Google Inc.
Form 10-Q
October 30, 2012
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**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, 2012

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

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

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 15, 2012, there were 264,956,901 shares of Google s Class A common stock outstanding and 63,637,291 shares of Google s Class B common stock outstanding.

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**Google Inc.**

**Form 10-Q**

**For the Quarterly Period Ended September 30, 2012**

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**NOTE ABOUT FORWARD-LOOKING STATEMENTS**

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 revenues and our expectations about the factors that influence our success and trends in our business;
- 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, facilities, infrastructure, and our hiring, provide competitive compensation programs, and continue our current pace of acquisitions;
- the potential for declines 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 fees we receive from advertisers to our Google Network Members;
- our expectations about the impact of our acquisition of Motorola Mobility Holdings, Inc. (Motorola) on our results and business and our ability to realize the expected benefits from the acquisition and successfully implement our plans and expectations for Motorola s business;
- 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;
- the increase of costs related to hedging activities under our foreign exchange risk management program;
- 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;
- our potential exposure in connection with pending investigations and proceedings;

our expectations about our board of directors intention to declare a dividend of shares of the new Class C capital stock, as well as the timing of that dividend, if declared and paid;

our expectation that our traffic acquisition costs will fluctuate in the future;

continued investments in international markets;

our future compensation expenses;

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; and

fluctuations in our capital expenditures;

as well as other statements regarding our future operations, financial condition and prospects, and business strategies. Forward-looking statements may appear throughout this report, including without limitation, the following sections: Part I, Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 1A, Risk Factors. Forward-looking statements generally can be identified by words such as anticipates, believes, estimates, expects, intends, plans, predicts, projects, will be, will continue, and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which 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 caption Risk Factors in Part II, Item 1A of this report and those discussed in other documents we file with the Securities and Exchange Commission (SEC). 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.

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As used herein, Google, we, our, and similar terms include Google Inc. and its subsidiaries, unless the context indicates otherwise.

Google and other trademarks of ours appearing in this report are our property. This report contains additional trade names and trademarks of other companies. We do not intend our use or display of other companies trade names or trademarks to imply an endorsement or sponsorship of us by such companies, or any relationship with any of these companies.

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## 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, 2011 | As of September 30, 2012 (unaudited) |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 9,983 | $ 16,260 |
| Marketable securities | 34,643 | 29,464 |
| Total cash, cash equivalents, and marketable securities (including securities loaned of $2,778 and $2,861) | 44,626 | 45,724 |
| Accounts receivable, net of allowance of $133 and $560 | 5,427 | 7,259 |
| Inventories | 35 | 618 |
| Receivable under reverse repurchase agreements | 745 | 550 |
| Deferred income taxes, net | 215 | 230 |
| Prepaid revenue share, expenses and other assets | 1,710 | 2,440 |
| Total current assets | 52,758 | 56,821 |
| Prepaid revenue share, expenses and other assets, non-current | 499 | 2,206 |
| Non-marketable equity securities | 790 | 1,063 |
| Property and equipment, net | 9,603 | 11,401 |
| Intangible assets, net | 1,578 | 7,754 |
| Goodwill | 7,346 | 10,485 |
| Total assets | $ 72,574 | $ 89,730 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 588 | $ 2,233 |
| Short-term debt | 1,218 | 3,218 |
| Accrued compensation and benefits | 1,818 | 1,926 |
| Accrued expenses and other current liabilities | 1,370 | 3,313 |
| Accrued revenue share | 1,168 | 1,108 |
| Securities lending payable | 2,007 | 1,686 |
| Deferred revenue | 547 | 905 |
| Income taxes payable, net | 197 | 45 |
| Total current liabilities | 8,913 | 14,434 |
| Long-term debt | 2,986 | 2,988 |
| Deferred revenue, non-current | 44 | 100 |
| Income taxes payable, non-current | 1,693 | 2,034 |

| | | |
|---|---|---|
| Deferred income taxes, net, non-current | 287 | 1,461 |
| Other long-term liabilities | 506 | 685 |
| 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 (Class A 6,000,000, Class B 3,000,000) and 12,000,000 shares authorized (Class A 9,000,000, Class B 3,000,000); 324,895 (Class A 257,553, Class B 67,342) and par value of $325 (Class A $258, Class B $67) and 328,552 (Class A 264,515, Class B 64,037) and par value of $329 (Class A $265, Class B $64) shares issued and outstanding | 20,264 | 22,204 |
| Class C capital stock, $0.001 par value per share: 3,000,000 shares authorized; no shares issued and outstanding | 0 | 0 |
| Accumulated other comprehensive income | 276 | 368 |
| Retained earnings | 37,605 | 45,456 |
| Total stockholders equity | 58,145 | 68,028 |
| Total liabilities and stockholders equity | $ 72,574 | $ 89,730 |

See accompanying notes.

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**Google Inc.**

**CONSOLIDATED STATEMENTS OF INCOME**

**(In millions, except per share amounts)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Revenues: | | | | |
| Google (advertising and other) | $ 9,720 | $ 11,526 | $ 27,322 | $ 33,135 |
| Motorola (hardware and other) | 0 | 2,575 | 0 | 3,825 |
| Total revenues | $ 9,720 | $ 14,101 | $ 27,322 | $ 36,960 |
| Costs and expenses: | | | | |
| Cost of revenues Google (advertising and other)[1] | 3,378 | 4,440 | 9,485 | 12,213 |
| Cost of revenues Motorola (hardware and other)[1] | 0 | 2,114 | 0 | 3,143 |
| Research and development [1] | 1,404 | 2,009 | 3,861 | 5,035 |
| Sales and marketing [1] | 1,204 | 1,760 | 3,322 | 4,462 |
| General and administrative[1] | 676 | 1,042 | 1,919 | 2,779 |
| Charge related to the resolution of Department of Justice investigation | 0 | 0 | 500 | 0 |
| Total costs and expenses | 6,662 | 11,365 | 19,087 | 27,632 |
| Income from operations | 3,058 | 2,736 | 8,235 | 9,328 |
| Interest and other income, net | 302 | 63 | 602 | 473 |
| Income before income taxes | 3,360 | 2,799 | 8,837 | 9,801 |
| Provision for income taxes | 631 | 623 | 1,804 | 1,950 |
| Net income | $ 2,729 | $ 2,176 | $ 7,033 | $ 7,851 |
| Net income per share of Class A and Class B common stock: | | | | |
| Basic | $ 8.44 | $ 6.64 | $ 21.82 | $ 24.05 |
| Diluted | $ 8.33 | $ 6.53 | $ 21.53 | $ 23.69 |
| [1] Includes stock-based compensation expense as follows: | | | | |
| Cost of revenues Google (advertising and other) | $ 72 | $ 103 | $ 172 | $ 259 |
| Cost of revenues Motorola (hardware and other) | 0 | 8 | 0 | 13 |
| Research and development | 311 | 378 | 795 | 968 |
| Sales and marketing | 104 | 155 | 256 | 372 |
| General and administrative | 84 | 118 | 214 | 364 |
| | $ 571 | $ 762 | $ 1,437 | $ 1,976 |

See accompanying notes.

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**Google Inc.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In millions)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Net income | $ 2,729 | $ 2,176 | $ 7,033 | $ 7,851 |
| Other comprehensive income (loss): | | | | |
| Change in foreign currency translation adjustment | (328) | 220 | 129 | (98) |
| Available-for-sale investments: | | | | |
| Change in net unrealized gains | 10 | 198 | 175 | 408 |
| Less: reclassification adjustment for net gains included in net income | (91) | (21) | (170) | (169) |
| Net change (net of tax effect of $35, $73, $33, and $83) | (81) | 177 | 5 | 239 |
| Cash flow hedges: | | | | |
| Change in net unrealized gains | 39 | (74) | (27) | 65 |
| Less: reclassification adjustment for net gains included in net income | (1) | (39) | (13) | (114) |
| Net change (net of tax effect of $23, $67, $32, and $29) | 38 | (113) | (40) | (49) |
| Other comprehensive income (loss) | (371) | 284 | 94 | 92 |
| Comprehensive income | $ 2,358 | $ 2,460 | $ 7,127 | $ 7,943 |

See accompanying notes.

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**Google Inc.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In millions)**

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2011 | 2012 |
| | (unaudited) | |
| **Operating activities** | | |
| Net income | $ 7,033 | $ 7,851 |
| Adjustments: | | |
| Depreciation and amortization of property and equipment | 1,011 | 1,358 |
| Amortization of intangible and other assets | 337 | 651 |
| Stock-based compensation expense | 1,437 | 1,976 |
| Excess tax benefits from stock-based award activities | (61) | (113) |
| Deferred income taxes | 526 | 23 |
| Gain on divestiture of business | 0 | (188) |
| Other | 3 | (24) |
| Changes in assets and liabilities, net of effects of acquisitions and divestiture: | | |
| Accounts receivable | (247) | (228) |
| Income taxes, net | 268 | 1,336 |
| Inventories | (18) | 188 |
| Prepaid revenue share, expenses and other assets | (128) | (1,215) |
| Accounts payable | 72 | (274) |
| Accrued expenses and other liabilities | 255 | 484 |
| Accrued revenue share | 70 | (57) |
| Deferred revenue | 83 | 182 |
| Net cash provided by operating activities | 10,641 | 11,950 |
| **Investing activities** | | |
| Purchases of property and equipment | (2,487) | (2,253) |
| Purchases of marketable securities | (43,693) | (24,246) |
| Maturities and sales of marketable securities | 33,107 | 29,800 |
| Investments in non-marketable equity securities | (358) | (246) |
| Cash collateral related to securities lending | 694 | (321) |
| Investments in reverse repurchase agreements | (395) | 195 |
| Acquisitions, net of cash acquired and proceeds received from divestiture, and purchases of intangible and other assets | (1,350) | (10,471) |
| Net cash used in investing activities | (14,482) | (7,542) |
| **Financing activities** | | |
| Net payments from stock-based award activities | (20) | (189) |
| Excess tax benefits from stock-based award activities | 61 | 113 |
| Proceeds from issuance of debt, net of costs | 8,780 | 12,125 |
| Repayment of debt | (8,054) | (10,128) |
| Net cash provided by financing activities | 767 | 1,921 |
| Effect of exchange rate changes on cash and cash equivalents | 74 | (52) |

| | | |
|---|---|---|
| Net increase (decrease) in cash and cash equivalents | (3,000) | 6,277 |
| Cash and cash equivalents at beginning of year | 13,630 | 9,983 |
| Cash and cash equivalents at end of period | $ 10,630 | $ 16,260 |
| **Supplemental disclosures of cash flow information** | | |
| Cash paid for taxes | $ 914 | $ 1,684 |
| Cash paid for interest | $ 0 | $ 38 |
| Non-cash financing activity: | | |
| Fair value of stock-based awards assumed in connection with acquisition of Motorola | $ 0 | $ 41 |

See accompanying notes.

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**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 generate revenues primarily by delivering relevant, cost-effective online advertising in our Google segment. In addition, as a result of our acquisition of Motorola Mobility Holdings, Inc. (Motorola) on May 22, 2012, we generate revenues from sales of mobile devices in our Motorola Mobile (Mobile) segment and digital set-top boxes in our Motorola Home (Home) segment. See Notes 8 and 15 for further discussion of the acquisition and our segment information.

***Basis of Consolidation***

The consolidated financial statements include the accounts of Google Inc. 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, 2012, the Consolidated Statements of Income for the three and nine months ended September 30, 2011 and 2012, the Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2011 and 2012, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2012 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, 2012, our results of operations for the three and nine months ended September 30, 2011 and 2012, and our cash flows for the nine months ended September 30, 2011 and 2012. The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the results to be expected for the year ending December 31, 2012.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC on January 26, 2012.

The prior period balance related to inventories has been reclassified to conform to the current year presentation.

***Use of Estimates***

The preparation of 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, inventory valuation, 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.

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***Revenue Recognition***

The following table presents our revenues by revenue source (in millions, unaudited):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| Google: | | | | |
| Advertising revenues: | | | | |
| Google websites | $ 6,740 | $ 7,727 | $ 18,851 | $ 22,581 |
| Google Network Members websites | 2,595 | 3,133 | 7,506 | 9,029 |
| Total advertising revenues | 9,335 | 10,860 | 26,357 | 31,610 |
| Other revenues | 385 | 666 | 965 | 1,525 |
| Total Google revenues (advertising and other) | 9,720 | 11,526 | 27,322 | 33,135 |
| Motorola: | | | | |
| Total Motorola revenues (hardware and other) | 0 | 2,575 | 0 | 3,825 |
| Total revenues | $ 9,720 | $ 14,101 | $ 27,322 | $ 36,960 |

We recognize revenues when the services or goods have been provided or delivered, the fees we charge are fixed or determinable, we and our advertisers or other customers understand the specific nature and terms of the agreed upon transactions, and collectability is reasonably assured.

*Google*

Google AdWords is our auction-based advertising program that enables advertisers to place text-based and display ads on our websites and our Google Network Members websites. Display advertising comprises the videos, text, images, and other interactive ads that run across the web on computers and mobile devices, including smart phones and handheld computers such as netbooks and tablets. 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 advertisers.

Google AdSense refers to the online programs through which we distribute our advertisers AdWords ads for display on our Google Network Members websites, as well as programs to deliver ads on television broadcasts.

We recognize as revenues 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 those advertisers using our AdWords cost-per-impression pricing, we recognize as revenues the fees charged to advertisers each time their ads are displayed on our websites or our Google Network Members websites. We report our Google AdSense revenues on a gross basis principally because we are the primary obligor to our advertisers.

We record deferred revenue upon invoicing or when cash payments are received in advance of our performance in the underlying agreement in the accompanying Consolidated Balance Sheets.

*Motorola*

Our Motorola business is comprised of two operating segments. The Mobile segment is focused on mobile wireless devices and related products and services. The Home segment is focused on technologies and devices that provide video entertainment services to consumers by enabling subscribers to access a variety of interactive digital television services.

For hardware product sales, revenue recognition generally occurs when products have been shipped, risk of loss has transferred to the customer, objective evidence exists that customer acceptance provisions have been met, no significant obligations remain and allowances for discounts, price protection, returns and customer incentives can be reasonably and reliably estimated. Recorded revenues are reduced by these allowances.

Where these allowances cannot be reasonably and reliably estimated, we recognize revenue at the time the product sells through the distribution channel to the end customer.

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For arrangements that include multiple deliverables, primarily for products that contain software essential to the hardware products functionality and services, we allocate revenue to each unit of accounting based on their relative selling prices. In such circumstances, we use a hierarchy to determine the selling prices to be used for allocating revenue: (i) vendor-specific objective evidence of fair value (VSOE), (ii) third-party evidence of selling price, and (iii) best estimate of the selling price (ESP). VSOE generally exists only when we sell the deliverable separately and is the price actually charged by us for that deliverable. ESPs reflect our best estimates of what the selling prices of elements would be if they were sold regularly on a stand-alone basis.

***Inventories***

Inventories are stated at the lower of cost or market, computed using the first-in, first-out method.

**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):

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2012 | | 2011 | | 2012 | |
| | (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 | $ 2,151 | $ 578 | $ 1,746 | $ 430 | $ 5,521 | $ 1,512 | $ 6,269 | $ 1,582 |
| Denominator | | | | | | | | |
| Weighted-average common shares outstanding | 254,709 | 68,446 | 263,086 | 64,699 | 252,995 | 69,309 | 260,666 | 65,786 |
| Number of shares used in per share computation | 254,709 | 68,446 | 263,086 | 64,699 | 252,995 | 69,309 | 260,666 | 65,786 |
| Basic net income per share | $ 8.44 | $ 8.44 | $ 6.64 | $ 6.64 | $ 21.82 | $ 21.82 | $ 24.05 | $ 24.05 |
| Diluted net income per share: | | | | | | | | |
| Numerator | | | | | | | | |
| Allocation of undistributed earnings for basic computation | $ 2,151 | $ 578 | $ 1,746 | $ 430 | $ 5,521 | $ 1,512 | $ 6,269 | $ 1,582 |
| Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares | 578 | 0 | 430 | 0 | 1,512 | 0 | 1,582 | 0 |
| Reallocation of undistributed earnings to Class B shares | 0 | (7) | 0 | (7) | 0 | (19) | 0 | (23) |
| Allocation of undistributed earnings | $ 2,729 | $ 571 | $ 2,176 | $ 423 | $ 7,033 | $ 1,493 | $ 7,851 | $ 1,559 |
| Denominator | | | | | | | | |
| Number of shares used in basic computation | 254,709 | 68,446 | 263,086 | 64,699 | 252,995 | 69,309 | 260,666 | 65,786 |
| Weighted-average effect of dilutive securities | | | | | | | | |
| Add: | | | | | | | | |
| Conversion of Class B to Class A common shares outstanding | 68,446 | 0 | 64,699 | 0 | 69,309 | 0 | 65,786 | 0 |
| Employee stock options, including warrants issued under Transferable Stock Option program | 2,839 | 43 | 3,015 | 36 | 2,939 | 47 | 2,943 | 39 |
| Restricted stock units | 1,445 | 0 | 2,514 | 0 | 1,376 | 0 | 2,019 | 0 |
| Number of shares used in per share computation | 327,439 | 68,489 | 333,314 | 64,735 | 326,619 | 69,356 | 331,414 | 65,825 |
| Diluted net income per share | $ 8.33 | $ 8.33 | $ 6.53 | $ 6.53 | $ 21.53 | $ 21.53 | $ 23.69 | $ 23.69 |

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

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**Note 3. Cash and Investments**

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

| | As of December 31, 2011 | As of September 30, 2012 (unaudited) |
|---|---|---|
| Cash and cash equivalents: | | |
| Cash | $ 4,712 | $ 6,224 |
| Cash equivalents: | | |
| Time deposits | 534 | 360 |
| Money market and other funds [1] | 4,462 | 8,926 |
| U.S. government agencies | 275 | 0 |
| U.S. government notes | 0 | 750 |
| Total cash and cash equivalents | 9,983 | 16,260 |
| Marketable securities: | | |
| Time deposits | 495 | 507 |
| U.S. government agencies | 6,226 | 1,616 |
| U.S. government notes | 11,579 | 9,179 |
| Foreign government bonds | 1,629 | 1,898 |
| Municipal securities | 1,794 | 1,596 |
| Corporate debt securities | 6,112 | 7,160 |
| Agency residential mortgage-backed securities | 6,501 | 6,754 |
| Asset backed securities | 0 | 729 |
| Marketable equity securities | 307 | 25 |
| Total marketable securities | 34,643 | 29,464 |
| Total cash, cash equivalents, and marketable securities | $ 44,626 | $ 45,724 |

[1] The balances at December 31, 2011 and September 30, 2012 included $1.3 billion and $1.1 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.

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

| | As of December 31, 2011 | | | |
|---|---|---|---|---|
| | Adjusted Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Time deposits | $ 495 | $ 0 | $ 0 | $ 495 |
| U.S. government agencies | 6,211 | 15 | 0 | 6,226 |
| U.S. government notes | 11,475 | 104 | 0 | 11,579 |
| Foreign government bonds | 1,608 | 32 | (11) | 1,629 |
| Municipal securities | 1,775 | 19 | 0 | 1,794 |
| Corporate debt securities | 6,023 | 187 | (98) | 6,112 |
| Agency residential mortgage-backed securities | 6,359 | 147 | (5) | 6,501 |

| | | | | |
|---|---|---|---|---|
| Marketable equity securities | 228 | 79 | 0 | 307 |
| Total | $ 34,174 | $ 583 | $ (114) | $ 34,643 |

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| | As of September 30, 2012 | | | |
|---|---|---|---|---|
| | Adjusted Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | | (unaudited) | | |
| Time deposits | $ 507 | $ 0 | $ 0 | $ 507 |
| U.S. government agencies | 1,592 | 24 | 0 | 1,616 |
| U.S. government notes | 9,091 | 88 | 0 | 9,179 |
| Foreign government bonds | 1,825 | 77 | (4) | 1,898 |
| Municipal securities | 1,568 | 28 | 0 | 1,596 |
| Corporate debt securities | 6,755 | 420 | (15) | 7,160 |
| Agency residential mortgage-backed securities | 6,576 | 180 | (2) | 6,754 |
| Asset backed securities | 728 | 1 | 0 | 729 |
| Marketable equity securities | 38 | 4 | (17) | 25 |
| Total | $ 28,680 | $ 822 | $ (38) | $ 29,464 |

Gross unrealized gains and losses on cash equivalents were not material at December 31, 2011 and September 30, 2012.

We recognized gross realized gains of $140 million and $274 million for the three and nine months ended September 30, 2011 and $82 million and $290 million for the three and nine months ended September 30, 2012. We recognized gross realized losses of $31 million and $63 million for the three and nine months ended September 30, 2011 and $46 million and $79 million for the three and nine months ended September 30, 2012. 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, net, in the accompanying Consolidated Statements of Income.

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

| | As of September 30, 2012 (unaudited) |
|---|---|
| Due in 1 year | $ 3,407 |
| Due in 1 year through 5 years | 11,051 |
| Due in 5 years through 10 years | 6,645 |
| Due after 10 years | 8,336 |
| Total | $ 29,439 |

The following tables present gross unrealized losses and fair values for those investments that were in an unrealized loss position as of December 31, 2011 and September 30, 2012, 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, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Greater | | Total | |
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| Foreign government bonds | $ 302 | $ (11) | $ 6 | $ 0 | $ 308 | $ (11) |
| Corporate debt securities | 2,160 | (97) | 17 | (1) | 2,177 | (98) |
| Agency residential mortgage-backed securities | 716 | (3) | 19 | (2) | 735 | (5) |
| Total | $ 3,178 | $ (111) | $ 42 | $ (3) | $ 3,220 | $ (114) |

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| | As of September 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | 12 Months or Greater | | Total | |
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| | (unaudited) | | | | | |
| Foreign government bonds | $ 405 | $ (2) | $ 18 | $ (2) | $ 423 | $ (4) |
| Corporate debt securities | 532 | (9) | 123 | (6) | 655 | (15) |
| Agency residential mortgage-backed securities | 507 | (2) | 0 | 0 | 507 | (2) |
| Marketable equity securities | 13 | (17) | 0 | 0 | 13 | (17) |
| Total | $ 1,457 | $ (30) | $ 141 | $ (8) | $ 1,598 | $ (38) |

***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 in 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 in 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. Debt and Credit Facility**

***Short-Term Debt***

We have a debt financing program of up to $3.0 billion through the issuance of commercial paper. Net proceeds from this program are used for general corporate purposes. At December 31, 2011 and September 30, 2012, we had $750 million and $2.7 billion of outstanding commercial paper recorded as short-term debt with weighted-average interest rate of 0.1%.

We have a secured promissory note in the amount of $468 million with an interest rate of 1.0% maturing in December 2012. Proceeds were used for the acquisition of an office building in New York City. As of December 31, 2011 and September 30, 2012, the outstanding balance was $468 million.

The estimated fair value of the short-term debt approximated its carrying value at December 31, 2011 and September 30, 2012.

***Long-Term Debt***

In May 2011, we issued $3.0 billion of unsecured senior notes in three tranches as described in the table below (collectively, the Notes) (in millions):

| | Outstanding Balance as of September 30, 2012 (unaudited) |
|---|---|
| 1.25% Notes due on May 19, 2014 | $ 1,000 |
| 2.125% Notes due on May 19, 2016 | 1,000 |
| 3.625% Notes due on May 19, 2021 | 1,000 |
| Unamortized discount for the Notes above | (12) |
| Total | $ 2,988 |

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The effective interest yields of the 2014, 2016, and 2021 Notes were 1.258%, 2.241%, and 3.734%. Interest on the Notes is payable semi-annually in arrears on May 19 and November 19 of each year. We may redeem the Notes at any time in whole or from time to time in part at specified redemption prices. We are not subject to any financial covenants under the Notes. We used the net proceeds from the issuance of the Notes to repay a portion of our outstanding commercial paper and for general corporate purposes. The total estimated fair value of the Notes was approximately $3.2 billion, which is based on quoted prices for our publicly-traded debt as of September 30, 2012.

***Credit Facility***

In conjunction with the commercial paper program, we have a $3.0 billion revolving credit facility expiring in July 2016. The interest rate for the credit facility is determined based on a formula using certain market rates. At December 31, 2011 and September 30, 2012, we were in compliance with the financial covenant in the credit facility and no amounts were outstanding.

**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. We use certain interest rate derivative contracts to hedge interest rate exposures on our fixed income securities and our anticipated debt issuance. Our program is not designated for trading or speculative purposes.

We recognize derivative instruments as either assets or liabilities in 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, net, as part of revenues, or to accumulated other comprehensive income (AOCI) in the accompanying Consolidated Balance Sheets.

***Cash Flow Hedges***

We use foreign currency options designated as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar. The notional principal of foreign exchange contracts to purchase U.S. dollars with Euros was 2.8 billion (or approximately $3.8 billion) and 4.6 billion (or approximately $5.9 billion) at December 31, 2011 and September 30, 2012; the notional principal of foreign exchange contracts to purchase U.S. dollars with British pounds was £1.4 billion (or approximately $2.2 billion) and £1.9 billion (or approximately $3.0 billion) at December 31, 2011 and September 30, 2012; and the notional principal of foreign exchange contracts to purchase U.S. dollars with Canadian dollars was C$504 million (or approximately $490 million) and C$656 million (or approximately $644 million) at December 31, 2011 and September 30, 2012. These foreign exchange contracts have maturities of 36 months or less.

During the second quarter of 2012, we began to hedge the variability of forecasted interest payments on an anticipated debt issuance using forward-starting interest swaps. The total notional amount of these forward-starting interest swaps was $1.0 billion as of September 30, 2012 with terms calling for us to receive interest at a variable rate and to pay interest at a fixed rate. These forward-starting interest swaps effectively fix the benchmark interest rate on an anticipated debt issuance of $1.0 billion in 2014, and they will be terminated upon issuance of the debt.

We initially report any gain or loss on the effective portion of a cash flow hedge as a component of AOCI and subsequently reclassify to revenues or interest expense when the hedged transactions are recorded. If the hedged transactions become probable of not occurring, the corresponding amounts in AOCI would be reclassified to interest and other income, net. 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 on the date of purchase as an asset. Thereafter, we recognize any change to this time value in interest and other income, net.

At September 30, 2012, the effective portion of our cash flow hedges before tax effect was $76 million, of which $66 million is expected to be reclassified from AOCI to earnings within the next 12 months.

***Fair Value Hedges***

We use 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, 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, net. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $1.0 billion

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and $1.1 billion at December 31, 2011 and September 30, 2012. The notional principal of foreign exchange contracts to sell U.S. dollars with foreign currencies was $51 million at September 30, 2012 and no such contracts were outstanding at December 31, 2011.

***Other Derivatives***

Other derivatives not designated as hedging instruments consist of forward and option contracts that we use to hedge intercompany transactions 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, net, along with the losses and gains of the related hedged items. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $2.3 billion and $3.1 billion at December 31, 2011 and September 30, 2012. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $472 million and $438 million at December 31, 2011 and September 30, 2012. The notional principal of foreign exchange contracts to purchase Euros with other foreign currencies was 711 million (or approximately $929 million) and 930 million (or approximately $1.2 billion) at December 31, 2011 and September 30, 2012. The notional principal of foreign exchange contracts to sell Euros for other foreign currencies was 17 million (or approximately $22 million) at September 30, 2012 and no such contracts were outstanding at December 31, 2011.

We also use exchange-traded interest rate futures contracts and To Be Announced (TBA) forward purchase commitments of mortgage-backed assets to hedge interest rate risks on certain fixed income securities. The TBA contracts meet the definition of derivative instruments in cases where physical delivery of the assets is not taken at the earliest available delivery date. Our interest rate futures and TBA contracts (together interest rate contracts) are not designated as hedging instruments. We recognize gains and losses on these contracts as well as the related costs in interest and other income, net. The gains and losses are generally economically offset by unrealized gains and losses in the underlying available-for-sale securities, which are recorded as a component of AOCI until the securities are sold or other-than-temporarily impaired, at which time the amounts are moved from AOCI into interest and other income, net. The total notional amounts of interest rate contracts outstanding were $100 million at both December 31, 2011 and September 30, 2012.

The fair values of our outstanding derivative instruments were as follows (in millions):

| | Balance Sheet Location | Fair Value of Derivative Instruments As of December 31, 2011 | As of September 30, 2012 (unaudited) |
|---|---|---|---|
| **Derivative Assets** | | | |
| Derivatives designated as hedging instruments: | | | |
| Foreign exchange contracts | Prepaid revenue share, expenses and other assets, current and non-current | $ 333 | $ 239 |
| Derivatives not designated as hedging instruments: | | | |
| Foreign exchange contracts | Prepaid revenue share, expenses and other assets, current | 4 | 2 |
| Total | | $ 337 | $ 241 |
| **Derivative Liabilities** | | | |
| Derivatives designated as hedging instruments: | | | |
| Foreign exchange contracts | Accrued expenses and other current liabilities | $ 5 | $ 0 |
| Interest rate contracts | Other long-term liabilities | 0 | 8 |
| | | $ 5 | $ 8 |
| Derivatives not designated as hedging instruments: | | | |
| Foreign exchange contracts | Accrued expenses and other current liabilities | 1 | 0 |

| | | | | |
|---|---|---|---|---|
| Total | $ | 6 | $ | 8 |

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The effect of derivative instruments in cash flow hedging relationships on income and AOCI is summarized below (in millions):

| Derivatives in Cash Flow Hedging Relationship | Gains (Losses) Recognized in OCI on Derivatives Before Tax Effect (Effective Portion) | | | |
|---|---|---|---|---|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Foreign exchange contracts | $ 61 | $ (110) | $ (54) | $ 110 |
| Interest rate contracts | 0 | (8) | 0 | (8) |
| Total | $ 61 | $ (118) | $ (54) | $ 102 |

| 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 | 2011 | 2012 | 2011 | 2012 |
| | | (unaudited) | | | |
| Foreign exchange contracts | Revenues | $ 1 | $ 62 | $ 19 | $ 180 |

| Derivatives in Cash Flow Hedging Relationship | | Gains (Losses) Recognized in Income on Derivatives (Amount Excluded from Effectiveness Testing and Ineffective Portion)[1] | | | |
|---|---|---|---|---|---|
| | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | Location | 2011 | 2012 | 2011 | 2012 |
| | | (unaudited) | | | |
| Foreign exchange contracts | Interest and other income, net | $ (18) | $ (124) | $ (189) | $ (370) |

(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 is summarized below (in millions):

| Derivatives in Fair Value Hedging Relationship | | Gains (Losses) Recognized in Income on Derivatives[2] | | | |
|---|---|---|---|---|---|
| | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | Location | 2011 | 2012 | 2011 | 2012 |
| | | (unaudited) | | | |
| Foreign exchange contracts | Interest and other income, net | $ 51 | $ (38) | $ (8) | $ (22) |
| Hedged item | Interest and other income, net | (55) | 36 | (2) | 15 |
| Total | | $ (4) | $ (2) | $ (10) | $ (7) |

(2) Losses related to the amount excluded from effectiveness testing of the hedges were $4 million and $10 million for the three and nine months ended September 30, 2011, and $2 million and $7 million for the three and nine months ended September 30, 2012.

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The effect of derivative instruments not designated as hedging instruments on income is summarized below (in millions):

| Derivatives not Designated as Hedging Instruments | Location | Gains (Losses) Recognized in Income on Derivatives | | | |
|---|---|---|---|---|---|
| | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| | | 2011 | 2012 | 2011 | 2012 |
| | | (unaudited) | | | |
| Foreign exchange contracts | Interest and other income, net | $ 40 | $ (82) | $ 41 | $ (107) |
| Interest rate contracts | Interest and other income, net | (10) | 0 | (19) | (5) |
| Total | | $ 30 | $ (82) | $ 22 | $ (112) |

**Note 6. Fair Value Measurements**

We measure our cash equivalents, marketable securities, auction rate securities (ARS), and foreign currency and interest rate 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 inputs that are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant inputs are observable in the market or can be derived from observable market data. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, foreign exchange rates, and credit ratings.

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 models with significant unobservable marketable inputs. We classify our foreign currency and interest rate derivative contracts primarily 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):

| Description | As of December 31, 2011 | Fair Value Measurement at Reporting Date Using | | |
|---|---|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Assets** | | | | |
| Cash equivalents: | | | | |
| Time deposits | $ 534 | $ 0 | $ 534 | $ 0 |
| Money market and other funds | 4,462 | 3,202 | 1,260[1] | 0 |

| | | | | |
|---|---|---|---|---|
| U.S. government agencies | 275 | 0 | 275 | 0 |
| Marketable securities: | | | | |
| Time deposits | 495 | 0 | 495 | 0 |
| U.S. government agencies | 6,226 | 0 | 6,226 | 0 |
| U.S. government notes | 11,579 | 11,579 | 0 | 0 |
| Foreign government bonds | 1,629 | 0 | 1,629 | 0 |
| Municipal securities | 1,794 | 0 | 1,794 | 0 |
| Corporate debt securities | 6,112 | 0 | 6,112 | 0 |
| Agency residential mortgage-backed securities | 6,501 | 0 | 6,501 | 0 |

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| Description | As of December 31, 2011 | Fair Value Measurement at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Marketable equity securities | 307 | 307 | 0 | 0 |
| Derivative contracts | 337 | 0 | 337 | 0 |
| Auction rate securities | 118 | 0 | 0 | 118 |
| Total | $ 40,369 | $ 15,088 | $ 25,163 | $ 118 |
| **Liabilities** | | | | |
| Derivative contracts | $ 6 | $ 0 | $ 6 | $ 0 |
| Total | $ 6 | $ 0 | $ 6 | $ 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.

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| Description | As of September 30, 2012 | Fair Value Measurement at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| | | (unaudited) | | |
| **Assets** | | | | |
| Cash equivalents: | | | | |
| Time deposits | $ 360 | $ 0 | $ 360 | $ 0 |
| Money market and other funds | 8,926 | 7,796 | 1,130[1] | 0 |
| U.S. government notes | 750 | 750 | 0 | 0 |
| Marketable securities: | | | | |
| Time deposits | 507 | 0 | 507 | 0 |
| U.S. government agencies | 1,616 | 0 | 1,616 | 0 |
| U.S. government notes | 9,179 | 9,179 | 0 | 0 |
| Foreign government bonds | 1,898 | 0 | 1,898 | 0 |
| Municipal securities | 1,596 | 0 | 1,596 | 0 |
| Corporate debt securities | 7,160 | 0 | 7,160 | 0 |
| Agency residential mortgage-backed securities | 6,754 | 0 | 6,754 | 0 |
| Asset backed securities | 729 | 0 | 729 | 0 |
| Marketable equity securities | 25 | 25 | 0 | 0 |
| Derivative contracts | 241 | 0 | 241 | 0 |
| Auction rate securities | 80 | 0 | 0 | 80 |
| Total | $ 39,821 | $ 17,750 | $ 21,991 | $ 80 |
| **Liabilities** | | | | |
| Derivative contracts | $ 8 | $ 0 | $ 8 | $ 0 |
| Total | $ 8 | $ 0 | $ 8 | $ 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.

**Note 7. Balance Sheet Components**

***Inventories***

Inventories consisted of the following (in millions):

| | As of December 31, 2011 | As of September 30, 2012 (unaudited) |
|---|---|---|
| Raw materials and work in process | $ 0 | $ 132 |
| Finished goods | 35 | 486 |
| Inventories | $ 35 | $ 618 |

***Property and Equipment***

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

| | As of December 31, 2011 | As of September 30, 2012 (unaudited) |
|---|---|---|
| Information technology assets | $ 6,060 | $ 7,324 |
| Land and buildings | 5,228 | 6,127 |
| Construction in progress | 2,128 | 2,233 |
| Leasehold improvements | 919 | 1,284 |
| Furniture and fixtures | 65 | 70 |
| Total | 14,400 | 17,038 |
| Less: accumulated depreciation and amortization | 4,797 | 5,637 |
| Property and equipment, net | $ 9,603 | $ 11,401 |

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***Accumulated Other Comprehensive Income***

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

| | As of December 31, 2011 | As of September 30, 2012 (unaudited) |
|---|---|---|
| Foreign currency translation adjustment | $ (148) | $ (246) |
| Net unrealized gains on available-for-sale investments, net of taxes | 327 | 566 |
| Net unrealized gains on cash flow hedges, net of taxes | 97 | 48 |
| Accumulated other comprehensive income | $ 276 | $ 368 |

**Note 8. Acquisitions**

On May 22, 2012, we completed our acquisition of Motorola, a provider of innovative technologies, products and services that enable a range of mobile and wireline digital communication, information and entertainment experiences. The acquisition is expected to protect and advance our Android ecosystem and enhance competition in mobile computing. Under the transaction, we acquired all outstanding common shares of Motorola for $40 per share and all vested Motorola stock options and restricted stock units, for a total purchase price of approximately $12.4 billion in cash. In addition, we assumed $401 million of unvested Motorola stock options and restricted stock units, which will be recorded as stock-based compensation expense over the remaining service periods. Transaction costs were approximately $50 million, which were recorded as general and administrative expense as incurred.

The fair value of assets acquired and liabilities assumed was based upon a preliminary valuation and our estimates and assumptions are subject to change within the measurement period. The primary areas of the purchase price that are not yet finalized are related to certain legal matters, income taxes, and residual goodwill. Of the $12.4 billion total purchase price, $2.9 billion was cash acquired, $5.5 billion was attributed to patents and developed technology, $2.5 billion to goodwill, $720 million to customer relationships, and $831 million to other net assets acquired.

The goodwill of $2.5 billion is primarily attributed to the synergies expected to arise after the acquisition. Goodwill is not expected to be deductible for tax purposes.

Supplemental information on an unaudited pro forma basis, as if the Motorola acquisition had been consummated on January 1, 2011, is presented as follows (in millions, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Revenues | $ 12,928 | $ 14,101 | $ 36,750 | $ 41,730 |
| Net income | $ 2,582 | $ 2,198 | $ 6,261 | $ 7,688 |
| Net income per share of Class A and Class B common stock diluted | $ 7.87 | $ 6.60 | $ 19.14 | $ 23.18 |

These pro forma results are based on estimates and assumptions, which we believe are reasonable. They are not necessarily indicative of our consolidated results of operations in future periods or the results that actually would have been realized had we been a combined company during the periods presented. The pro forma results include adjustments primarily related to amortization of acquired intangible assets, severance and benefit arrangements in connection with the acquisition, and stock-based compensation expenses for assumed unvested stock options and restricted stock units.

During the nine months ended September 30, 2012, we completed 39 other acquisitions and purchases of intangible assets for a total cash consideration of approximately $1.1 billion, of which $693 million was attributed to goodwill, $436 million to acquired intangible assets, and $31 million to net liabilities assumed. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other

functional areas, our technologies, and our product offerings. The amount of goodwill expected to be deductible for tax purposes is approximately $5 million.

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Pro forma results of operations for these acquisitions have not been presented because they are not material to the consolidated results of operations, either individually or in aggregate.

For all acquisitions completed during the nine months ended September 30, 2012, patents and developed technology have a weighted-average useful life of 8.9 years, customer relationships have a weighted-average useful life of 7.4 years and trade names and other have a weighted-average useful life of 9.3 years.

**Note 9. Goodwill and Other Intangible Assets**

The changes in the carrying amount of goodwill for the nine months ended September 30, 2012 were as follows (in millions, unaudited):

| | |
|---|---|
| Balance as of December 31, 2011 | $ 7,346 |
| Goodwill acquired | 3,183 |
| Goodwill adjustment | (44) |
| Balance as of September 30, 2012 | $ 10,485 |

As a result of the acquisition of Motorola, we have three operating segments: Google, Mobile, and Home. Amounts of goodwill allocated to the Mobile and Home segments were not material. See Note 15 for further discussion of segment information.

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

| | As of December 31, 2011 | | |
|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
| Patents and developed technology | $ 1,451 | $ 698 | $ 753 |
| Customer relationships | 1,288 | 573 | 715 |
| Trade names and other | 359 | 249 | 110 |
| Total | $ 3,098 | $ 1,520 | $ 1,578 |

| | As of September 30, 2012 | | |
|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization (unaudited) | Net Carrying Value |
| Patents and developed technology | $ 7,283 | $ 1,097 | $ 6,186 |
| Customer relationships | 2,061 | 767 | 1,294 |
| Trade names and other | 562 | 288 | 274 |
| Total | $ 9,906 | $ 2,152 | $ 7,754 |

Amortization expense of acquisition-related intangible assets was $126 million and $327 million for the three and nine months ended September 30, 2011 and $317 million and $634 million for the three and nine months ended September 30, 2012. As of September 30, 2012, expected amortization expense for acquisition-related intangible assets for each of the next five years and thereafter was as follows (in millions, unaudited):

| | |
|---|---|
| Remainder of 2012 | $ 317 |
| 2013 | 1,177 |
| 2014 | 1,104 |
| 2015 | 946 |
| 2016 | 877 |
| 2017 | 820 |
| Thereafter | 2,513 |
| | $ 7,754 |

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**Note 10. Restructuring Charges**

Subsequent to our acquisition of Motorola in May 2012, we initiated a restructuring plan primarily in our Mobile segment to reduce workforce, reorganize management structure, close or consolidate certain facilities, as well as simplify our mobile product portfolio. These changes are designed to return Motorola s Mobile segment to profitability. For the nine months ended September 30, 2012, activities related to restructuring charges were summarized as below (in millions, unaudited):

| | Severance and Other Charges |
|---|---|
| Balance as of December 31, 2011 | $ 0 |
| Charges | 454 |
| Cash payments | (98) |
| Non-cash items[1] | (143) |
| Balance as of September 30, 2012 | $ 213 |

[1] Non-cash items were primarily related to restricted stock units and stock options.

For the three and nine months ended September 30, 2012, restructuring charges were included in Costs and Expenses as follows (in millions, unaudited):

| | Three Months | Nine Months |
|---|---|---|
| | Ended September 30, 2012 | |
| Cost of revenues Motorola | $ 56 | $ 65 |
| Research and development | 116 | 128 |
| Sales and marketing | 100 | 128 |
| General and administrative | 25 | 133 |
| Total charges | $ 297 | $ 454 |

**Note 11. Interest and Other Income, Net**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Interest income | $ 211 | $ 172 | $ 613 | $ 534 |
| Interest expense | (21) | (21) | (38) | (63) |
| Realized gains on available-for-sale investments, net | 109 | 36 | 211 | 211 |
| Foreign currency exchange losses, net | (24) | (147) | (224) | (439) |
| Gain on divestiture of business | 0 | 0 | 0 | 188 |
| Other | 27 | 23 | 40 | 42 |
| Interest and other income, net | $ 302 | $ 63 | $ 602 | $ 473 |

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**Note 12. Contingencies**

***Legal Matters***

*Antitrust Investigations*

On June 23, 2011, we received a Civil Investigative Demand (CID) from the U.S. Federal Trade Commission s (FTC) Bureau of Competition and a subpoena from the FTC s Bureau of Consumer Protection relating to a review by the FTC of our business practices, including search and advertising. State attorneys general from the states of Texas, Ohio, and Mississippi have issued similar CIDs. We are cooperating with the FTC and the state attorneys general and are responding to their information requests on an ongoing basis.

The European Commission s (EC) Directorate General for Competition has also opened an investigation into various antitrust-related complaints against us. On February 10, 2010, we received notification from the EC about three antitrust complaints filed by Ciao, Ejustice, and Foundem, respectively. On November 30, 2010, the EC formally opened proceedings against us. Since November 2010, 1plusV, parent company of Ejustice, and VfT, an association of business listings providers in Germany, have filed similar complaints against us. On March 31, 2011, Microsoft Corporation submitted a similar complaint to the EC against us. On the same day, the EC notified us of additional complaints filed by Elfvoetbal, Hotmaps, Interactive Lab, and nnpt.it, and on August 30, 2011 of a complaint by dealdujour.pro. In addition, in December 2011, the Spanish Association of Daily Newspaper Publishers also submitted a complaint to the EC against us. In January 2012, Twenga brought a complaint against us and, in February 2012, the German newspaper associations, Bundesverband Deutscher Zeitungsverleger (BDZV) and Verband Deutscher Zeitschriftenverleger (VDZ), also brought a complaint against us with the EC. In March and April of 2012, the EC asked us to comment on Expedia s, Tripadvisor s, Odigeo s and Streetmap s complaints against us. In August 2012, Nextag submitted its complaint, echoing similar issues. We believe we have adequately responded to all of the allegations made against us. We are cooperating with the EC and are pursuing a potential resolution.

In June 2012, we received a CID and a subpoena duces tecum from the FTC s Bureau of Competition seeking documents and information broadly related to Motorola s licensing practices for standards-essential patents and use of standards-essential patents in litigation. We are cooperating with the FTC and responding to the information requests on an ongoing basis. The EC has also opened an investigation into Motorola s licensing practices for standards-essential patents and use of standards-essential patents in litigation on the basis of complaints brought by Microsoft and Apple. We are cooperating with the EC and responding to the information requests on an ongoing basis.

The Comision Nacional de Defensa de la Competencia in Argentina, the Competition Commission of India, and the Korea Fair Trade Commission in South Korea have also opened investigations into certain business practices.

*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 center 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.

*Patent and Intellectual Property Claims*

We have had patent, copyright, and trademark infringement lawsuits filed against us claiming that certain of our products, services, and technologies, including Android, Google Search, Google AdWords, Google AdSense, Google Books, Google News, Google Image Search, Google Chrome, Google Talk, Google Voice, Motorola devices and YouTube, infringe the intellectual property 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 features, functionalities, products, or services, and may also cause us to change our business practices, and require development of non-infringing products or technologies, which could result in a loss of revenues for us and otherwise harm our business. In addition, the U.S. International Trade Commission (ITC) has increasingly become an important forum to litigate intellectual property disputes because an ultimate loss for a company or its suppliers in an ITC action could result in a prohibition on importing infringing products into the U.S. Since the U.S. is an important market, a prohibition on importation could have an adverse effect on us, including preventing us from importing many important products into the U.S. or necessitating workarounds that may limit certain features of our products.

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Furthermore, many of our agreements with our customers and partners require us to indemnify them for certain intellectual property infringement claims against them, which would increase our costs as a result of defending such claims, and may require that we pay significant damages if there were an adverse ruling in any such claims. Our customers and partners may discontinue the use of our products, services, and technologies, as a result of injunctions or otherwise, which could result in loss of revenues and adversely impact our business.

*Other*

We are also regularly subject to claims, suits, government investigations, and other proceedings involving competition and antitrust (such as the pending investigations by the FTC and the EC described above), intellectual property, privacy, tax, labor and employment, commercial disputes, content generated by our users, goods and services offered by advertisers or publishers using our platforms, personal injury, consumer protection, and other matters. Such claims, suits, government investigations, and other proceedings could result in fines, civil or criminal penalties, or other adverse consequences.

Certain of our outstanding legal matters include speculative claims for substantial or indeterminate amounts of damages. We record a liability when we believe that it is both probable that a loss has been incurred, and the amount can be reasonably estimated. We evaluate, on a monthly basis, developments in our legal matters that could affect the amount of liability that has been previously accrued, and make adjustments as appropriate. Significant judgment is required to determine both likelihood of there being and the estimated amount of a loss related to such matters.

With respect to our outstanding legal matters, based on our current knowledge, we believe that the amount or range of reasonably possible loss will not, either individually or in the aggregate, have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows. However, the outcome of such legal matters is inherently unpredictable and subject to significant uncertainties.

We expense legal fees in the period in which they are incurred.

***Income Taxes***

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

**Note 13. Stockholders Equity**

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

| | Three Months Ended September 30, | Nine Months Ended September 30, | |
|---|---|---|---|
| | 2011 | 2011 | 2012 |
| | | (unaudited) | |
| Risk-free interest rate | 1.7% | 2.3% | 1.0% |
| Expected volatility | 33% | 33% | 29% |
| Expected life (in years) | 6.2 | 5.9 | 5.3 |
| Dividend yield | 0 | 0 | 0 |
| Weighted-average estimated fair value of options granted during the period | $210.06 | $ 210.24 | $ 193.80 |

There were no stock options granted during the three months ended September 30, 2012.

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The following table summarizes the activities for our stock options for the nine months ended September 30, 2012:

| | 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, 2011 | 9,807,252 | $ 357.92 | | |
| Granted [2] | 1,374,577 | $ 578.12 | | |
| Exercised | (1,929,716) | $ 307.57 | | |
| Forfeited/canceled | (219,673) | $ 462.80 | | |
| Balance at September 30, 2012 | 9,032,440 | $ 399.63 | 5.5 | $ 3,205 |
| Vested and exercisable as of September 30, 2012 | 6,095,398 | $ 343.12 | 4.2 | $ 2,507 |
| Vested and exercisable as of September 30, 2012 and expected to vest thereafter [3] | 8,645,925 | $ 394.40 | 5.5 | $ 3,113 |

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $754.50 of our Class A common stock on September 28, 2012.

(2) Includes options granted in connection with the acquisition of Motorola.

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

The following table summarizes additional information regarding outstanding, exercisable, and vested and exercisable stock options at September 30, 2012:

| | Options Outstanding | | | Options Exercisable | | Options Vested and Exercisable | |
|---|---|---|---|---|---|---|---|
| Range of Exercise Prices | Number of Shares | Weighted-Average Remaining Life (in years) | Weighted-Average Exercise Price | Number of Shares | Weighted-Average Exercise Price | Number of Shares | Weighted-Average Exercise Price |
| | | | (unaudited) | | | | |
| $0.30 $94.80 | 194,011 | 1.7 | $ 27.88 | 194,011 | $ 27.88 | 187,955 | $ 25.96 |
| $117.84 $198.41 | 268,416 | 2.2 | $ 178.42 | 268,416 | $ 178.42 | 268,416 | $ 178.42 |
| $205.96 $298.86 | 309,878 | 2.7 | $ 275.33 | 309,104 | $ 275.30 | 309,104 | $ 275.30 |
| $300.97 $399.00 | 4,229,411 | 4.1 | $ 309.73 | 3,672,966 | $ 309.74 | 3,672,966 | $ 309.74 |
| $401.78 $499.07 | 1,097,537 | 6.2 | $ 443.35 | 797,978 | $ 442.21 | 797,978 | $ 442.21 |
| $501.27 $595.35 | 1,840,306 | 7.2 | $ 536.11 | 757,132 | $ 528.90 | 757,132 | $ 528.90 |
| $601.17 $699.35 | 1,092,801 | 9.2 | $ 629.39 | 101,767 | $ 614.69 | 101,767 | $ 614.69 |
| $710.84 | 80 | 5.2 | $ 710.84 | 80 | $ 710.84 | 80 | $ 710.84 |
| $0.30 $710.84 | 9,032,440 | 5.5 | $ 399.63 | 6,101,454 | $ 342.87 | 6,095,398 | $ 343.12 |

The above tables include approximately 1.5 million warrants held by selected financial institutions that were stock options purchased from employees under our Transferable Stock Option (TSO) program, with a weighted-average exercise price of $364.72 and a weighted-average remaining life of 1.3 years.

During the nine months ended September 30, 2012, the number of shares underlying TSOs sold to selected financial institutions under the TSO program was 986,858 at a total value of $283 million, or an average price of $287.22 per share, including an average premium of $9.94 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.

The total grant date fair value of stock options vested during the three and nine months ended September 30, 2011 was $172 million and $422 million. The total grant date fair value of stock options vested during the three and nine months ended September 30, 2012 was $112 million and $400 million. The aggregate intrinsic value of all stock options and warrants exercised during the three and nine months ended September 30, 2011 was $141 million and $454 million. The aggregate intrinsic value of all stock options and warrants exercised during the three and nine months ended September 30, 2012 was $406 million and $638 million. These amounts do not include the aggregate sales price of stock options sold under our TSO program.

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As of September 30, 2012, there was $455 million of unrecognized compensation cost related to outstanding stock options. This amount is expected to be recognized over a weighted-average period of 2.3 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) for the nine months ended September 30, 2012:

| | Unvested Restricted Stock Units | |
|---|---|---|
| | Number of Shares | Weighted-Average Grant-Date Fair Value |
| | (unaudited) | |
| Unvested at December 31, 2011 | 8,822,648 | $ 520.27 |
| Granted[1] | 6,170,515 | $ 595.16 |
| Vested | (2,803,258) | $ 524.98 |
| Forfeited/canceled | (522,873) | $ 540.51 |
| Unvested at September 30, 2012 | 11,667,032 | $ 557.96 |
| Expected to vest after September 30, 2012 [2] | 10,131,651 | $ 557.96 |

(1) Includes RSUs granted in connection with the acquisition of Motorola.
(2) RSUs expected to vest reflect an estimated forfeiture rate.

As of September 30, 2012, there was $5.2 billion of unrecognized compensation cost related to unvested RSUs. This amount is expected to be recognized over a weighted-average period of 2.8 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.

***Stock Dividend***

In April 2012, our board of directors approved amendments to our certificate of incorporation that would, among other things, create a new class of non-voting capital stock (Class C capital stock). The amendments authorized 3 billion shares of Class C capital stock and also increased the authorized shares of Class A common stock from 6 billion to 9 billion. The amendments are reflected in our Fourth Amended and Restated Certificate of Incorporation (New Charter), the adoption of which was approved by stockholders at our 2012 Annual Meeting of Stockholders held on June 21, 2012. We have announced the intention of our board of directors to consider a distribution of shares of the Class C capital stock as a dividend to our holders of Class A and Class B common stock (Dividend). The Class C capital stock will have no voting rights, except as required by applicable law. Except as expressly provided in the New Charter, shares of Class C capital stock will have the same rights and privileges and rank equally, share ratably and be identical in all other respects to the shares of Class A common stock and Class B common stock as to all matters.

The par value per share of our shares of Class A common stock and Class B common stock will remain unchanged at $0.001 per share after the Dividend. On the effective date of the Dividend, there will be a transfer between retained earnings and common stock and the amount transferred will be equal to the $0.001 par value of the Class C capital stock that is issued. We will give retroactive effect to prior period share and per share amounts in our consolidated financial statements for the effect of the Dividend, such that prior periods are comparable to current period presentation.

**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 were $1,564 million and $1,887 million as of December 31, 2011 and September 30, 2012. Our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were $1,350 million and $1,645 million as of December 31, 2011 and September 30, 2012. Our existing tax positions will continue to generate an increase in liabilities for unrecognized tax benefits.

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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 that have lower statutory rates and higher than anticipated in countries that 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, or accounting principles, as well as certain discrete items. In addition, we are subject to the continuous examination of our income tax returns by the IRS 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 Segments and Geographic Areas**

Prior to the second quarter of 2012, our chief operating decision makers (i.e., chief executive officer and his direct reports) reviewed 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. As a result of our Motorola acquisition in the second quarter of 2012, our chief operating decision makers review financial information for the following three operating segments:

Google includes our advertising and other non-advertising businesses

Mobile includes our mobile device business acquired from Motorola

Home includes our digital set-top box business acquired from Motorola

Our chief operating decision makers do not evaluate operating segments using asset information.

The following table sets forth revenues and operating income (loss) by operating segment (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Google: | | | | |
| Revenues | $ 9,720 | $ 11,526 | $ 27,322 | $ 33,135 |
| Operating income | 3,629 | 3,951 | 10,172 | 11,884 |
| Mobile: | | | | |
| Revenues | 0 | 1,778 | 0 | 2,621 |
| Operating loss | 0 | (176) | 0 | (217) |
| Home: | | | | |
| Revenues | 0 | 797 | 0 | 1,204 |
| Operating income | 0 | 25 | 0 | 28 |

A reconciliation of the total segment operating income to the consolidated operating income is as follows (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Total segment operating income | $ 3,629 | $ 3,800 | $ 10,172 | $ 11,695 |
| Unallocated items | (571) | (1,064) | (1,937) | (2,367) |
| Consolidated operating income | $ 3,058 | $ 2,736 | $ 8,235 | $ 9,328 |

Unallocated items, including stock-based compensation expense, restructuring and other charges related to our Motorola business, and a charge related to the resolution of a Department of Justice investigation, are not allocated to each segment because we do not include this information in our measurement of the performance of our operating segments.

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Revenues by geography are based on the billing addresses of our customers for the Google segment, and the ship-to addresses of our customers for the Mobile and the Home segments. The following tables set forth revenues and long-lived assets by geographic area (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Revenues: | | | | |
| United States | $ 4,420 | $ 6,999 | $ 12,580 | $ 17,569 |
| United Kingdom | 1,047 | 1,226 | 2,993 | 3,562 |
| Rest of the world | 4,253 | 5,876 | 11,749 | 15,829 |
| Total revenues | $ 9,720 | $ 14,101 | $ 27,322 | $ 36,960 |

| | As of December 31, 2011 | As of September 30, 2012 (unaudited) |
|---|---|---|
| Long-lived assets: | | |
| United States | $ 15,963 | $ 20,558 |
| International | 3,853 | 12,351 |
| Total long-lived assets | $ 19,816 | $ 32,909 |

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

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 in Part I, Item 1 of this Quarterly Report on Form 10-Q.

**Overview**

Google is a global technology leader focused on improving the ways people connect with information. Our innovations in web search and advertising have made our 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 and offline ads to customers across Google-owned websites and through the Google Network, which is the network of 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 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. 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. We share most of the fees these ads generate with these content providers, thereby creating an important revenue stream for these partners.

As a result of our acquisition of Motorola, we also provide innovative technologies, products and services that enable a range of mobile and wireline digital communication, information and entertainment experiences. Motorola s integrated products and platforms deliver rich multimedia content, such as voice, video, messaging and internet-based applications and services to multiple screens, such as mobile devices, including smartphones and media tablets, televisions, and personal computers.

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Our Motorola business is comprised of two segments. The Mobile segment is focused on mobile wireless devices and related products and services. The Home segment is focused on technologies and devices that provide video entertainment services to consumers by enabling subscribers to access a variety of interactive digital television services.

**How We Generate Revenue**

We generate revenues from our Google business primarily by delivering online advertising, and from our Motorola business primarily by selling hardware products.

*Google (Advertising and Other)*

Advertising revenues made up 96% of our Google revenues for the three and nine months ended September 30, 2011, and 94% and 95% of our Google revenues for the three and nine months ended September 30, 2012, respectively. We derive most of our other revenues from our enterprise products, as well as our display advertising management services to advertisers, ad agencies, and publishers.

Google AdWords is our auction-based advertising program that enables advertisers to place text-based and display ads on our websites and our Google Network Members websites. Display advertising comprises the videos, text, images, and other interactive ads that run across the web on computers and mobile devices, including smart phones and handheld computers such as netbooks and tablets. Most of our AdWords advertisers 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 advertisers. 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 our Google Network Members websites, as well as programs to deliver ads on television broadcasts. 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 websites. 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 to 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 require 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.

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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 require 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 from which the content is viewed and share most of the fees these ads generate with the content providers. We recognize these advertiser fees as revenue and the fees we pay to our content providers as content acquisition costs under cost of revenues.

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

- The relevance, objectivity, quality, and precision 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) and the platform used to initiate the searches (for instance, whether they are initiated via desktop or mobile devices).
- Our ability to increase traffic on our websites and our Google Network Members websites via new and improved ad formats, through devices other than personal computers, such as mobile phones and tablets.
- 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 and other available online environments for advertising, including those of our competitors.
- 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.

We also generate revenues from the sale of hardware products. We recognize fees derived from the sale of these products as other revenues in the period in which they are delivered.

*Motorola (Hardware and Other)*

We generate revenues from our Motorola business through two segments. The Mobile segment designs, manufactures, sells and services wireless mobile devices, with integrated software and accessory products. The Home segment designs, manufactures, sells, installs and services set-top boxes for digital and Internet protocol (IP) video, satellite and terrestrial broadcast networks, and Internet protocol television (IPTV) distribution systems, broadband access network infrastructure platforms, and associated software solutions to cable TV and telecommunication service providers.

**Trends in Our Businesses**

Advertising transactions continue to shift from offline to online as the digital economy evolves. This has contributed to the rapid growth of our business 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 it could do so in the future as a result of a number of factors, including increasing competition, our investments in new business strategies, products, services, and technologies, changes in our product mix, query growth rates and how users make queries, challenges in maintaining our growth rate as our revenues increase to higher levels, and the evolution of the online advertising market, including the increasing variety of online platforms for advertising, and other markets in which we participate. Mobile search queries and mobile commerce are growing dramatically around the world, and consumers are using multiple devices to access information. Over time these trends have resulted in changes in our product mix, including a significant increase in mobile search queries and a deceleration in the growth of desktop queries. We expect that our revenue growth rate will continue to be affected by evolving consumer preferences, as well as by advertising trends, the acceptance by mobile users of our products and services, and our ability to create a seamless experience for both users and advertisers in a multi-screen environment. In addition, if there is a further general economic downturn, this may result in fewer commercial queries by our users and may cause advertisers to reduce the amount they spend on online advertising, including the amount they are willing to pay for each click or impression, which could negatively affect the growth rate of our revenues. We plan to continue to invest aggressively in our core areas of strategic focus.

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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 websites 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. Also, the margins on advertising revenues from mobile devices and other newer advertising formats are generally lower than those from desktop computers and tablets. We expect this trend to continue in the near future and that it will continue to pressure our margins, particularly if we fail to realize the opportunities we anticipate with the transition to a dynamic multi-screen environment.

We conduct our Motorola business in highly competitive markets, facing both new and established competitors. The markets for many of our products are characterized by rapidly changing technologies, frequent new product introductions, changing consumer trends, short product life cycles, consumer loyalty and evolving industry standards. Market disruptions caused by new technologies, the entry of new competitors, consolidations among our customers and competitors, changes in regulatory requirements, changes in economic conditions, supply chain interruptions or other factors, can introduce volatility into our businesses. Meeting all of these challenges requires consistent operational planning and execution and investment in technology, resulting in innovative products that meet the needs of our customers around the world.

From an overall business perspective, we continue to invest aggressively in our systems, data centers, corporate facilities, information technology infrastructure, and employees. We expect to continue our hiring in the remainder of 2012 and provide competitive compensation programs for our employees. Our full-time employee headcount was 31,353 at September 30, 2011 and 53,546 at September 30, 2012, which includes 17,428 headcount related to Motorola. Acquisitions will also remain an important component of our strategy and use of capital, and we expect our current pace of acquisitions to continue. 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, content acquisition costs, credit card and other transaction fees, manufacturing and inventory-related 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.

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. 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**

We completed our acquisition of Motorola on May 22, 2012 (the acquisition date). The operating results of Motorola were included in our Consolidated Statement of Income from the acquisition date through September 30, 2012. In addition, we initiated a restructuring plan in our Motorola business. See Note 10 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further discussion of this restructuring plan and the associated restructuring charges. We continue to evaluate our plans and further restructuring actions may occur, which may cause us to incur additional restructuring charges, some of which may be significant.

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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, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| **Consolidated Statements of Income Data:** | | | | |
| Revenues: | | | | |
| Google (advertising and other) | 100.0% | 81.7% | 100.0% | 89.7% |
| Motorola (hardware and other) | 0 | 18.3 | 0 | 10.3 |
| Total revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Costs and expenses: | | | | |
| Cost of revenues Google (advertising and other) | 34.8 | 31.5 | 34.7 | 33.0 |
| Cost of revenues Motorola (hardware and other) | 0 | 15.0 | 0 | 8.5 |
| Research and development | 14.4 | 14.2 | 14.1 | 13.6 |
| Sales and marketing | 12.4 | 12.5 | 12.2 | 12.1 |
| General and administrative | 6.9 | 7.4 | 7.1 | 7.6 |
| Charge related to resolution of Department of Justice investigation | 0 | 0 | 1.8 | 0 |
| Total costs and expenses | 68.5 | 80.6 | 69.9 | 74.8 |
| Income from operations | 31.5 | 19.4 | 30.1 | 25.2 |
| Interest and other income, net | 3.1 | 0.4 | 2.2 | 1.3 |
| Income before income taxes | 34.6 | 19.8 | 32.3 | 26.5 |
| Provision for income taxes | 6.5 | 4.4 | 6.6 | 5.3 |
| Net income | 28.1% | 15.4% | 25.7% | 21.2% |

**Revenues**

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

| | Three Months Ended September 30 | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Google: | | | | |
| Advertising revenues: | | | | |
| Google websites | $ 6,740 | $ 7,727 | $ 18,851 | $ 22,581 |
| Google Network Members websites | 2,595 | 3,133 | 7,506 | 9,029 |
| Total advertising revenues | 9,335 | 10,860 | 26,357 | 31,610 |
| Other revenues | 385 | 666 | 965 | 1,525 |
| Total Google revenues (advertising and other) | 9,720 | 11,526 | 27,322 | 33,135 |
| Motorola: | | | | |
| Total Motorola revenues (hardware and other) | 0 | 2,575 | 0 | 3,825 |

| | | | | |
|---|---|---|---|---|
| Total revenues | $ 9,720 | $ 14,101 | $ 27,322 | $ 36,960 |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Google (advertising and other) | 100% | 82% | 100% | 90% |
| Motorola (hardware and other) | 0 | 18 | 0 | 10 |
| Total revenues | 100% | 100% | 100% | 100% |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Advertising revenues: | | | | |
| Google websites | 69% | 67% | 69% | 68% |
| Google Network Members websites | 27 | 27 | 27 | 27 |
| Total advertising revenues | 96 | 94 | 96 | 95 |
| Google websites as % of advertising revenues | 72 | 71 | 72 | 71 |
| Google Network Members websites as % of advertising revenues | 28 | 29 | 28 | 29 |
| Other revenues | 4% | 6% | 4% | 5% |

Our revenues increased $4,381 million and $9,638 million from the three and nine months ended September 30, 2011 to the three and nine months ended September 30, 2012. These increases 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 driven by hardware product sales. The increase in advertising revenues for Google websites and Google Network Members websites resulted primarily from an increase in the number of paid clicks through our advertising programs, partially offset by a decrease in the average cost-per-click paid by our advertisers. The increase in the number of paid clicks generated through our advertising programs was due to an increase in aggregate traffic including mobile queries, certain monetization improvements including new ad formats, the continued global expansion of our products, advertisers, and user base, as well as an increase in the number of Google Network Members. The decrease in the average cost-per-click paid by our advertisers was driven by various factors, such as the general strengthening of the U.S dollar compared to certain foreign currencies (primarily the Euro), the revenue shift mix between Google websites and Google Network Members websites, the changes in platform mix due to traffic growth in mobile devices, where the average cost-per-click is typically lower compared to desktop computers and tablets, and 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.

In addition, the increase in our revenues from the three and nine months ended September 30, 2011 to the three and nine months ended September 30, 2012 resulted from the inclusion of revenues from our Motorola business of $2,575 million (of which $1,778 million was from the Mobile segment and $797 million from the Home segment) and $3,825 million (of which $2,621 million was from the Mobile segment and $1,204 million from the Home segment), respectively.

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 increasing site links to be full size links with the URL (uniform resource locator), moving a portion of the first line of the ad to the heading to better promote the content of the ad, providing an option to preview the ad, and moving the ad s URL to a separate line below the heading for greater page format consistency.

Aggregate paid clicks on Google websites and Google Network Members websites increased approximately 33% from the three months ended September 30, 2011 to the three months ended September 30, 2012 and 38% from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. Average cost-per-click on Google websites and Google Network Members websites decreased approximately 15% from the three months ended

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September 30, 2011 to the three months ended September 30, 2012 and 14% from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. 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, changes in advertising quality or formats, and general economic conditions. In addition, traffic growth in emerging markets compared to more mature markets and across various advertising verticals and channels, including mobile devices, 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 Google domestic and international revenues as a percentage of Google revenues, determined based on the billing addresses of our customers for our Google business:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| United States | 45% | 47% | 46% | 46% |
| United Kingdom | 11% | 11% | 11% | 11% |
| Rest of the world | 44% | 42% | 43% | 43% |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| United States | 45% | 50% | 46% | 47% |
| United Kingdom | 11% | 9% | 11% | 10% |
| Rest of the world | 44% | 41% | 43% | 43% |

The increase in revenues from the United States as a percentage of Google revenues and the decline in international revenues (other than the United Kingdom) as a percentage of Google revenues from the three months ended September 30, 2011 to the three months ended September 30, 2012 was primarily related to the general strengthening of the U.S. dollar compared to foreign currencies (primarily the Euro). In addition, the increase in revenues from the United States as a percentage of consolidated revenues and the decline in international revenues as a percentage of consolidated revenues from the three months ended September 30, 2011 to the three months ended September 30, 2012 was a result of the inclusion of Motorola revenues which were primarily generated in the United States.

The general strengthening of the U.S. dollar relative to certain foreign currencies (primarily the Euro) from the three months ended September 30, 2011 to the three months ended September 30, 2012 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 $48 million, or 3.9%, higher and our revenues from the rest of the world would have been approximately $584 million, or 10.0%, higher in the three months ended September 30, 2012. This is before consideration of hedging gains of $6 million and $56 million recognized to revenues from the United Kingdom and the rest of the world in the three months ended September 30, 2012.

The general strengthening of the U.S. dollar relative to certain foreign currencies (primarily the Euro) from the nine months ended September 30, 2011 to the nine months ended September 30, 2012 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 $73 million, or 2.1%, higher and our revenues from the rest of the world would have been approximately $1,006 million, or 6.4%, higher in the nine months ended September 30,

2012. This is before consideration of hedging gains of $17 million and $163 million recognized to revenues from the United Kingdom and the rest of the world in the nine months ended September 30, 2012.

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Although we expect to continue to make investments in international markets, these investments may not result in an increase in our international revenues as a percentage of total revenues in 2012 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 and fixed fee 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. These 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, the fees are charged to expense as incurred. The estimated useful life of the access points is based on the historical average period of time they generate traffic and revenues.

Cost of revenues also includes the expenses associated with the operation of our data centers, including depreciation, labor, energy, and bandwidth costs, amortization of certain acquired intangible assets, credit card and other transaction fees related to processing customer transactions, as well as content acquisition costs. We have entered into arrangements with certain content providers under which we distribute or license their video and other content. In a number of these arrangements, we display ads on the pages of our websites from which the content is viewed and share most of the fees these ads generate with the content providers. To the extent we are obligated to make guaranteed minimum revenue share payments to our content providers, we recognize as content acquisition costs the contractual revenue share amount or the minimum guarantee on a straight-line basis, whichever is greater, over the terms of the agreements.

In addition, cost of revenues includes manufacturing and inventory-related costs from our Motorola business.

The following tables present our cost of revenues and cost of revenues as a percentage of revenues by business, and our traffic acquisition costs and traffic acquisition costs as a percentage of advertising revenues in the Google business, for the periods presented (dollars in millions):

| | | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|---|
| | | 2011 | 2012 | 2011 | 2012 |
| | | (unaudited) | | | |
| Cost of revenues | Google (advertising and other) | $ 3,378 | $ 4,440 | $ 9,485 | $ 12,213 |
| Cost of revenues | Motorola (hardware and other) | 0 | 2,114 | 0 | 3,143 |
| Total cost of revenues | | $ 3,378 | $ 6,554 | $ 9,485 | $ 15,356 |
| Cost of revenues | Google (advertising and other) as a percentage of Google revenues | 34.8% | 38.5% | 34.7% | 36.9% |
| Cost of revenues | Motorola (hardware and other) as a percentage of Motorola revenues | 0 | 82.1% | 0 | 82.2% |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Traffic acquisition costs related to AdSense arrangements | $ 1,827 | $ 2,214 | $ 5,282 | $ 6,349 |

| | | | | |
|---|---|---|---|---|
| Traffic acquisition costs related to distribution arrangements | 383 | 556 | 1,076 | 1,531 |
| Traffic acquisition costs | $ 2,210 | $ 2,770 | $ 6,358 | $ 7,880 |
| Traffic acquisition costs as a percentage of advertising revenues in the Google business | 23.7% | 25.5% | 24.1% | 24.9% |

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Cost of revenues increased $3,176 million from the three months ended September 30, 2011 to the three months ended September 30, 2012. The increase was primarily related to the inclusion of manufacturing and inventory-related costs from our Motorola business of $2,114 million. Additionally, there was an increase in traffic acquisition costs of $560 million resulting from more advertiser fees generated through our AdSense program, more traffic directed to our websites, as well as more distribution fees paid. The remaining increase was primarily driven by increase in data center costs, hardware product costs and content acquisition costs. The increase in traffic acquisition costs as a percentage of advertising revenues was primarily the result of a greater increase in traffic acquisition costs related to distribution arrangements compared to the increase in advertising revenues generated by Google websites. The increase in Google cost of revenues as a percentage of Google revenues was also driven by an increase in hardware product costs.

Cost of revenues increased $5,871 million from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. The increase was primarily related to the inclusion of manufacturing and inventory-related costs from our Motorola business of $3,143 million. Additionally, there was an increase in traffic acquisition costs of $1,522 million resulting from more advertiser fees generated through our AdSense program, more traffic directed to our websites, as well as more distribution fees paid. The remaining increase was primarily driven by increase in data center costs, hardware product costs and content acquisition costs. The increase in traffic acquisition costs as a percentage of advertising revenues was primarily the result of a greater increase in traffic acquisition costs related to distribution arrangements compared to the increase in advertising revenues generated by Google websites. The increase in Google cost of revenues as a percentage of Google revenues was also driven by an increase in hardware product costs.

We expect cost of revenues will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2012 and in future periods, primarily as a result of forecasted increases in traffic acquisition costs, data center costs, manufacturing and inventory-related costs, content acquisition costs, credit card and other transaction fees, 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.

*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, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Research and development expenses | $ 1,404 | $ 2,009 | $ 3,861 | $ 5,035 |
| Research and development expenses as a percentage of revenues | 14.4% | 14.2% | 14.1% | 13.6% |

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 incurred.

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Research and development expenses increased $605 million from the three months ended September 30, 2011 to the three months ended September 30, 2012, which includes $469 million related to Motorola. The remaining increase of $136 million was primarily due to an increase in labor and facilities-related costs of $42 million, largely as a result of a 14% increase in research and development headcount. In addition, there was an increase in stock-based compensation expense of $39 million.

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Research and development expenses increased $1,174 million from the nine months ended September 30, 2011 to the nine months ended September 30, 2012, which includes $612 million related to Motorola. The remaining increase of $562 million was primarily due to an increase in labor and facilities-related costs of $252 million, largely as a result of a 14% increase in research and development headcount. In addition, there was an increase in stock-based compensation expense of $133 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 2012 and in future periods because we expect to continue to invest in building 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, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Sales and marketing expenses | $ 1,204 | $ 1,760 | $ 3,322 | $ 4,462 |
| Sales and marketing expenses as a percentage of revenues | 12.4% | 12.5% | 12.2% | 12.1% |

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 $556 million from the three months ended September 30, 2011 to the three months ended September 30, 2012, which includes $375 million related to Motorola. The remaining increase of $181 million was primarily due to an increase in labor and facilities-related costs of $69 million, largely as a result of a 12% increase in sales and marketing headcount, as well as an increase in advertising and promotional expenses of $60 million. In addition, there was an increase in stock-based compensation expense of $22 million.

Sales and marketing expenses increased $1,140 million from the nine months ended September 30, 2011 to the nine months ended September 30, 2012, which includes $522 million related to Motorola. The remaining increase of $618 million was primarily due to an increase in labor and facilities-related costs of $296 million, largely as a result of a 12% increase in sales and marketing headcount, as well as an increase in advertising and promotional expenses of $177 million. In addition, there was an increase in stock-based compensation expense of $68 million.

We expect that sales and marketing expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2012 and in future periods, as we expand our business globally, increase advertising and promotional expenditures in connection with new and existing products, and increase the level of service we provide to our advertisers, Google Network Members, and other partners.

*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, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| General and administrative expenses | $ 676 | $ 1,042 | $ 1,919 | $ 2,779 |
| General and administrative expenses as a percentage of revenues | 6.9% | 7.4% | 7.1% | 7.6% |

General and administrative expenses consist primarily of compensation and related costs for personnel and facilities, and include costs 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 also include amortization of certain acquired intangible assets.

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General and administrative expenses increased $366 million from the three months ended September 30, 2011 to the three months ended September 30, 2012, which includes $144 million related to Motorola. The remaining increase of $222 million was primarily due to an increase in labor and facilities-related costs of $55 million, largely as a result of an 11% increase in general and administrative headcount, as well as an increase in amortization of intangible assets of $107 million. In addition, there was an increase in stock-based compensation expense of $25 million.

General and administrative expenses increased $860 million from the nine months ended September 30, 2011 to the nine months ended September 30, 2012, which includes $308 million related to Motorola. The remaining increase of $552 million was primarily due to an increase in labor and facilities-related costs of $121 million, primarily as a result of a 11% increase in general and administrative headcount, as well as an increase in professional services expense of $120 million, the majority of which was related to legal costs, as well as an increase in amortization of intangible assets of $170 million. In addition, there was an increase in stock-based compensation expense of $71 million.

As we expand our business and incur additional expenses, we expect general and administrative expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2012 and in future periods.

*Charge Related to the Resolution of Department of Justice Investigation*

In connection with a resolution of an investigation by the United States Department of Justice into the use of Google advertising by certain advertisers, we accrued $500 million during the first quarter of 2011, which was paid in August 2011 upon final resolution of that matter.

*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, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Stock-based compensation | $ 571 | $ 762 | $ 1,437 | $ 1,976 |
| Stock-based compensation as a percentage of revenues | 5.9% | 5.4% | 5.3% | 5.3% |

Stock-based compensation increased $191 million and $539 million from the three and nine months ended September 30, 2011 to the three and nine months ended September 30, 2012. This increase was primarily due to additional stock awards issued to existing and new employees, awards issued in connection with the acquisition of Motorola, and acceleration of certain awards resulting from Motorola restructuring.

We estimate stock-based compensation to be approximately $2.7 billion in 2012 and $5.4 billion thereafter. This estimate does not include expenses to be recognized related to employee stock awards that are granted after September 30, 2012 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, Net**

Interest and other income, net, decreased $239 million from the three months ended September 30, 2011 to the three months ended September 30, 2012. This decrease was primarily driven by an increase in foreign currency exchange loss of $123 million, a decrease in realized gains on available-for-sale investments of $73 million, and a decrease in interest income of $39 million due to lower average cash and investment balances.

Interest and other income, net, decreased $129 million from the nine months ended September 30, 2011 to the nine months ended September 30, 2012. This decrease was primarily driven by an increase in foreign currency exchange loss of $215 million, as well as decrease in interest income of $79 million due to lower average cash and investment balances, offset by a gain on divestiture of business of $188 million.

The costs of our foreign exchange hedging activities that we recognized to interest and other income, net, are primarily a function of the notional amount of the option and forward contracts and their related duration, 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.

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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 2012 and in future periods.

**Provision for Income Taxes**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2012 | 2011 | 2012 |
| | (unaudited) | | | |
| Provision for income taxes | $ 631 | $ 623 | $ 1,804 | $ 1,950 |
| Effective tax rate | 18.8% | 22.3% | 20.4% | 19.9% |

Our provision for income taxes decreased from the three months ended September 30, 2011 to the three months ended September 30, 2012, primarily as a result of decreases in federal income taxes, driven by lower taxable income year over year. Our effective tax rate increased from the three months ended September 30, 2011 to the three months ended September 30, 2012, primarily as a result of the expiration of Federal research credit in 2012 and less tax benefits recognized from certain discrete items during the three months ended September 30, 2012.

Our provision for income taxes increased from the nine months ended September 30, 2011 to the nine months ended September 30, 2012, primarily as a result of increases in federal income taxes, driven by higher taxable income year over year. Our effective tax rate decreased from the nine months ended September 30, 2011 to the nine months ended September 30, 2012, primarily as a result of a discrete item recognized related to an investigation by the Department of Justice in the three months ended March 31, 2011, which was not deductible for income tax purposes.

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, or accounting principles, as well as certain discrete items. In addition, we are subject to the continuous examination of our income tax returns by the IRS and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

**Liquidity and Capital Resources**

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2011 | 2012 |
| | (unaudited) | |
| Net cash provided by operating activities | $ 10,641 | $ 11,950 |
| Net cash used in investing activities | (14,482) | (7,542) |
| Net cash provided by financing activities | 767 | 1,921 |

At September 30, 2012, we had $45.7 billion of cash, cash equivalents, and marketable securities. Cash equivalents and marketable securities are comprised of time deposits, money market and other funds, including cash collateral received related to our securities lending program, highly liquid debt instruments of the U.S. government and its agencies, debt instruments issued by foreign governments and municipalities in the U.S., corporate securities, mortgage-backed securities, and asset-backed securities.

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As of September 30, 2012, $29.1 billion of cash, cash equivalents, and marketable securities was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

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 September 30, 2012, we had unused letters of credit for approximately $95 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.

We have established 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, 2012, we had $2.7 billion of outstanding commercial paper recorded as short-term debt, with a weighted-average interest rate of 0.1% that matures at various dates through December 2012. Average commercial paper borrowings during the three months ended September 30, 2012 were $2.7 billion, and the maximum amount of commercial paper borrowings outstanding during the three months ended September 30, 2012 was $2.7 billion. In conjunction with this program, we established a $3.0 billion revolving credit facility expiring in July 2016. Interest rate for the credit facility is determined based on a formula using certain market rates. As of September 30, 2012, we were in compliance with the financial covenant in this credit facility and no amounts were outstanding.

Additionally, as of September 30, 2012, we had a $468 million secured promissory note outstanding recorded as short-term debt, with an interest rate of 1.0% that matures in December 2012.

In May 2011, we issued $3.0 billion of unsecured senior notes in three equal tranches, due in 2014, 2016, and 2021, with stated interest rates of 1.25%, 2.125%, and 3.625%. The net proceeds from the sale of the notes were used to repay a portion of our outstanding commercial paper and for general corporate purposes. As of September 30, 2012, the total carrying value and estimated fair value of these notes were $3.0 billion and $3.2 billion. The estimated fair value was based on quoted prices for our publicly-traded debt as of September 30, 2012. We are not subject to any financial covenants under the notes.

*Cash Provided by Operating Activities*

Cash provided by operating activities consists of net income adjusted for certain non-cash items, primarily including amortization, depreciation, deferred income taxes, excess tax benefits from stock-based award activities, and stock-based compensation expense, as well as gain on divestiture of business and the effect of changes in working capital and other activities.

Cash provided by operating activities in the nine months ended September 30, 2012 was $11,950 million and consisted of net income of $7,851 million, adjustments for non-cash items of $3,871 million, a gain on divestiture of business of $188 million and cash generated in working capital and other activities of $416 million. Adjustments for non-cash items primarily consisted of $1,976 million of stock-based compensation expense, $1,358 million of depreciation and amortization expense on property and equipment, $651 million of amortization of intangible and other assets, and $113 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 an increase in income taxes, net, of $1,336 million, an increase in accrued expenses and other liabilities of $484 million, a decrease in inventories of $188 million, and an increase in deferred revenue of $182 million. These changes were partially offset by an increase in prepaid revenue share, expenses, and other assets of $1,215 million, a decrease in accounts payable of $274 million, and an increase of accounts receivable of $228 million.

Cash provided by operating activities in the nine months ended September 30, 2011 was $10,641 million and consisted of net income of $7,033 million, adjustments for non-cash items of $3,253 million, and cash provided by working capital and other activities of $355 million. Adjustments for non-cash items primarily consisted of $1,437 million of stock-based compensation expense, $1,011 million of depreciation and amortization expense of property and equipment, $526 million of deferred income taxes, and $337 million of amortization of intangible and other assets. In addition, the increase in cash from changes in working capital activities primarily consisted of a net increase in income taxes payable and deferred income taxes of $268 million and an increase in accrued expenses and other liabilities of $255 million. These increases were partially offset by an increase in accounts receivable of $247 million due to the growth in fees billed to our advertisers, and an increase in prepaid revenue share, expenses and other assets of $128 million. In addition, we paid $500 million related to the resolution of a Department of Justice investigation.

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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*

Cash used in investing activities in the nine months ended September 30, 2012 of $7,542 million was primarily attributable to cash consideration used in acquisitions and other investments of $10,471 million, including $9,518 million net cash paid in connection with the acquisition of Motorola, and capital expenditures of $2,253 million related primarily to our facilities, data centers, and related equipment. These decreases were partially offset by net maturities and sales of marketable securities of $5,554 million. Also, in connection with our securities lending program, there was a decrease in investments in reverse repurchase agreements of $195 million and a cash collateral return of $321 million.

Cash used in investing activities in the nine months ended September 30, 2011 of $14,482 million was primarily attributable to net purchases of marketable securities of $10,586 million, capital expenditures of $2,487 million related primarily to our facilities, data centers, and related equipment, and cash consideration used in acquisitions and other investments of $1,708 million, including $676 million paid in connection with the acquisition of ITA. Also, in connection with our securities lending program, we received additional $694 million of cash collateral and invested $395 million in reverse repurchase agreements.

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 expect to make significant investments in our systems, data centers, corporate facilities, and information technology infrastructure in the remainder of 2012 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*

Cash provided by financing activities in the nine months ended September 30, 2012 of $1,921 million was primarily driven by net proceeds of $1,997 million from short-term debt issued under our commercial paper program and excess tax benefits from stock-based award activities of $113 million. This was partially offset by net payments for stock-based award activities of $189 million.

Cash provided by financing activities in the nine months ended September 30, 2011 of $767 million was primarily driven by net proceeds of $726 million of debt issued and excess tax benefits from stock-based award activities of $61 million.

**Contractual Obligations**

We recorded long-term taxes payable of $342 million in the nine months ended September 30, 2012 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 U.S. 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 some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations will be affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies and estimates, which we discuss further below. We have reviewed our critical accounting policies and estimates with the audit committee of our board of directors.

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*Income Taxes*

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

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

Our effective tax rates have differed from the statutory rate primarily due to the tax impact of foreign operations, state taxes, certain benefits realized related to stock award activities, and research and experimentation tax credits. The effective tax rates were 18.8% and 22.3% for the three months ended September 30, 2011 and 2012 and 20.4% and 19.9% for the nine months ended September 30, 2011 and 2012. 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, or accounting principles, as well as certain discrete items. In addition, we are subject to the continuous examination of our income tax returns by the IRS 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.

*Loss Contingencies*

We are regularly subject to claims, suits, government investigations, and other proceedings involving competition and antitrust, intellectual property, privacy, tax, labor and employment disputes, content generated by our users, goods and services offered by advertisers or publishers using our platforms, personal injury, consumer protection, and other matters. Certain of these matters include speculative claims for substantial or indeterminate amounts of damages. We record a liability when we believe that it is both probable that a loss has been incurred, and the amount can be reasonably estimated. We evaluate, on a monthly basis, developments in our legal matters that could affect the amount of liability that has been previously accrued, and make adjustments as appropriate. Significant judgment is required to determine both likelihood of there being and the estimated amount of a loss related to such matters. Until the final resolution of such matters, there may be an exposure to loss in excess of the amount recorded, and such amounts could be material. Should any of our estimates and assumptions change or prove to have been incorrect, it could have a material impact on our business, consolidated financial position, results of operations, or cash flows. See Note 12 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information regarding contingencies.

*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 expected term. 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 and our expectations regarding future pre-vesting termination behavior of employees. To the extent our actual forfeiture rate is different from our estimate, stock-based compensation expense is adjusted accordingly.

**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 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 three years. These filings 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, including Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports, our Proxy Statements, and other ownership related 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.

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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. Investors and others can receive notifications of new information posted on our investor relations website in real time by signing up for email alerts and RSS feeds. Further corporate governance information, including our certificate of incorporation, bylaws, governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website under the heading Corporate Governance. The contents of our 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 our websites are intended to be inactive textual references only.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

### Foreign Currency 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 the risk of fluctuations in foreign currency exchange rates. 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 AOCI and subsequently reclassified into revenues when the hedged revenues are recorded or as interest and other income, 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, net, immediately.

At December 31, 2011, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 2.8 billion (or approximately $3.8 billion) and $232 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £1.4 billion (or approximately $2.2 billion) and $80 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$504 million (or approximately $490 million) and $17 million. At September 30, 2012, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 4.6 billion (or approximately $5.9 billion) and $193 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £1.9 billion (or approximately $3.0 billion) and $29 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$656 million (or approximately $644 million) and $9 million. These foreign exchange option contracts have maturities of 36 months or less. 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 AOCI before tax effect would have been approximately $72 million lower at September 30, 2012, and the total amount of expense recorded as interest and other income, net, would have been approximately $138 million higher in the three months ended September 30, 2012. If the U.S. dollar strengthened by 20%, the amount recorded in AOCI before tax effect would have been approximately $1.7 billion higher at September 30, 2012, and the total amount of expense recorded as interest and other income, net, would have been approximately $171 million higher in the three months ended September 30, 2012.

*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 and the British pound. Our foreign subsidiaries primarily 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 $2.3 billion and $3.1 billion at December 31, 2011 and September 30, 2012. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $472 million and $438 million at December 31, 2011 and September 30, 2012. The notional principal of foreign exchange contracts to purchase

Euros with other foreign currencies was 711 million (or approximately $929 million) and 930 million (or approximately $1.2 billion) at December 31, 2011 and September 30, 2012. The notional principal of foreign exchange contracts to sell Euros for other foreign currencies was 17 million (or approximately $22 million) at September 30, 2012 and no such contracts were outstanding at December 31, 2011.

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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 $27 million and $10 million at December 31, 2011 and September 30, 2012. The adverse impact at December 31, 2011 and September 30, 2012 is after consideration of the offsetting effect of approximately $503 million and $707 million from foreign exchange contracts in place for the months of December 2011 and September 2012. 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 U.S. government and its agency securities, money market and other funds, corporate debt securities, mortgage-backed securities, debt instruments issued by foreign governments, municipal securities, time deposits, and asset backed securities. By policy, we limit the amount of credit exposure to any other 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. However, we use certain interest rate derivative contracts to hedge interest rate risk of our fixed income securities.

During the second quarter of 2012, we began to hedge the variability of forecasted interest payments using forward-starting interest swaps. The total notional amount of these swaps was $1.0 billion as of September 30, 2012, with terms calling for us to receive interest at a variable rate and to pay interest at a fixed rate. These forward-starting interest swaps effectively fix the benchmark interest rate on an anticipated debt issuance of $1.0 billion in 2014, and they will be terminated upon issuance of the debt.

When entering into forward-starting interest rate swaps, we are subject to market risk with respect to changes in the underlying benchmark interest rate that impacts the fair value of the forward-starting interest swaps. We manage market risk by matching the terms of the swaps with the critical terms of the expected debt issuance.

We considered the historical volatility of 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 $934 million and $914 million at December 31, 2011 and September 30, 2012, after taking into consideration of the offsetting effect from interest rate derivative contracts outstanding as of December 31, 2011 and September 30, 2012. A hypothetical 1.00% (100 basis points) decrease in interest rates would have resulted in a decrease in the fair values of our forward-starting interest swaps of approximately $110 million at September 30, 2012.

## 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, as of September 30, 2012, 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.

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**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2012 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

For a description of our material pending legal proceedings, please refer to Note 12 Contingencies Legal Matters of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

### 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. 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 be adversely affected.***

Our business is rapidly evolving and intensely competitive, and is subject to changing technologies, shifting user needs, and frequent introductions of new products and services. Our ability to compete successfully depends heavily on providing products and services that make using the internet a more useful and enjoyable experience for our users and delivering innovative products and technologies to the marketplace. With our acquisition of Motorola, the competitive pressure to innovate will now encompass a wider range of products and services, including products and services that may be outside of our historical core business.

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, wireless mobile device 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 users, and they can use their experience and resources in ways that could affect our competitive position, including by making acquisitions, investing aggressively in research and development, aggressively initiating intellectual property claims (whether or not meritorious) and competing aggressively for advertisers and websites. Emerging start-ups may be able to innovate and provide products and services faster than we can.

Our competitors are constantly developing innovations in web search, online advertising, wireless mobile devices, and web-based products and services. The research and development of new, technologically advanced products is also a complex and uncertain process requiring high levels of innovation and investment, as well as the accurate anticipation of technology, market trends and consumer needs. As a result, we must continue to invest significant resources in research and development, including through acquisitions, 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 acceptance rates for our products and services could decline and affect consumer and advertiser perceptions of our brand. In addition, these new products and services may present new and difficult technological and legal challenges, and we may be subject to claims if users of these offerings

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experience service disruptions or failures or other 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 technology continues to develop, our competitors may be able to offer user experiences 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. 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 operating results could be adversely affected.

***Our ongoing investment in new business strategies and new products, services, and technologies is inherently risky, and could disrupt our ongoing businesses.***

We have invested and expect to continue to invest in new business strategies, products, services, and technologies. Such endeavors may involve significant risks and uncertainties, including distraction of management from current operations, insufficient revenues to offset liabilities assumed and expenses associated with these new investments, inadequate return of capital on our investments, and unidentified issues not discovered in our due diligence of such strategies and offerings. Because these new ventures are inherently risky, no assurance can be given that such strategies and offerings will be successful and will not adversely affect our reputation, financial condition, and operating results.

***Acquisitions and investments could result in operating difficulties, dilution, and other harmful consequences that may adversely impact our business and results of operations.***

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:

- Diversion of management time and focus from operating our business to acquisition integration challenges.
- Implementation or remediation of controls, procedures, and policies at the acquired company.
- Integration of the acquired company s accounting, human resource, and other administrative systems, and coordination of product, engineering, and sales and marketing functions.
- Transition of operations, users, and customers onto our existing platforms.
- Failure to obtain required approvals on a timely basis, if at all, from governmental authorities, or conditions placed upon approval, under competition and antitrust laws 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.
- 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 business or technology.
- Cultural challenges associated with integrating employees from the acquired company into our organization, and retention of employees from the businesses we acquire.

- 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.

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.

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, and restructuring charges, any of which could harm our financial condition or results. Also, the anticipated benefit of many of our acquisitions may not materialize.

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***We generate a significant portion of our revenues from advertising, and the reduction in spending by or loss of advertisers could seriously harm our business.***

We generated 96% of Google revenues from our advertisers in 2011 and 95% in the nine months ended September 30, 2012. Following our acquisition of Motorola, we still expect a significant portion of our revenues to come from advertising. 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. If we are unable to remain competitive and provide value to our advertisers, they may stop placing ads with us, which would adversely affect our revenues and business. In addition, expenditures by advertisers tend to be cyclical, reflecting overall economic conditions and budgeting and buying patterns. Adverse macroeconomic conditions can also have a material negative impact on the demand for advertising and cause our advertisers to reduce the amounts they spend on advertising, which could adversely affect our revenues and business.

***Our revenue growth rate could decline over time, and we anticipate downward pressure on our operating margin in the future.***

Our revenue growth rate could decline over time as a result of a number of factors, including increasing competition, changes in our product mix, including a significant increase in mobile search queries and a deceleration in the growth of desktop queries if monetization stays at current levels, and how users make queries and act on them, the challenges in maintaining our growth rate as our revenues increase to higher levels, the evolution of the online advertising market, including the increasing variety of online platforms for advertising, and the other markets in which we participate and the success of our investments in new business strategies, products, services, and technologies, such as our acquisition of Motorola.

The revenue growth rate of our Motorola business will also depend on a number of factors, including our reliance on several large customers, the absence of long-term exclusivity arrangements with such customers, our ability to gain significant market share in the mobile devices space, our reliance on third-party distributors, representatives and retailers to sell certain of its products and the successful implementation of our product and operating system strategies. Furthermore, industry consolidation in the telecommunications and cable industries could negatively impact Motorola s business because there would be fewer network operators and it could be more difficult to replace any lost customers. Any of these factors could have a negative impact on Motorola s business and have an adverse effect on our consolidated financial results.

We believe our operating margin will experience downward pressure as a result of increasing competition and increased expenditures for many aspects of our business, including Motorola. For instance, our operating margin will 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 Chrome. Both the margin on revenues we generate from our Google Network Members and the margin on revenues from our Motorola business is significantly less than the margin on revenues we generate from advertising on our websites. Also, the margins on advertising revenues from mobile devices and newer advertising formats are generally 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.

***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 we have experienced increased regulatory scrutiny as we have grown. In particular, we are cooperating with the regulatory authorities in the United States and abroad, including the U.S. Federal Trade Commission (FTC), the European Commission (EC), and several state attorneys general in investigations they are conducting with respect to our business and its impact on competition. Legislators and regulators, including those conducting investigations in the U.S. and Europe, 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, expose us to unanticipated civil or criminal liability, or cause us to change our business practices. These changes or increased costs could negatively impact our business and results of operations in material ways.

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***We are regularly subject to claims, suits, government investigations, and other proceedings that may result in adverse outcomes.***

We are regularly subject to claims, suits, government investigations, and other proceedings involving competition and antitrust (such as the pending investigations by the FTC and the EC), intellectual property, privacy, consumer protection, tax, labor and employment, commercial disputes, content generated by our users, goods and services offered by advertisers or publishers using our platforms, and other matters. Our acquisition of Motorola and our sale of hardware products (such as Nexus 7 tablet) also expose us to the risk of product liability and other litigation involving assertions about product defects, as well as health and safety, hazardous materials usage, and other environmental concerns. In addition, our businesses face intellectual property litigation, as further discussed later, that exposes us to the risk of exclusion and cease and desist orders, which could limit our ability to sell products and services.

Such claims, suits, government investigations, and proceedings are inherently uncertain and their results cannot be predicted with certainty. Regardless of the outcome, such legal proceedings can have an adverse impact on us because of legal costs, diversion of management resources, and other factors. Determining reserves for our pending litigation is a complex, fact-intensive process that requires significant judgment. It is possible that a resolution of one or more such proceedings could result in substantial fines and penalties that could adversely affect our business, consolidated financial position, results of operations, or cash flows in a particular period. These proceedings could also result in reputational harm, criminal sanctions, consent decrees, or orders preventing us from offering certain features, functionalities, products, or services, requiring a change in our business practices or product recalls or other field action, or requiring development of non-infringing or otherwise altered products or technologies. Any of these consequences could adversely affect our business and results of operations.

***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 data protection and security issues, service outages, and product malfunctions. 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 innovative products and services, which we may not do successfully.

***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 numerous U.S. and foreign laws and regulations covering a wide variety of subject matters. New laws and regulations (or new interpretations of existing laws and regulations) may also impact our business. The costs of compliance with these laws and regulations are high and are likely to increase in the future. Any failure on our part to comply with these laws and regulations can result in negative publicity and diversion of management time and effort and may subject us to significant liabilities and other penalties.

Furthermore, 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 also been, or may be, threatened and filed against us under both U.S. and foreign laws for defamation, invasion of privacy and other tort claims, unlawful activity, patent, 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. Moreover, recent amendments to U.S. patent laws may affect the ability of companies, including us, to protect their innovations and defend against claims of patent infringement.

In addition, the Digital Millennium Copyright Act has provisions that limit, but do not necessarily eliminate, our liability for caching or 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. Any future legislation impacting these safe harbors may adversely impact us. 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.

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***We are, and may in the future be, subject to intellectual property or other 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.

We have had patent, copyright, and trademark infringement lawsuits filed against us claiming that certain of our products, services, and technologies, including Android, Google Search, Google AdWords, Google AdSense, Motorola, Google Books, Google News, Google Image Search, Google Chrome, Google Talk, Google Voice, and YouTube, infringe the intellectual property rights of others. Third parties have also sought broad injunctive relief against us by filing claims in the U.S. International Trade Commission (ITC) for exclusion and cease and desist orders, which could limit our ability to sell our products or services in the U.S. or elsewhere if our products or services or those of our customers or suppliers are found to infringe the intellectual property subject to the claims. Adverse results in any of these lawsuits may include awards of substantial monetary damages, costly royalty or licensing agreements (if licenses are available at all), or orders preventing us from offering certain features, functionalities, products, or services, and may also cause us to change our business practices, and require development of non-infringing products or technologies, which could result in a loss of revenues for us and otherwise harm our business.

In addition, many of our agreements with our customers and partners, including certain suppliers, require us to indemnify them for certain intellectual property infringement claims against them, which could increase our costs as a result of defending such claims, and may require that we pay significant damages if there were an adverse ruling in any such claims. Such customers and partners may also discontinue the use of our products, services, and technologies, as a result of injunctions or otherwise, which could result in loss of revenues and adversely impact our business. Moreover, supplier provided intellectual property indemnities to us, when obtainable, may not cover all damages and losses suffered by us and our customers from covered products.

Regardless of the merits of the claims, intellectual property claims are often time consuming, expensive to litigate or settle, and cause significant diversion of management attention. To the extent such intellectual property infringement claims are successful, they may have an adverse effect on our business, consolidated financial position, results of operations, or cash flows.

***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, services and technologies. 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.

Although we seek to obtain patent protection for our innovations, it is possible we may not be able to protect some of these innovations. 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 seek to maintain certain intellectual property as trade secrets. The secrecy could be compromised by outside parties, or by our employees, which could cause us to lose the competitive advantage resulting from these trade secrets.

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.

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Any significant impairment of our intellectual property rights could harm our business and 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.

***We may be subject to legal liability associated with providing online services or content.***

We host and provide a wide variety of services and products that enable users to exchange information, advertise products and services, conduct business, and engage in various online activities both domestically and internationally. The law relating to the liability of providers of these online services and products for activities of their users is still somewhat unsettled both within the U.S. and internationally. Claims have been threatened and have been brought against us for defamation, negligence, breaches of contract, copyright or trademark infringement, unfair competition, unlawful activity, tort, including personal injury, fraud, or other theories based on the nature and content of information which we publish or to which we provide links or that may be posted online or generated by us or by third parties, including our users. In addition, we are and have been and may again in the future be subject to domestic or international actions alleging that certain content we have generated or third-party content that we have made available within our services violates laws in domestic and international jurisdictions.

We also arrange for the distribution of third-party advertisements to third-party publishers and advertising networks, and we offer third-party products, services, or content. We may be subject to claims concerning these products, services, or content by virtue of our involvement in marketing, branding, broadcasting, or providing access to them, even if we do not ourselves host, operate, provide, or provide access to these products, services, or content. Defense of any such actions could be costly and involve significant time and attention of our management and other resources, may result in monetary liabilities or penalties, and may require us to change our business in an adverse manner.

***More people are using devices other than personal computers to access the internet and accessing new platforms to make search queries. If manufacturers and users 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 phones, smartphones, handheld computers such as netbooks and tablets, 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. Some manufacturers may also elect not to include our products on their devices. In addition, search queries are increasingly being undertaken via apps tailored to particular devices or social media platforms, which could affect our share of the search market over time. As new devices and platforms are continually being released, it is difficult to predict the problems we may encounter in adapting our products and services and developing competitive new products and services. We expect to continue to devote significant resources to the creation, support, and maintenance of mobile products and services. 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 and platforms, we will fail to capture the opportunities available as consumers and advertisers transition to a dynamic, multi-screen environment.

***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 by regulators and others about whether our products, services, or processes compromise the privacy of users and others. Concerns about, or regulatory actions involving 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 adversely affect operating results. While we strive to comply with all applicable data protection laws and regulations, as well as our own posted privacy policies, the failure or perceived failure to comply may result, and in some cases has resulted, in inquiries and other 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.

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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 expect to continue 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, and operate in more countries.

Regulatory authorities around the world are considering a number of legislative and regulatory proposals concerning data protection. In addition, the interpretation and application of consumer and data protection laws in the U.S., Europe and elsewhere are often 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 and results of operations. 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.

***With our acquisition of Motorola, we face a number of manufacturing and supply chain risks that, if not properly managed, could adversely impact our financial results and prospects.***

With our acquisition of Motorola, we face a number of risks related to manufacturing and supply chain management. For instance, the products we sell may have quality issues resulting from the design or manufacture of the product, or from the software used in the product. Sometimes, these issues may be caused by components we purchase from other manufacturers or suppliers. If the quality of our Motorola products does not meet our customers expectations or our products are found to be defective, then our sales and operating earnings, and ultimately our reputation, could be negatively impacted.

We rely on third parties to manufacture many of Motorola s assemblies and finished products, and we have third-party arrangements for the design of some components and parts. Our Motorola business could be negatively affected if we are not able to engage third parties with the necessary capabilities or capacity on reasonable terms, or if those we engage fail to meet their obligations (whether due to financial difficulties or other reasons), or make adverse changes in the pricing or other materials terms of our arrangements with them.

Motorola, like many electronics manufacturers, has also experienced supply shortages and price increases in the past driven by raw material availability, manufacturing capacity, labor shortages, industry allocations, natural disasters and significant changes in the financial or business condition of its suppliers. Workaround plans to address shortages have entailed in the past, and could entail in the future, increased freight costs for expedited shipments. We cannot assure you that we will not experience shortages or other supply chain disruptions in the future or that they will not negatively impact our operations. In addition, some of the components we use in our Motorola products are available only from a single source or limited sources, and we cannot assure you that we would be able to find replacement vendors on favorable terms or at all in the event of a supply chain disruption.

Additionally, because many of our supply contracts have volume-based pricing or minimum purchase requirements, if the volume of our Motorola sales decreases or does not reach projected targets, we could face increased materials and manufacturing costs or other financial liabilities that could make our Motorola products more costly per unit to manufacture and therefore less competitive and negatively impact our financial results. Further, certain of our competitors may negotiate more favorable contractual terms based on volume and other commitments that may provide them with competitive advantages and may impact our supply.

The Dodd-Frank Wall Street Reform and Consumer Protection Act included disclosure requirements regarding the use of conflict minerals mined from the Democratic Republic of Congo and adjoining countries (DRC) and procedures regarding a manufacturer s efforts to prevent the sourcing of such conflict minerals. The Securities and Exchange Commission recently adopted rules to implement these requirements. These rules may have the effect of reducing the pool of suppliers who can supply DRC conflict free components and parts, and we may not be able to obtain DRC conflict free products or supplies in sufficient quantities for our operations. Also, since our supply chain is complex, we may face reputational challenges with our customers, stockholders and other stakeholders if we are unable to sufficiently verify the origins for the conflict minerals used in our products.

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***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 expose us to a risk of loss of this information, litigation, and potential liability. We experience cyber attacks of varying degrees on a regular basis, and as a result, unauthorized parties have obtained, and may in the future obtain, access to our data or our users or customers data. Our security measures may also be breached due to employee error, malfeasance, or otherwise. 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.

***Web spam and content farms could decrease our search quality, which could damage our reputation and deter our current and potential users from using our products and services.***

Web spam refers to websites that attempt to violate a search engine s quality guidelines or that otherwise seek to rank higher in search results than a search engine s assessment of their relevance and utility would rank them. Although English-language web spam in our search results has been significantly reduced, and web spam in most other languages is limited, we expect web spammers will continue to seek ways to improve their rankings inappropriately. We continuously combat web spam, including through indexing technology that makes it harder for spam-like, less useful web content to rank highly. We face challenges from low-quality and irrelevant content websites, including content farms, which are websites that generate large quantities of low-quality content to help them improve their search rankings. We are continually launching algorithmic changes focused on low-quality websites. If web spam and content farms continue to increase on Google, this could hurt our reputation for delivering relevant information or reduce user traffic to our websites. In addition, as we continue to take actions to improve our search quality and reduce low-quality content, this may in the short run reduce our AdSense revenues, since some of these websites are AdSense partners.

***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.

***Our international operations expose us to additional risks that could harm our business, operating results, and financial condition.***

Our international operations are significant to our revenues and net income, and we plan to further expand internationally. International revenues accounted for approximately 54% of our consolidated revenues in 2011 and 53% of our consolidated revenues in the nine months ended September 30, 2012, and more than half of our user traffic has been coming from outside the U.S. In certain international markets, we have limited operating experience and may not benefit from any first-to-market advantages or otherwise succeed.

Our Motorola business also has many manufacturing, research and development, administrative and sales facilities outside the U.S., and more than half of our Motorola employees are employed outside the U.S. Most of our Motorola suppliers operations are outside the U.S. and nearly all of our Motorola products (other than some prototypes) are

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manufactured outside the U.S., primarily in China, Taiwan and Brazil. If our manufacturing in these regions is disrupted, our overall capacity could be significantly reduced and sales or profitability could be negatively impacted. We require these suppliers and business partners to operate in compliance with applicable laws, regulations and company policies regarding workplace and employment practices, environmental compliance and intellectual property licensing, but we do not control them or their practices. If one of these suppliers or business partners violates labor or other laws or implements practices that are regarded as unethical, we could experience supply chain disruptions, canceled orders, terminations of or damage to key relationships, and damage to our reputation. If one of our suppliers or business partners fails to procure necessary license rights to third-party intellectual property, legal action could ensue that could impact the salability of our products and expose us to financial obligations to third parties. Any of these events could have a negative impact on our financial results and prospects.

Moreover, in connection with our operations in Brazil, we have had and continue to have legal disputes and controversies, including tax, labor and trade compliance controversies and other legal matters that take many years to resolve. We incur legal and other costs in managing and defending these matters and expect to continue to incur such costs. Based on our assessment of these matters, we have recorded reserves on only a small portion of the total potential exposure. It is, however, very difficult to predict the outcome of legal disputes and controversies, including litigation, in Brazil and our ultimate exposure may be greater than our current assessments and related reserves.

In addition to risks described elsewhere in this section, our international operations expose us to other risks, including the following:

- Changes in local political, economic, social, and labor conditions, which may adversely harm our business.
- Restrictions on foreign ownership and investments, and stringent foreign exchange controls that might prevent us from repatriating cash earned in countries outside the U.S.
- Import and export requirements, tariffs, trade disputes and barriers, and customs classifications that may prevent us from offering products or providing services to a particular market and may increase our operating costs.
- Potential injunctions from importation into the U.S. of our Motorola products manufactured outside the U.S. in an ITC matter.
- Longer payment cycles in some countries, increased credit risk, and higher levels of payment fraud.
- Still developing foreign laws and legal systems.
- Uncertainty regarding liability for services and content, including uncertainty as a result of local laws and lack of legal precedent.
- Different employee/employer relationships, existence of workers councils and labor unions, and other challenges caused by distance, language, and cultural differences, making it harder to do business in certain jurisdictions.
- Natural disasters, military or political conflicts, including war and other hostilities, and public health issues and outbreaks.

In addition, compliance with complex foreign and U.S. laws and regulations that apply to our international operations increases our cost of doing business. These numerous and sometimes conflicting laws and regulations include internal control and disclosure rules, data privacy and filtering requirements, anti-corruption laws, such as the Foreign Corrupt Practices Act, and other local laws prohibiting corrupt payments to governmental officials, and antitrust and competition regulations, among others. Violations of these laws and regulations could result in fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business and on our ability to offer our products and services in one or more countries, and could also materially affect our brand, our international expansion efforts, our ability to attract and retain employees, our business, and our operating results. Although we have implemented policies and procedures designed

to ensure compliance with these laws and regulations, there can be no assurance that our employees, contractors, or agents will not violate our policies.

Furthermore, our Motorola business has had, and continues to have, a policy requiring our suppliers, business partners and customers to operate in compliance with applicable laws, rules and regulations and Motorola s code of business conduct regarding working conditions, employment practices, environmental compliance and trademark and copyright licensing. However, we do not control their labor and other business practices. If one of our suppliers violates labor or other laws or implements labor or other business practices that are regarded as unethical, the shipment of finished products to us could be interrupted, orders could be canceled, relationships could be terminated and our reputation could be damaged. If one of our suppliers fails to procure necessary license rights to trademarks, copyrights or

patents owned by third parties, legal action could be taken against us that could impact the salability of our products and expose us to financial obligations to third parties. Any of these events could have an adverse effect on our revenues and results of operations and harm our brand.

Finally, 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. Although we hedge a portion of our international currency exposure, significant fluctuations in exchange rates between the U.S. dollar and foreign currencies may adversely affect our net income. Additionally, hedging programs are inherently risky and could expose us to additional risks that could adversely affect our financial condition and results of operations.

***If we were to lose the services of Larry, Sergey, Eric, or other key personnel, 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, Larry Page and Sergey Brin are critical to the overall management of Google and the development of our technology. Along with our Executive Chairman Eric E. Schmidt, they also play a key role in maintaining our culture and setting 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 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, mobile communications companies, and government-owned service providers. Some of these providers have taken, or 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. Such 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.

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

Technologies have been developed (including by us) that can block the display of our ads and that provide tools to users to opt out of our advertising products. Most of our revenues are derived from fees paid to us by advertisers in connection with the display of ads on web pages for our users. As a result, such technologies and tools could adversely affect our operating results.

***We are exposed to fluctuations in the market values of our investment portfolio.***

Given the global nature of our business, we have investments both domestically and internationally. Credit ratings and pricing of these investments can be negatively impacted by liquidity, credit deterioration or losses, financial results, or other factors. As a result, the value or liquidity of our cash equivalents and marketable securities could decline and result in a material impairment, which could materially adversely affect our financial condition and operating results.

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***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 that have lower statutory tax rates and higher than anticipated in jurisdictions that 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, or accounting principles, as well as certain discrete items. 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.

***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 section in addition to 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, and 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 and other factors, such as changes in product mix, including a significant increase in mobile search queries and a deceleration in the growth of desktop queries if monetization stays at current levels, and the geographic mix of our revenues that can affect revenue growth rates and margins.
- 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, including new business strategies and new products, services, technologies and acquisitions.
- 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 Google Wallet.

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.

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***Motorola could be subject to significant liability under a Tax Sharing Agreement with Motorola Solutions Inc. (Motorola Solutions) if the Merger or subsequent transactions were to cause the spinoff of Motorola from Motorola Solutions (the Spinoff) to fail to qualify as a tax-free reorganization for U.S. federal income tax purposes.***

In connection with the Spinoff, Motorola and Motorola Solutions entered into a Tax Sharing Agreement (the Tax Sharing Agreement) under which Motorola agreed not to take any of certain actions during the two-year period ending January 4, 2013, without the receipt of a private letter ruling from the Internal Revenue Service or an opinion of tax counsel, in either case acceptable to Motorola Solutions in its discretion, to the effect that such action will not affect the tax-free status of the Spinoff and certain related transactions (or the waiver by Motorola Solutions of the requirement to obtain the private letter ruling or opinion of tax counsel). Wachtell, Lipton, Rosen & Katz issued an opinion to Motorola and to Motorola Solutions, dated August 14, 2011, to the effect that, based on representations made by Motorola and Motorola Solutions and subject to the limitations and qualifications set out in the opinion, the acquisition of Motorola will not affect the tax-free status of the Spinoff and certain related transactions. Motorola Solutions accepted that opinion as satisfying the requirements of the Tax Sharing Agreement with respect to the acquisition.

Notwithstanding acceptance of the opinion by Motorola Solutions, under the Tax Sharing Agreement, which remains in effect, Motorola must indemnify Motorola Solutions and its affiliates against any and all tax-related liabilities incurred by them relating to the Spinoff and certain related transactions to the extent caused by Motorola. This obligation is not capped and could subject Motorola to substantial liabilities. Moreover, restrictions under the Tax Sharing Agreement may limit our ability to pursue strategic transactions with respect to Motorola s stock or assets, or to engage in new business or other transactions intended to maximize the value of Motorola s business.

**Risks Related to Ownership of Our Stock**

***The trading price for our Class A common stock may continue to be volatile, and if the shares of the new class of non-voting Class C capital stock are distributed as expected, the trading price of that class may also be volatile and may affect the trading price for the Class A common stock***.

The trading price of our Class A common stock has at times experienced substantial price volatility and may continue to be volatile. For example, from October 1, 2011 through September 30, 2012, the closing price of our Class A common stock ranged from $495.52 per share to $756.50 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, among others:

- 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.
- Commentary by industry and market professionals about our products, strategies, and other matters affecting our business and results, regardless of its accuracy.

The volume of shares of Class A common stock available for public sale.

Sales of Class A common 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, our board of directors approved amendments to our certificate of incorporation in April 2012 that would, among other things, create a new class of non-voting capital stock, known as Class C capital stock. The amendments authorize 3 billion shares of Class C capital stock and also increase the authorized shares of Class A common stock from 6 billion to 9 billion. The amendments are reflected in our new certificate of incorporation, the adoption of which was approved by stockholders at our 2012 Annual Meeting of Stockholders held on June 21, 2012. We have announced the intention of our board of directors to consider a distribution of shares of the Class C capital stock as a dividend to our holders of Class A and Class B common stock.

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Although we plan to list the Class C capital stock on The Nasdaq Stock Market, we cannot predict whether, or to what extent, a liquid trading market will develop for the Class C capital stock. If it does not or if the Class C capital stock is not attractive to targets as an acquisition currency or to our employees as an incentive, we may not achieve our objectives in creating this new class. As in the case of the Class A common stock, the trading price for the Class C capital stock may also be volatile and affected by the factors noted above, as well as by the difference in voting rights as between the Class A common stock and the Class C capital stock, the volume of Class C capital stock available for public sale and sales by us and our stockholders of Class C capital stock, including by institutional investors that may be unwilling, unable or choose not to hold non-voting shares they receive as part of the stock dividend, if it is declared and paid. Whether or not the Class C capital stock is included in stock indices in the future may also affect the trading prices of the Class A common stock and the Class C capital stock.

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 harm the market price of our Class A common stock, and, if issued, our Class C capital Stock, regardless of our actual operating performance.

***The concentration of our stock ownership limits 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, 2012, Larry, Sergey, and Eric beneficially owned approximately 92% of our outstanding Class B common stock, representing approximately 65% 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 our assets, for the foreseeable future. In addition, as noted above, the creation of the Class C capital stock was approved by stockholders at our 2012 Annual Meeting of Stockholders held on June 21, 2012 and we have announced the intention of our board of directors to consider a stock dividend of shares of this new class. Because the Class C capital stock carries no voting rights (except as required by applicable law), the issuance of the Class C capital stock, including in future stock-based acquisition transactions and to fund employee equity incentive programs, could prolong the duration of Larry and Sergey s current relative ownership of our voting power and their ability to elect all of our directors and to determine the outcome of most matters submitted to a vote of our stockholders. Together with Eric, they would also continue to be able to control any required stockholder vote with respect to certain change in control transactions involving Google (including an acquisition of Google by another company).

This concentrated control limits or severely restricts 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 and, if issued, our Class C capital 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, Larry, Sergey, and Eric 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 our 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. As noted above, the issuance of the Class C capital stock could have the effect of prolonging the influence of Larry, Sergey, and Eric.

- 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.

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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 outstanding voting stock unless the holder has held the stock for three years or, among other things, the Board of Directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

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

**Results of Google s Transferable Stock Option (TSO) Program**

Under our TSO program, eligible employees are able to sell vested stock options to participating financial institutions in an online auction as an alternative to exercising options using 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, 2012 (unaudited):

| | Aggregate Amounts | | | Weighted-Average Per Share Amounts | | |
|---|---|---|---|---|---|---|
| **Period [1]** | **Number of Shares Underlying TSOs Sold** | **Sale Price of TSOs Sold** | **TSO Premium[2]** | **Exercise Price of TSOs Sold** | **Sale Price of TSOs Sold** | **TSO Premium[2]** |
| | | (in thousands) | | | | |
| July 1-31 | 129,009 | $ 36,358 | $ 1,165 | $ 347.32 | $ 281.63 | $ 9.03 |
| August 1-31 | 364,225 | 114,953 | 3,176 | 356.51 | 315.61 | 8.72 |
| September 1-30 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total (except weighted-average per share amounts)** | **493,324** | **$ 151,311** | **$ 4,341** | **$ 354.10** | **$ 306.72** | **$ 8.80** |

(1) The TSO program is generally active during regular trading hours for The Nasdaq Stock Market when our 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 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.

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In April 2009, we amended our TSO program to allow participation by executive officers (other than Larry Page, Sergey Brin, and Eric E. Schmidt). The following table provides information with respect to sales by our executive officers of TSOs during the three months ended September 30, 2012 (unaudited):

| | | Aggregate Amounts | |
|---|---|---|---|
| **Executive Officer** | **Number of Shares Underlying TSOs Sold** | **Sale Price of TSOs Sold** | **TSO Premium** |
| | | **(in thousands)** | |
| Nikesh Arora | 3,197 | $ 1,042 | $ 0 |
| Patrick Pichette | 9,293 | 2,144 | 223 |
| **Total** | **12,490** | **$ 3,186** | **$ 223** |

**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.

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**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 30, 2012

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

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**EXHIBIT INDEX**

| Exhibit Number | | Description | Incorporated by reference herein Form | Date |
|---|---|---|---|---|
| 12 | * | Computation of Ratio of Earnings to Fixed Charges | | |
| 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.