millions):

Derivatives in Fair Value Hedging Relationship		Gains (Losses) Recognized in Income on Derivatives[2]	
	Location	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2010
		(unaudited)	
Foreign exchange forward contracts	Interest and other income (expense), net	$ (58)	$ (37)
Hedged item	Interest and other income (expense), net	55	34
Total		$ (3)	$ (3)

(2) Losses related to the amount excluded from effectiveness testing of the hedges were $3 million for both the three and nine months ended September 30, 2010.

The effect of derivative instruments not designated as hedging instruments on income for the three and nine months ended September 30, 2009 and 2010 is summarized below (in millions):

Derivatives not Designated as Hedging Instruments	**Gains (Losses) Recognized in Income on Derivative**				
		Three Months Ended September 30,		**Nine Months Ended September 30,**	
	Location	**2009**	**2010**	**2009**	**2010**
		(unaudited)			
Foreign exchange forward contracts	Interest and other income (expense), net	$ (53)	$ (230)	$ (87)	$ (34)

Table of Contents

Note 6. Fair Value Measurements

We measure our cash equivalents, marketable securities, ARS, and foreign currency derivative contracts at fair value. 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. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for 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 that 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.

We classify our cash equivalents and marketable securities within Level 1 or Level 2. This is because we value our cash equivalents and marketable securities using quoted market prices or alternative pricing sources and models utilizing market observable inputs. We classify our investments in ARS 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. We classify our foreign currency derivative contracts within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

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

		Fair value measurement at reporting date using		
Description	**As of December 31, 2009**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets				
Cash equivalents:				
Time deposits	$ 3,740	$ 0	$ 3,740	$ 0
Money market mutual funds	2,153	2,153	0	0
U.S. government agencies	2	0	2	0
Marketable securities:				
Time deposit	1,250	0	1,250	0
Money market mutual funds	28	0	28	0
U.S. government agencies	3,703	0	3,703	0
U.S. government notes	2,492	2,492	0	0
Foreign government bonds	37	0	37	0
Municipal securities	2,130	0	2,130	0
Corporate debt securities	2,822	0	2,822	0
Agency residential mortgage-backed securities	1,578	0	1,578	0
Commercial mortgage-backed securities	48	0	48	0
Marketable equity security	199	199	0	0
Foreign currency derivative contracts	105	0	105	0
Auction rate securities	182	0	0	182
Total	$ 20,469	$ 4,844	$ 15,443	$ 182

Table of Contents

Description	As of September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		Fair value measurement at reporting date using (unaudited)		
Assets				
Cash equivalents:				
Time deposits	$ 1,041	$ 0	$ 1,041	$ 0
Money market and other funds	5,635	3,649	1,986[1]	0
U.S. government notes	500	500	0	0
Corporate debt securities	35	0	35	0
Marketable securities:				
Time deposit	257	0	257	0
Money market mutual funds	3	0	3	0
U.S. government agencies	1,969	0	1,969	0
U.S. government notes	3,831	3,831	0	0
Foreign government bonds	1,288	0	1,288	0
Municipal securities	2,349	0	2,349	0
Corporate debt securities	6,403	0	6,403	0
Agency residential mortgage-backed securities	5,739	0	5,739	0
Commercial mortgage-backed securities	46	0	46	0
Marketable equity security	238	238	0	0
Foreign currency derivative contracts	216	0	216	0
Auction rate securities	156	0	0	156
Total	$ 29,706	$ 8,218	$ 21,332	$ 156
Liabilities				
Foreign currency derivative contracts	$ 30	$ 0	$ 30	$ 0
Total	$ 30	$ 0	$ 30	$ 0

(1) This balance represents cash collateral received in connection with our securities lending program, which was invested in reverse repurchase agreements maturing within three months.

The following table presents a reconciliation for our assets measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2009 (in millions):

	Level 3 (unaudited)
Balance at June 30, 2009	$ 194
Change in unrealized loss included in other comprehensive income	3
Net settlements	0
Balance at September 30, 2009	$ 197

	Level 3 (unaudited)
Balance at December 31, 2008	$ 197

Change in unrealized loss included in other comprehensive income		12
Net settlements		(12)
Balance at September 30, 2009	$	197

Table of Contents

The following table presents a reconciliation for our assets measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) for the three and nine months ended September 30, 2010 (in millions):

	Level 3 (unaudited)
Balance at June 30, 2010	$ 168
Change in unrealized loss included in other comprehensive income	(1)
Net settlements	(11)
Balance at September 30, 2010	$ 156

	Level 3 (unaudited)
Balance at December 31, 2009	$ 182
Change in unrealized loss included in other comprehensive income	(1)
Net settlements	(25)
Balance at September 30, 2010	$ 156

Note 7. Property and Equipment

Property and equipment consist of the following (in millions):

	As of December 31, 2009	As of September 30, 2010 (unaudited)
Information technology assets	$ 3,868	$ 4,263
Construction in progress	1,644	2,358
Land and buildings	1,907	1,995
Leasehold improvements	646	704
Furniture and fixtures	65	63
Total	8,130	9,383
Less accumulated depreciation and amortization	3,285	3,877
Property and equipment, net	$ 4,845	$ 5,506

Note 8. Acquisitions

In August 2010, we completed the acquisition of Slide, Inc. (Slide), a privately-held social technology company for a cash consideration of $179 million.

In May 2010, we completed the acquisition of AdMob, Inc. (AdMob), a privately-held mobile display ads technology provider. The purchase price was $681 million, consisting of the issuance of approximately 1.2 million shares of our Class A common stock and assumed vested options valued at $655 million, and cash of $26 million. The issued shares were valued based on the closing price of our Class A common stock on May 27, 2010. The fair values of stock options assumed were estimated using Black-Scholes-Merton option-pricing model.

In February 2010, we completed the acquisition of On2 Technologies, Inc. (On2), a publicly-held company, and developer of video compression technology. The purchase price was $123 million, consisting of the issuance of approximately 174,000 shares of our Class A common stock valued at $95 million, based on the closing price of our Class A common stock on February 19, 2010, and cash of $28 million.

To offset the dilutive impact of issuing shares in connection with the AdMob and On2 acquisitions, we also repurchased and subsequently retired 1.6 million shares of our Class A common stock for $801 million pursuant to Rule 10b5-1 trading plans.

During the nine months ended September 30, 2010, we also completed 37 other acquisitions for a total cash consideration of approximately $626 million. These acquisitions were not material individually or in aggregate.

Table of Contents

The following table summarizes the allocation of the purchase price for all the acquisitions (in millions, unaudited):

	On2	AdMob	Slide	Other	Total
Goodwill	$ 87	$ 573	$ 136	$ 389	$ 1,185
Patents and developed technology	27	20	10	182	239
Customer relationships	2	97	10	26	135
Tradenames and other	0	15	8	32	55
Net assets acquired (liabilities assumed)	(9)	12	(2)	10	11
Deferred tax assets (liabilities)	16	(36)	17	(13)	(16)
Total	$ 123	$ 681	$ 179	$ 626	$ 1,609

For all acquisitions completed during the nine months ended September 30, 2010, patents and developed technology have a weighted-average useful life of 4.1 years, customer relationships have a weighted-average useful life of 3.3 years and tradenames and other have a weighted-average useful life of 4.0 years. The amount of goodwill expected to be deductible for tax purposes is $35 million.

Note 9. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2010 are as follows (in millions, unaudited):

Balance as of December 31, 2009	$ 4,903
Goodwill acquired	1,185
Goodwill adjustment	11
Balance as of September 30, 2010	$ 6,099

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

	As of December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Patents and developed technology	$ 566	$ 380	$ 186
Customer relationships	784	258	526
Tradenames and other	211	148	63
Total	$ 1,561	$ 786	$ 775

	As of September 30, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
		(unaudited)	
Patents and developed technology	$ 825	$ 468	$ 357
Customer relationships	919	357	562
Tradenames and other	252	178	74

Total	$ 1,996	$ 1,003	$ 993

17

Amortization expense of acquisition-related intangible assets for the three and nine months ended September 30, 2009 was $63 million and $206 million and for the three and nine months ended September 30, 2010 was $86 million and $219 million. As of September 30, 2010, expected amortization expense for acquisition-related intangible assets for each of the next five years and thereafter is as follows (in millions, unaudited):

Remainder of 2010	$ 88
2011	315
2012	256
2013	160
2014	114
2015	30
Thereafter	30
	$ 993

Note 10. Interest and Other Income (Expense), Net

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Interest income	$ 47	$ 172	$ 163	$ 403
Realized gains on marketable securities, net	19	62	69	130
Foreign currency exchange losses, net	(74)	(70)	(248)	(280)
Other	1	3	(3)	2
Interest and other income (expense), net	$ (7)	$ 167	$ (19)	$ 255

Note 11. Comprehensive Income

The changes in the components of other comprehensive income are as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Net income	$ 1,639	$ 2,167	$ 4,546	$ 5,962
Change in unrealized gains on marketable securities, net of taxes(1)	103	214	110	421
Change in cumulative translation adjustment	59	139	88	(29)
Change in unrealized gains on cash flow hedges, net of taxes(2)	(11)	(168)	(191)	34
Comprehensive income	$ 1,790	$ 2,352	$ 4,553	$ 6,388

(1) Change in unrealized gains on marketable securities is recorded net of taxes of $6 million and $92 million for the three months ended September 30, 2009 and 2010, and $5 million and $124 million for the nine months ended September 30, 2009 and 2010.

(2) Change in unrealized gains on cash flow hedges is recorded net of taxes of $8 million and $115 million for the three months ended September 30, 2009 and 2010, and $133 million and $24 million for the nine months ended September 30, 2009 and 2010.

The components of accumulated other comprehensive income are as follows (in millions):

	As of December 31, 2009	As of September 30, 2010 (unaudited)
Unrealized net gains on available-for-sale investments, net of taxes	$ 13	$ 434
Foreign currency translation adjustment	83	54
Unrealized gains on cash flow hedges, net of taxes	9	43
Accumulated other comprehensive income	$ 105	$ 531

Note 12. 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. In addition, we have had trademark infringement and related claims filed against us for allowing advertisers to bid for keywords corresponding to their competitors trademarks. 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, Taiwan, and the United Kingdom.

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 Android, Google Web Search, Google AdWords, Google AdSense, Google Talk, Google Chrome, and Google Voice, infringe patents held by others. In addition, the number of demands for license fees and the dollar amounts associated with each demand 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.

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, copyright, and patent matters noted above), government investigations, 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 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 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.

19

Table of Contents

Note 13. Stockholders Equity

The following table presents the weighted-average assumptions used to estimate the fair values of the stock options granted in the periods presented:

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2010
		(unaudited)		
Risk-free interest rate	2.8%	1.8%	2.6%	1.9%
Expected volatility	35%	35%	37%	35%
Expected life (in years)	5.8	5.7	5.8	5.3
Dividend yield	0	0	0	0
Weighted-average estimated fair value of options granted during the period	$ 168.23	$ 181.33	$ 160.05	$ 219.70

The following table summarizes the activities for our options for the nine months ended September 30, 2010:

	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, 2009	12,776,488	$ 298.73		
Granted	1,456,145	$ 443.06		
Exercised	(755,742)	$ 239.79		
Canceled/forfeited	(397,740)	$ 358.13		
Balance at September 30, 2010	13,079,151	$ 316.80	6.2	$ 2,739
Vested and exercisable as of September 30, 2010	7,202,585	$ 277.28	5.8	$ 1,794
Vested and exercisable as of September 30, 2010 and expected to vest thereafter [2]	12,467,988	$ 314.44	6.2	$ 2,640

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $525.79 of our Class A common stock on September 30, 2010.

(2) Options expected to vest reflect an estimated forfeiture rate.

The following table summarizes additional information regarding outstanding, exercisable, and vested and exercisable stock options and warrants at September 30, 2010:

Range of Exercise	Options Outstanding: Number of Shares	Weighted-Average	Weighted-Average	Options Exercisable: Number of Shares	Weighted-Average	Options Vested and Exercisable: Number of Shares	Weighted-Average

Prices		Remaining Life (in years)	Exercise Price		Exercise Price		Exercise Price
			(unaudited)				
\$0.30 \$94.80	642,802	4.2	\$ 27.95	633,652	\$ 27.34	551,071	\$ 23.72
\$117.84 \$198.41	898,328	3.3	\$ 178.15	898,315	\$ 178.15	898,315	\$ 178.15
\$205.96 \$298.91	984,624	3.7	\$ 274.90	974,682	\$ 274.76	974,682	\$ 274.76
\$300.97 \$399.00	8,043,257	6.1	\$ 309.62	4,294,312	\$ 309.77	4,294,312	\$ 309.77
\$401.78 \$499.07	1,111,709	8.3	\$ 438.27	355,468	\$ 437.26	355,468	\$ 437.26
\$500.03 \$594.05	1,392,170	9.1	\$ 512.01	126,560	\$ 546.20	126,560	\$ 546.20
\$611.68 \$699.35	6,181	6.7	\$ 627.15	2,122	\$ 649.88	2,122	\$ 649.88
\$710.84	80	7.2	\$ 710.84	55	\$ 710.84	55	\$ 710.84
\$0.30 \$710.84	13,079,151	6.2	\$ 316.80	7,285,166	\$ 274.72	7,202,585	\$ 277.28

Table of Contents

The above tables include approximately 1.7 million warrants held by selected financial institutions that were options purchased from employees under our Transferable Stock Option (TSO) program, with a weighted-average exercise price of $302.07 and a weighted-average remaining life of 1.1 years.

The total grant date fair value of stock options vested during the three and nine months ended September 30, 2009 was $281 million and $423 million. The total grant date fair value of stock options vested during the three and nine months ended September 30, 2010 was $348 million and $554 million. The aggregate intrinsic value of all options and warrants exercised during the three and nine months ended September 30, 2009 was $73 million and $284 million. The aggregate intrinsic value of all options and warrants exercised during the three and nine months ended September 30, 2010 was $71 million and $204 million. These amounts do not include the aggregate sales price of options sold under our TSO program.

During the nine months ended September 30, 2010, the number of shares underlying TSOs sold to selected financial institutions under the TSO program was 616,724 at a total value of $139 million, or an average price of $224.90 per share, including an average premium of $22.32 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.

As of September 30, 2010, there was $951 million of unrecognized compensation cost related to outstanding employee stock options. This amount is expected to be recognized over a weighted-average period of 2.7 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 (RSUs) and restricted shares for the nine months ended September 30, 2010:

	Unvested Restricted Stock Units and Restricted Shares	
	Number of Shares	Weighted-Average Grant-Date Fair Value
	(unaudited)	
Unvested at December 31, 2009	4,626,487	$ 492.42
Granted	3,454,848	$ 505.76
Vested	(1,230,812)	$ 472.59
Forfeited	(206,485)	$ 484.76
Unvested at September 30, 2010	6,644,038	$ 503.13
Expected to vest after September 30, 2010 [(1)]	5,953,058	$ 503.13

(1) RSUs and restricted shares expected to vest reflect an estimated forfeiture rate.

As of September 30, 2010, there was $2,767 million of unrecognized compensation cost related to employee unvested RSUs and restricted shares. This amount is expected to be recognized over a weighted-average period of 3.2 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 14. 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. Our total unrecognized tax benefits as of December 31, 2009 and September 30, 2010 were $1,188 million and $1,058 million. Our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were $814 million and $863 million as of December 31, 2009 and September 30, 2010. Our existing tax positions will continue to generate an increase in liabilities for unrecognized tax benefits.

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.

Note 15. Information about Geographic Areas

Our chief operating decision-makers (i.e., chief executive officer, certain of his direct reports, and our founders) 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.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Revenues:				
United States	$ 2,802	$ 3,517	$ 8,038	$ 10,001
United Kingdom	765	840	2,214	2,452
Rest of the world	2,378	2,929	6,725	8,428
Total revenues	$ 5,945	$ 7,286	$ 16,977	$ 20,881

	As of December 31, 2009	As of September 30, 2010 (unaudited)
Long-lived assets:		
United States	$ 9,432	$ 11,729
International	1,898	2,166
Total long-lived assets	$ 11,330	$ 13,895

Table of Contents

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things, statements regarding:

- *the growth of our business and revenue;*
- *seasonal fluctuations in internet usage and traditional retail seasonality, which are likely to cause fluctuations in our quarterly results;*
- *our plans to continue to invest in systems infrastructures, increase our hiring, adjust our compensation programs, and continue our current pace of acquisitions;*
- *the decline in our revenue growth rate;*
- *our expectation that growth in advertising revenues from our websites will continue to exceed that from our Google Network members websites, which will have a positive impact on our operating margins;*
- *our expectation that we will continue to pay most of the Google AdSense fees we receive from advertisers to our Google Network members;*
- *our expectation that we will continue to take steps to improve the relevance of the ads we deliver and to reduce the number of accidental clicks;*
- *fluctuations in aggregate paid clicks and average cost-per-click;*
- *our belief that our foreign exchange risk management program will not fully offset the exposure to fluctuations in foreign currency exchange rates;*
- *our expectation that our cost of revenues, research and development expenses, sales and marketing expenses, and general and administrative expenses will increase in dollars and may increase as a percentage of revenues;*
- *the fact that traffic acquisition costs may fluctuate in the future;*
- *the timing for the consummation of our acquisition of ITA Software;*
- *continued investments in international markets;*

our future stock-based compensation expenses;

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

fluctuations in our effective tax rate;

the sufficiency of our sources of funding;

our payment terms to certain advertisers, which may increase our working capital requirements;

fluctuations in our capital expenditures; and

our belief that the EPA s investigation will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows;

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 Quarterly Report on Form 10-Q, and in particular, the risks discussed under the heading Risk Factors in Part II, Item 1A 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, except as required by law. 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.

Table of Contents

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 website 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 websites 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 websites and our Google Network members websites. 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 Revenue

Advertising revenues made up 97% of our revenues for the three and nine months ended September 30, 2009, 97% of our revenues for the three months ended September 30, 2010, and 96% of our revenues for the nine months ended September 30, 2010. We derive most of our additional revenues from offering display advertising management services to advertisers, ad agencies, and publishers, as well as licensing 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 websites and our Google Network members websites. Display advertising typically includes static or animated images, as well as interactive audio or video media, such as the banner ads on the top or sides of many popular websites. 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 websites and our Google Network members websites as specified by the advertiser. For advertisers using our AdWords cost-per-click pricing, we recognize as revenue the fees charged to advertisers each time a user clicks on one of the ads that appears next to the search results or content on our websites or our Google Network members websites. For advertisers using our AdWords cost-per-impression pricing, we recognize as revenue the fees charged to advertisers each time their ads are displayed on our websites or our Google Network members websites. 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 websites 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.

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 websites search either the website 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 websites. 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 websites. 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 websites).

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 websites 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. Google Network members do not pay any fees associated with the use of our AdSense program on their websites.

Our agreements with Google Network members consist largely of uniform online click-wrap agreements that members enter into by interacting with our registration websites. 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 website or, for advertisers who choose our cost-per-impression pricing, as the ads are displayed on the Google Network member s website. For example, under our standard agreements, we pay 51% and 68% of the fees collected from advertisers to our Google Network members in AdSense for search and AdSense for content, respectively.

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

We also offer display advertising management services such as media planning, buying, implementation, and measurement tools for advertisers and agencies and forecasting and reporting tools for publishers. We recognize the related fees as other revenues in the period advertising impressions are delivered.

In January 2010, we launched, and in July 2010, we discontinued, our direct-to-consumer web store channel of distributing our Nexus One mobile phone. We had recognized fees derived from the sale of these phones as other revenues in the period in which they were delivered. We do not expect to recognize any additional revenue associated with the sale of these phones in the future.

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 websites and our Google Network members websites 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.

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 websites and our Google Network members websites 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 websites and our Google Network members   websites.

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

The advertisers return on investment from advertising campaigns on our websites or our Google Network members websites 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 revenues we generate.

Our ability to increase searches on our websites and our Google Network members websites via new ad formats on devices other than personal computers, including mobile devices.

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, while general economic conditions have recently improved, the robustness and pace of the global economic recovery remain uncertain, which could negatively affect our revenue growth rate. However, we plan to continue to invest aggressively in our core areas of strategic focus.

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 websites and our Google Network members websites. 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 websites 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 aggregate 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 websites through our AdSense program is significantly lower than the operating margin we realize from revenues generated from ads placed on our websites because most of the advertiser fees from ads served on Google Network members websites are shared with our Google Network members. For the past five years, growth in advertising revenues from our websites has generally exceeded that from our Google Network members websites. 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 websites compared to the rate of growth in revenues from our Google Network members websites may vary over time.

We continue to invest in systems infrastructures, increase our hiring, and adjust our compensation programs as required to manage our growth and develop and promote our products and services, and this may cause our operating margins to decrease. Acquisitions will also remain an important component of our strategy and use of capital, and we expect our current pace of acquisitions to continue. Our full-time employee headcount was 19,665 at September 30, 2009 and 23,331 at September 30, 2010. We expect our cost of revenues will 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, credit card and other transaction fees, content acquisition costs, and other costs. In particular, traffic acquisition costs as a percentage of 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 websites and our Google Network members websites.

Table of Contents

As we expand our advertising programs and other products to international markets, we continue to increase our exposure to fluctuations in foreign currency to U.S. dollar exchange rates. For example, in the third quarter of 2010, the general strengthening of the U.S. dollar relative to foreign currencies (primarily the Euro and the British pound) had an unfavorable impact on our revenues as compared to the third quarter of 2009. We have a foreign exchange risk management program that is designed to reduce our exposure to fluctuations in foreign currency exchange rates. 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 our revenues for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Consolidated Statements of Income Data:				
Revenues	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of revenues	37.4	35.0	37.9	35.8
Research and development	12.7	13.6	12.4	13.0
Sales and marketing	8.4	9.1	8.3	9.1
General and administrative	6.6	7.3	7.1	6.7
Total costs and expenses	65.1	65.0	65.7	64.6
Income from operations	34.9	35.0	34.3	35.4
Interest and other income (expense), net	(0.1)	2.2	(0.1)	1.3
Income before income taxes	34.8	37.2	34.2	36.7
Provision for income taxes	7.2	7.5	7.4	8.1
Net income	27.6%	29.7%	26.8%	28.6%

Revenues

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Advertising revenues:				
Google websites	$ 3,956	$ 4,833	$ 11,301	$ 13,772
Google Network websites	1,801	2,199	5,123	6,297
Total advertising revenues	5,757	7,032	16,424	20,069
Other revenues	188	254	553	812
Revenues	$ 5,945	$ 7,286	$ 16,977	$ 20,881

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Advertising revenues:				
Google websites	67%	67%	67%	66%
Google Network websites	30	30	30	30
Total advertising revenues	97	97	97	96
Google websites as % of advertising revenues	69	69	69	69
Google Network websites as % of advertising revenues	31	31	31	31
Other revenues	3%	3%	3%	4%

The increase in our revenues from the three months ended September 30, 2009 to the three months ended September 30, 2010 resulted primarily from an increase in advertising revenues generated by Google websites and Google Network members websites. The increase in our revenues from the nine months ended September 30, 2009 to the nine months ended September 30, 2010 resulted primarily from an increase in advertising revenues generated by Google websites and Google Network members websites and, to a lesser extent, an increase in other revenues primarily as a result of the launch of our mobile phone business in the first quarter of 2010. The increase in advertising revenue for Google websites and Google Network members websites from the three and nine months ended September 30, 2009 to the three and nine months ended September 30, 2010 resulted primarily from an increase in the number of paid clicks through our advertising programs and, to a lesser extent, an increase 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 including new ad formats, and the continued global expansion of our products, and our advertiser and user base, as well as an increase in the number of Google Network members. The increase in the average cost-per-click paid by our advertisers was primarily driven by the increased spending from advertisers, partially offset by the changes in geographical mix due to traffic growth in emerging markets, where the average cost-per-click is typically lower, compared to more mature markets.

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 websites they visit. For instance, these improvements include enabling previously promoted high quality ads to be shown on subsequent pages, adding merchant ratings information to improve users ability to evaluate ads, providing end users with multiple ad site links for certain web search ad results, reducing the minimum cost-per-click which results in the display of more relevant ads, and changing the clickable area around our AdSense for content text-based ads to only the title and URL (uniform resource locator) to reduce the number of accidental clicks.

Aggregate paid clicks on Google websites and Google Network members websites increased approximately 16% from the three months ended September 30, 2009 to the three months ended September 30, 2010 and 16% from the nine months ended September 30, 2009 to the nine months ended September 30, 2010. Average cost-per-click on Google websites and Google Network members websites increased approximately 3% from the three months ended September 30, 2009 to the three months ended September 30, 2010 and 5% from the nine months ended September 30, 2009 to the nine months ended September 30, 2010. 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 and may fluctuate in the future because of various factors, including the revenue growth rates on our websites 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 general economic conditions. In addition, traffic growth in emerging markets compared to more 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.

We believe that the increase in the number of paid clicks on Google websites and Google Network members websites is substantially the result of our commitment to improving the relevance and quality of both our search results and the advertisements displayed, which we believe results in a better user experience, which in turn results in more searches, advertisers, and Google Network members and other partners.

Revenues by Geography

The following table presents our domestic and international revenues as a percentage of consolidated revenues, determined based on the billing addresses of our customers:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
United States	47%	48%	47%	48%
United Kingdom	13%	12%	13%	12%
Rest of the world	40%	40%	40%	40%

Table of Contents

The decline in revenues from the United Kingdom as a percentage of consolidated revenues from the three and nine months ended September 30, 2009 to the three and nine months ended September 30, 2010 resulted primarily from a less robust economic recovery relative to the United States and rest of the world. The growth in revenues from the United States as a percentage of consolidated revenues from the three and nine months ended September 30, 2009 to the three months and nine months ended September 30, 2010 resulted largely from the recovery of certain key verticals such as retail, travel, finance, and insurance.

The general strengthening of the U.S. dollar relative to certain foreign currencies (primarily the Euro and the British pound) from the three months ended September 30, 2009 to the three months ended September 30, 2010 had an unfavorable impact on our international revenues. Had foreign exchange rates remained constant in these periods, our revenues from the United Kingdom would have been approximately $50 million, or 6%, higher, and our revenues from the rest of the world would have been approximately $119 million, or 4%, higher in the three months ended September 30, 2010. This is before consideration of hedging gains of $25 million and $14 million recognized to revenues from the United Kingdom and the rest of the world in the three months ended September 30, 2009, and hedging gains of $11 million and $78 million recognized to revenues from the United Kingdom and the rest of the world in the three months ended September 30, 2010.

The general weakening of the U.S. dollar relative to certain foreign currencies (primarily the Australian dollar, the Brazilian real, and the Japanese yen) from the nine months ended September 30, 2009 to the nine months ended September 30, 2010 had a favorable impact on our international revenues. Had foreign exchange rates remained constant in these periods, our revenues from the United Kingdom would have been $16 million, or 1%, lower and our revenues from the rest of the world would have been approximately $81 million, or 1%, lower in the nine months ended September 30, 2010. This is before consideration of hedging gains of $174 million and $143 million recognized to revenues from the United Kingdom and the rest of the world in the nine months ended September 30, 2009 and hedging gains of $41 million and $137 million recognized to revenues from the United Kingdom and the rest of the world in the nine months ended September 30, 2010.

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 2010 or thereafter. See Note 15 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 website (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 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, these 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 (approximately 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, we expense the fees 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, content acquisition costs, amortization of acquired intangible assets, and credit card and other transaction fees related to processing customer transactions. 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 websites and our Google Network members websites from which the content is viewed and share most of the fees these ads generate with the content providers and the Google Network members.

Table of Contents

The following table presents 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 September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Cost of revenues	$ 2,226	$ 2,552	$ 6,436	$ 7,471
Cost of revenues as a percentage of revenues	37.4%	35.0%	37.9%	35.8%
Traffic acquisition costs related to AdSense arrangements	$ 1,331	$ 1,520	$ 3,795	$ 4,426
Traffic acquisition costs related to distribution arrangements	228	285	654	822
Traffic acquisition costs	$ 1,559	$ 1,805	$ 4,449	$ 5,248
Traffic acquisition costs as a percentage of advertising revenues	27.1%	25.7%	27.1%	26.1%

Cost of revenues increased $326 million from the three months ended September 30, 2009 to the three months ended September 30, 2010. The increase was primarily related to an increase in traffic acquisition costs of $189 million primarily resulting from more advertiser fees generated through our AdSense program. The increase was also related to an increase in traffic acquisition costs of $57 million from our distribution arrangements as a result of more traffic directed to our websites, as well as more distribution fees paid. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to expiration of an AdSense arrangement under which we paid guaranteed minimum revenue share and more revenues realized from Google Network members to whom we paid less revenue share. In addition, there was an increase in content acquisition costs of $51 million primarily related to content displayed on YouTube.

Cost of revenues increased $1,035 million from the nine months ended September 30, 2009 to the nine months ended September 30, 2010. The increase was primarily related to an increase in traffic acquisition costs of $631 million primarily resulting from more advertiser fees generated through our AdSense program. The increase was also related to an increase in traffic acquisition costs of $168 million from our distribution arrangements as a result of more traffic directed to our websites, as well as more distribution fees paid. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to expiration of an AdSense arrangement under which we paid guaranteed minimum revenue share and more revenues realized from Google Network members to whom we paid less revenue share. In addition, there was an increase in mobile phone costs of $92 million and an increase in content acquisition costs of $90 million primarily related to content displayed on YouTube.

We expect cost of revenues will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2010 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 costs, 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 websites and from our Google Network members websites.

- 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.

- Whether we are able to continue to improve the monetization of traffic on our websites and our Google Network members websites.

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 websites.

Table of Contents

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 September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Research and development expenses	$ 758	$ 994	$2,107	$ 2,711
Research and development expenses as a percentage of revenues	12.7%	13.6%	12.4%	13.0%

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

Research and development expenses increased $236 million from the three months ended September 30, 2009 to the three months ended September 30, 2010. This increase was primarily due to an increase in labor related costs of $137 million primarily as a result of a 26% increase in research and development headcount, including headcount from acquisitions. In addition, there was an increase in stock-based compensation expense of $48 million and an increase in temporary services expense of $20 million.

Research and development expenses increased $604 million from the nine months ended September 30, 2009 to the nine months ended September 30, 2010. This increase was primarily due to an increase in labor related costs of $368 million primarily as a result of a 26% increase in headcount, including headcount from acquisitions. In addition, there was an increase in stock-based compensation expense of $91 million, an increase in depreciation and related expense of $59 million, and an increase in temporary services expense of $45 million.

We expect that research and development expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2010 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 September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Sales and marketing expenses	$ 498	$ 661	$ 1,401	$ 1,897
Sales and marketing expenses as a percentage of revenues	8.4%	9.1%	8.3%	9.1%

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

Sales and marketing expenses increased $163 million from the three months ended September 30, 2009 to the three months ended September 30, 2010. This increase was primarily due to an increase in advertising and promotional expenses of $70 million. In addition, there was an increase in labor related costs of $55 million primarily due to a 14% increase in sales and marketing headcount.

Sales and marketing expenses increased $496 million from the nine months ended September 30, 2009 to the nine months ended September 30, 2010. This increase was primarily due to an increase in advertising and promotional expenses of $230 million. In addition, there was an increase in labor related costs of $153 million primarily due to a 14% increase in sales and marketing headcount and higher commission expense.

We anticipate that sales and marketing expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2010 and future periods as we expand our business on a worldwide basis.

Table of Contents

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 September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
General and administrative expenses	$ 389	$ 532	$ 1,202	$ 1,403
General and administrative expenses as a percentage of revenues	6.6%	7.3%	7.1%	6.7%

General and administrative expenses consist primarily of compensation and related costs for personnel and facilities related to our facilities, finance, human resources, 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 increased $143 million from the three months ended September 30, 2009 to the three months ended September 30, 2010. This increase was primarily due to an increase in charitable contributions of $53 million, an increase in professional services of $32 million, the majority of which related to legal costs and consulting services, as well as an increase in labor and facilities related costs of $18 million primarily due to a 9% increase in general and administrative headcount.

General and administrative expenses increased $201 million from the nine months ended September 30, 2009 to the nine months ended September 30, 2010. This increase was primarily due to an increase in professional services of $121 million, the majority of which related to legal costs and consulting services. In addition, there was an increase in charitable contributions of $58 million.

As we expand our business and incur additional expenses, we believe general and administrative expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2010 and future periods.

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 September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Stock-based compensation	$ 318	$ 380	$888	$ 980
Stock-based compensation as a percentage of revenues	5.3%	5.2%	5.2%	4.7%

Stock-based compensation increased $62 million and $92 million from the three and nine months ended September 30, 2009 to the three and nine months ended September 30, 2010. These increases were primarily due to additional stock awards issued to existing and new employees.

We estimate stock-based compensation to be approximately $1.4 billion in 2010 and $3.3 billion thereafter. This estimate does not include expenses to be recognized related to employee stock awards that are granted after September 30, 2010 or non-employee stock awards that have been or may be granted. 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 increased $174 million from the three months ended September 30, 2009 to the three months ended September 30, 2010. This increase was primarily driven by an increase in interest income of $125 million due to an increase in our cash and investment balances and higher yields, as well as an increase in net realized gains on sales of marketable securities of $43 million.

Interest and other income (expense), net increased $274 million from the nine months ended September 30, 2009 to the nine months ended September 30, 2010. This increase was primarily driven by an increase in interest income of $240 million due to an increase in our cash and investment balances and higher yields, as well as an increase in net realized gains on sales of marketable securities of $61 million, partially offset by an increase in net foreign exchange related costs of $32 million.

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 and the movement of the foreign exchange rates relative to the strike prices of the contracts, as well as the volatility of the foreign exchange rates.

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 2010 and future periods.

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 September 30,		Nine Months Ended September 30,	
	2009	2010	2009	2010
	(unaudited)			
Provision for income taxes	$ 428	$ 547	$ 1,266	$ 1,692
Effective tax rate	20.7%	20.2%	21.8%	22.1%

Our provision for income taxes increased from the three months ended September 30, 2009 to the three months ended September 30, 2010, primarily as a result of increases in federal and state income taxes, driven by higher taxable income year over year. Our effective tax rate decreased from the three months ended September 30, 2009 to the three months ended September 30, 2010, primarily because we released certain tax reserves as a result of the settlement of our 2005 and 2006 tax audits in the three months ended September 30, 2010, which were more than the other discrete benefits we recognized in the three months ended September 30, 2009.

Our provision for income taxes increased from the nine months ended September 30, 2009 to the nine months ended September 30, 2010, primarily as a result of increases in federal and state income taxes, driven by higher taxable income year over year. Our effective tax rate increased from the nine months ended September 30, 2009 to the nine months ended September 30, 2010, primarily because we expect more of our annual earnings in 2010 compared to 2009 to be realized in countries where we have higher statutory tax rates.

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 (dollars in millions):

	Nine Months Ended September 30,	
	2009	2010
	(unaudited)	
Net cash provided by operating activities	$ 6,585	$ 7,555

Net cash used in investing activities	(3,246)	(7,831)
Net cash provided by financing activities	75	1,298

Table of Contents

At September 30, 2010, we had $33.4 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., debt instruments issued by foreign governments, time deposits, money market and other funds, including cash collateral received related to our securities lending program, mortgage-backed securities, and 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 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, 2009 and September 30, 2010, we had unused letters of credit for approximately $101 million and $63 million. We believe that our sources of funding 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. 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.

On July 1, 2010, we signed a definitive agreement to acquire ITA Software, a privately-held flight information software company, for $700 million in cash, subject to adjustments. The completion of this transaction is subject to customary closing conditions. We expect this transaction to close in the first half of 2011.

On July 15, 2010, we announced a debt financing program of up to $3.0 billion through the issuance of commercial paper. Net proceeds from the commercial paper program are used for general corporate purposes. As of September 30, 2010, we had $2.1 billion of commercial paper outstanding recorded as short-term debt, with a weighted-average interest rate of 0.3% that matures at various dates through September 2011. In conjunction with this program, we established a $3.0 billion revolving credit facility expiring on June 30, 2013. Interest rate for the credit facility is determined based on a formula using certain market rates. As of September 30, 2010, we were in compliance with the financial covenant in the credit facility. No amounts were outstanding under the credit facility as of September 30, 2010.

Cash provided by operating activities consisted of net income adjusted for certain non-cash items, including amortization, depreciation, deferred income taxes, excess tax benefits from stock-based award activities, stock-based compensation expense, and the effect of changes in working capital and other activities. Cash provided by operating activities in the nine months ended September 30, 2010 was $7,555 million and consisted of net income of $5,962 million, adjustments for non-cash items of $1,968 million and cash used in working capital and other activities of $375 million. Adjustments for non-cash items primarily consisted of $980 million of stock-based compensation expense, $787 million of depreciation and amortization expense on property and equipment, and $228 million of amortization of intangibles and other assets, partially offset by $43 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 an increase of $456 million in accounts receivable due to the growth in fees billed to our advertisers, an increase of $355 million in prepaid revenue share, expenses and other assets, a net decrease of $295 million of income taxes payable and deferred income taxes, which includes the same $43 million of excess tax benefits from stock-based awards included under adjustments for non-cash items, partially offset by an increase in accrued expenses and other liabilities of $316 million, an increase in accounts payable of $314 million and, to a lesser extent, an increase in accrued revenue share of $69 million. The net decrease in income taxes payable and deferred income taxes was primarily attributed to the release of certain tax reserves as a result of the settlement of our tax audits for our 2005 and 2006 tax years.

Cash provided by operating activities in the nine months ended September 30, 2009 was $6,585 million and consisted of net income of $4,546 million, adjustments for non-cash items of $1,669 million and cash provided by working capital and other activities of $370 million. Adjustments for non-cash items primarily consisted of $943 million of depreciation and amortization expense on property and equipment, $888 million of stock-based compensation expense, and $216 million of amortization of intangibles and other assets, partially offset by $288 million of deferred income taxes and $64 million of excess tax benefits from stock-based award activities. In addition, the increase in cash from changes in working capital activities primarily consisted of a decrease of $313 million in prepaid revenue share, expenses and other assets, a net increase in income taxes payable and deferred income taxes of $97 million, which includes the same $64 million of excess tax benefits from stock-based awards included under adjustments for non-cash items, and an increase of $57 million in accrued revenue share primarily due to the increase in our revenues, partially offset by an increase of $127 million in accounts receivable due to the growth in fees billed to our advertisers. The increase in income taxes payable and deferred income taxes was primarily a result of additional tax obligations accrued, partially offset by more estimated income taxes paid during the nine months ended September 30, 2009 for the year ended December 31, 2009.

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 nine months ended September 30, 2010 of $7,831 million was primarily attributable to net purchases of marketable securities of $7,220 million, capital expenditures of $1,473 million, and cash consideration used in acquisitions and other investments of $859 million. Also, in connection with our securities lending program, we received $2,861 million of cash collateral and invested $875 million in reverse repurchase agreements.

Cash used in investing activities in the nine months ended September 30, 2009 of $3,246 million was attributable to net purchases of marketable securities of $2,571 million and capital expenditures of $589 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 2010 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.

Cash provided by financing activities in the nine months ended September 30, 2010 of $1,298 million was primarily driven by $2,121 million of short term-debt issued under our commercial paper program. This was partially offset by $801 million in stock repurchases pursuant to Rule 10b5-1 trading plans in connection with our acquisitions of AdMob, Inc. and On2 Technologies, Inc.

Cash provided by financing activities in the nine months ended September 30, 2009 of $75 million was primarily due to excess tax benefits of $64 million from stock-based award activities during the period which represented a portion of the $164 million reduction to income taxes payable that we recorded in the nine months ended September 30, 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 $11 million.

Contractual Obligations

We recorded long-term taxes payable of $180 million in the nine months ended September 30, 2010 related to tax positions for which the timing of the ultimate resolution is uncertain. 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 GAAP. 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 addition, 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.

35

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, state taxes, certain benefits realized related to stock option activities, and research and experimentation tax credits. Our effective tax rates were 20.7% and 21.8% for the three and nine months ended September 30, 2009 and 20.2% and 22.1% for the three and nine months ended September 30, 2010. 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, 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, changes in the valuation of our deferred tax assets or liabilities, or 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

Our stock-based compensation expense 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 changes 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. To the extent our actual forfeiture rate is different from our estimate, stock-based compensation expense is adjusted accordingly.

Impairment of Marketable and Non-Marketable Securities

We periodically review our marketable securities and 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. Factors we consider to make such determination include the duration and severity of the impairment, the reason for the decline in value, the potential recovery period, and our intent to sell, or whether it is more likely than not that we will be required to sell, the investment before recovery. 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.

Available Information

Our website is located at www.google.com, and our investor relations website is located at http://investor.google.com. The following filings are available through our investor relations website 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 meetings of stockholders for the last two years. Our Annual Reports, Quarterly Reports, and Proxy Statements for the last two years are also available for download free of charge on our investor relations website. We also provide a link to the section of the SEC s website at www.sec.gov that has all of our public filings. 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.

We webcast our earnings calls and certain events we participate in or host with members of the investment community on our investor relations website. 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 website. The contents of these websites 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 with the SEC, and any references to these websites are intended to be inactive textual references only.

Table of Contents

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 contracts to reduce the volatility of cash flows 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 rates. 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 or related to an ineffective portion of a hedge is recognized as interest and other income (expense), net, immediately.

At December 31, 2009, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 1.6 billion (or approximately $2.2 billion) and $59 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £809 million (or approximately $1.3 billion) and $39 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$306 million (or approximately $268 million) and $6 million. At September 30, 2010, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 2.7 billion (or approximately $3.6 billion) and $142 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £1.5 billion (or approximately $2.2 billion) and $59 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$383 million (or approximately $356 million) and $8 million. These foreign exchange options have maturities of 36 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 $68 million lower at September 30, 2010, and the total amount of expense recorded as interest and other income (expense), net, would have been approximately $114 million higher in the three months ended September 30, 2010. If the U.S. dollar strengthened by 20%, the amount recorded in accumulated other comprehensive income before tax effect would have been approximately $1.0 billion higher at September 30, 2010, and the total amount of expense recorded as interest and other income (expense), net, would have been approximately $122 million higher in the three months ended September 30, 2010.

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 $2.4 billion and $3.6 billion at December 31, 2009 and September 30, 2010. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $115 million and $69 million at December 31, 2009 and September 30, 2010. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 618 million (or approximately $889 million) and 746 million (or approximately $1.0 billion) at December 31, 2009 and September 30, 2010. The notional principal of foreign exchange contracts to sell Euros for other foreign currencies was 8 million (or approximately $11 million) at December 31, 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 $102 million and $51 million at December 31, 2009 and September 30, 2010. The adverse impact at December 31, 2009 and September 30, 2010 is after consideration of the offsetting effect of approximately $594 million and $876 million from forward exchange contracts in place for the months of December 2009 and September 2010. These reasonably possible adverse changes in exchange rates of 20% were applied to total monetary assets and liabilities 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 income taxes in the near term.

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., debt instruments issued by foreign governments, time deposits, money market and other funds, mortgage-backed securities, and corporate debt 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 points) increase in interest rates would have resulted in a decrease in the fair values of our marketable securities of approximately $291 million and $891 million at December 31, 2009 and September 30, 2010.

ITEM 4. CONTROLS AND PROCEDURES

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 amended (Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on this 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 the SEC s 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.

Changes in Internal Control Over Financial Reporting

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.

Limitations on Effectiveness of Controls and Procedures

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.

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, government investigations, labor and employment claims, breach of contract 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 or other third party claims, which are costly to defend, could result in significant damage awards, 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 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 SEC regulations that call for disclosure of certain environmental proceedings that may result in monetary sanctions of $100,000 or more.

ITEM 1A. RISK FACTORS

Our operations and financial results are subject to various risks and uncertainties, including those described below, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our Class A common stock.

Risks Related to Our Business and Industry

We face intense competition.

Our business is rapidly evolving and intensely competitive, and is subject to changing technology, shifting user needs, and frequent introductions of new products and services. We have many competitors in different industries, including general purpose search engines, vertical search engines and e-commerce sites, social networking sites, traditional media companies, and providers of online products and services. Our current and potential competitors range 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 websites. Emerging start-ups may be able to innovate and provide products and services faster than we can. If our competitors are more successful than we are in developing compelling products or in attracting and retaining users, advertisers, and content providers, our revenues and growth rates could decline.

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 2009 and 96% of our revenues in the nine months ended September 30, 2010 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.

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, Google Network members, and other partners.

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. Our brand may be negatively impacted by a number of factors, including service outages, product malfunctions, and data privacy and security issues. 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.

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.

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 laws for defamation, 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 hosting, or for listing or linking to, third-party websites that include materials that infringe copyrights or other rights, so long as we comply with the statutory requirements of this act. Various U.S. and international laws 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.

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

Acquisitions are an important element of our overall corporate strategy and use of capital, and we expect our current pace of acquisitions to continue. These transactions could be material to our financial condition and results of operations. We also expect to continue to evaluate and enter into discussions regarding a wide array of potential strategic transactions. 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.

Failure to obtain required approvals from governmental authorities under competition and antitrust laws on a timely basis, if it all, which could, among other things, delay or prevent us from completing a transaction, or otherwise restrict our ability to realize the expected financial or strategic goals of an acquisition.

Our failure to address these risks or other problems encountered in connection with our past or future acquisitions and 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 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 53% of our total revenues in 2009 and approximately 52% in the nine months ended September 30, 2010. More than half of our user traffic came from outside the U.S. in the nine months ended September 30, 2010. 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 interfere with our ability to offer, or prevent us from offering, our products and services to one or more countries or 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 and filtering 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.

Table of Contents

If our security measures are breached, or if our services are subject to attacks that degrade or deny the ability of users to access our products and services, our products and services may be perceived as not being secure, users and customers may curtail or stop using our products and services, and we may incur significant legal and financial exposure.

Our products and services involve the storage and transmission of users and customers proprietary information, and security breaches could expose us to a risk of loss of this information, litigation, and potential liability. Our security measures may be breached due to the actions of outside parties, employee error, malfeasance, or otherwise, and, as a result, an unauthorized party may obtain access to our data or our users or customers data. Additionally, outside parties may attempt to fraudulently induce employees, users, or customers to disclose sensitive information in order to gain access to our data or our users or customers data. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and a loss of confidence in the security of our products and services that could potentially have an adverse effect on our business. Because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose users and customers.

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 and has resulted in proceedings or actions against us by government entities or others, or could cause us to lose users and customers, 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.

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, and the increasing maturity of the online advertising market. 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 websites compared to revenues generated through ads placed on our own websites 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 websites. 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 websites and satisfy existing users on our websites.
- Our ability to monetize (or generate revenues from) traffic on our websites and our Google Network members websites.
- Our ability to attract advertisers to our AdWords program.
- Our ability to attract websites to our AdSense program.
- The mix in our revenues between those generated on our websites 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 expenses, 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 websites operational at a reasonable cost and without service interruptions.
- 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. 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.

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.

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, foreign or domestic, may impact our ability to obtain patent protection. Moreover, because of our long-term interests in open source, we may not have adequate patent protection for 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.

Table of Contents

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 or other third party claims, which are costly to defend, could result in significant damage awards, and could limit our ability to use certain technologies in the future.

Internet, technology, and media companies 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. In addition, patent holding companies may continue to seek to monetize patents they have purchased or otherwise obtained. As we have grown, the intellectual property rights claims against us have increased and may continue to increase as we develop new products, services, and technologies. 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 and cause significant diversion of management attention. In addition, to the extent claims against us are successful, we may have to pay significant damage awards 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. In addition, we have had trademark infringement and related claims filed against us for allowing advertisers to bid for keywords corresponding to their competitors trademarks. 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, Taiwan, and the United Kingdom.

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. 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. We are, and may in the future 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, 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 Android, Google Web Search, Google AdWords, Google AdSense, Google Talk, Google Chrome, and Google Voice, infringe patents held by others. In addition, the number of demands for license fees and the dollar amounts associated with each demand 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.

More individuals are using devices other than personal computers 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, smart phones, handheld computers, video game consoles, and television set-top devices, has increased dramatically in the past few years. The lower resolution, functionality, and memory associated with some 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. We have limited experience to date in operating versions of our products and services developed or optimized for users of alternative devices, such as Google Mobile and Android, or in designing and selling alternative devices. 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 alternative 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.

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.

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 websites that link to it, people have attempted to link a group of websites 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.

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.

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 30% of our revenues in 2009 and in the nine months ended September 30, 2010. 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 websites, 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.

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.

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.

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 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. 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.

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 legal entities 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.

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. We are subject to regular review and audit by both domestic and foreign tax authorities. Any adverse outcome of such a review or audit 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.

Table of Contents

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. For example, in 2009, the price of our Class A common stock ranged from $282.75 per share to $625.99 per share. 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 (including sales by our directors, executive officers, and other employees).
- 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 September 30, 2010, 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 70% of the voting power of our outstanding capital stock. In particular, as of September 30, 2010, our two founders and our CEO, Larry, Sergey, and Eric, owned approximately 91% 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.

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.

Table of Contents

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 September 30, 2010:

	Aggregate Amounts			Weighted-Average Per Share Amounts		
Period[1]	**Number of Shares Underlying TSOs Sold**	**Sale Price of TSOs Sold (in millions)**	**TSO Premium**[2] **(in millions)**	**Exercise Price of TSOs Sold**	**Sale Price of TSOs Sold**	**TSO Premium**[2]
July 1-31	123,800	$ 25	$ 3	$ 304.98	$ 202.40	$ 26.22
August 1-31	166,575	$ 33	$ 4	$ 312.68	$ 197.52	$ 24.47
September 1-30	0	$ 0	$ 0	$ 0	$ 0	$ 0
Total (except weighted-average per share amounts)	**290,375**	**$ 58**	**$ 7**	**$ 309.39**	**$ 199.60**	**$ 25.21**

(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.

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. The following table provides information with respect to sales by our executive officers of TSOs during the three months ended September 30, 2010:

		Aggregate Amounts	
Executive Officer	**Number of Shares Underlying TSOs Sold**	**Sale Price of TSOs Sold (in thousands)**	**TSO Premium (in thousands)**
Patrick Pichette	7,046	$ 1,344	$ 102
Total	**7,046**	**$ 1,344**	**$ 102**

51

Table of Contents

ITEM 6. EXHIBITS

See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.

Table of Contents

SIGNATURE

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: October 29, 2010	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
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

* 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, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.