

Google Inc.  
Form 10-Q  
October 24, 2013  
Table of Contents

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

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

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Google Inc.  
(Exact name of registrant as specified in its charter)

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

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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  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  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  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

At October 17, 2013, there were 276,721,703 shares of Google’s Class A common stock outstanding and 57,365,706

shares of Google's Class B common stock outstanding.

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Table of Contents

Google Inc.  
 Form 10-Q  
 For the Quarterly Period Ended September 30, 2013  
 TABLE OF CONTENTS

|  | Page No. |
|--|----------|
| <u>Note About Forward-Looking Statements</u>   | 1        |
| <u>PART I. FINANCIAL INFORMATION</u>   |          |
| Item 1 <u>Financial Statements</u>   | 3        |
| <u>Consolidated Balance Sheets - December 31, 2012 and September 30, 2013 (unaudited)</u>                                    | 3        |
| <u>Consolidated Statements of Income - Three and Nine Months Ended September 30, 2012 and 2013 (unaudited)</u>               | 4        |
| <u>Consolidated Statements of Comprehensive Income - Three and Nine Months Ended September 30, 2012 and 2013 (unaudited)</u> | 5        |
| <u>Consolidated Statements of Cash Flows - Nine Months Ended September 30, 2012 and 2013 (unaudited)</u>                     | 6        |
| <u>Notes to Consolidated Financial Statements (unaudited)</u>  | 7        |
| Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                          | 29       |
| Item 3 <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 44       |
| Item 4 <u>Controls and Procedures</u>  | 45       |
| <u>PART II. OTHER INFORMATION</u>  |          |
| Item 1 <u>Legal Proceedings</u>  | 46       |
| Item 1A <u>Risk Factors</u>  | 46       |
| Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 58       |
| Item 6 <u>Exhibits</u>   | 59       |
| <u>Signature</u>   | 60       |
| <u>Exhibit Index</u>   | 61       |

Table of Contents

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 advertiser expenditures, traditional retail seasonality and macroeconomic conditions, which are likely to cause fluctuations in our quarterly results;

our plans to continue to invest in new businesses, products and technologies, systems, facilities, and infrastructure, to increase our hiring and provide competitive compensation programs, as well as to 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 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 our net exposure to fluctuations in foreign currency exchange rates;

the expected 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, proceedings, and other contingencies;

- our expectation 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;

our continued investments in international markets;

- estimates of 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," "will likely result," and similar ex

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.

1

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Table of Contents

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.

Table of Contents

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Google Inc.

## CONSOLIDATED BALANCE SHEETS

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

|   | As of<br>December 31,<br>2012 | As of<br>September 30,<br>2013<br>(unaudited) |
|---|-------------------------------|---|
| Assets  |                               |   |
| Current assets:   |                               |   |
| Cash and cash equivalents   | \$ 14,778                     | \$ 15,242                                     |
| Marketable securities   | 33,310                        | 41,281  |
| Total cash, cash equivalents, and marketable securities (including securities loaned of \$3,160 and \$5,103)          | 48,088                        | 56,523  |
| Accounts receivable, net of allowance of \$581 and \$486  | 7,885                         | 7,921   |
| Inventories   | 505                           | 235   |
| Receivable under reverse repurchase agreements  | 700                           | 100   |
| Deferred income taxes, net  | 1,144                         | 1,154   |
| Income taxes receivable, net  | 0                             | 571   |
| Prepaid revenue share, expenses and other assets  | 2,132                         | 2,354   |
| Total current assets  | 60,454                        | 68,858  |
| Prepaid revenue share, expenses and other assets, non-current   | 2,011                         | 1,784   |
| Non-marketable equity investments   | 1,469                         | 1,843   |
| Property and equipment, net   | 11,854                        | 14,867  |
| Intangible assets, net  | 7,473                         | 6,290   |
| Goodwill  | 10,537                        | 11,426  |
| Total assets  | \$93,798                      | \$ 105,068                                    |
| Liabilities and Stockholders' Equity  |                               |   |
| Current liabilities:  |                               |   |
| Accounts payable  | \$2,012                       | \$2,124                                       |
| Short-term debt   | 2,549                         | 3,009   |
| Accrued compensation and benefits   | 2,239                         | 1,999   |
| Accrued expenses and other current liabilities  | 3,258                         | 3,071   |
| Accrued revenue share   | 1,471                         | 1,472   |
| Securities lending payable  | 1,673                         | 1,893   |
| Deferred revenue  | 895                           | 907   |
| Income taxes payable, net   | 240                           | 0   |
| Total current liabilities   | 14,337                        | 14,475  |
| Long-term debt  | 2,988                         | 2,238   |
| Deferred revenue, non-current   | 100                           | 125   |
| Income taxes payable, non-current   | 2,046                         | 2,434   |
| Deferred income taxes, net, non-current   | 1,872                         | 2,097   |
| Other long-term liabilities   | 740                           | 710   |
| Stockholders' equity:   |                               |   |
| Convertible preferred stock, \$0.001 par value per share, 100,000 shares authorized; no shares issued and outstanding | 0                             | 0   |

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|  |          |           |
|--|----------|-----------|
| Class A and Class B common stock and additional paid-in capital, \$0.001 par value per share: 12,000,000 shares authorized (Class A 9,000,000, Class B 3,000,000); 329,979 (Class A 267,448, Class B 62,531) and par value of \$330 (Class A \$267, Class B \$63) and 334,157 (Class A 276,681, Class B 57,476) and par value of \$334 (Class A \$277, Class B \$57) shares issued and outstanding | 22,835   | 25,004    |
| 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   | 538      | 99        |
| Retained earnings  | 48,342   | 57,886    |
| Total stockholders' equity   | 71,715   | 82,989    |
| Total liabilities and stockholders' equity   | \$93,798 | \$105,068 |
| See accompanying notes.  |          |           |

3

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Table of Contents

Google Inc.

## CONSOLIDATED STATEMENTS OF INCOME

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

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2012                                | 2013     | 2012                               | 2013     |
|  | (unaudited)                         |          |                                    |          |
| Revenues:  |                                     |          |                                    |          |
| Google (advertising and other)   | \$11,526                            | \$13,754 | \$33,135                           | \$39,812 |
| Motorola Mobile (hardware and other)                                       | 1,778                               | 1,139    | 2,621                              | 3,155    |
| Total revenues   | 13,304                              | 14,893   | 35,756                             | 42,967   |
| Costs and expenses:  |                                     |          |                                    |          |
| Cost of revenues - Google (advertising and other) <sup>(1)</sup>           | 4,440                               | 5,409    | 12,213                             | 15,740   |
| Cost of revenues - Motorola Mobile (hardware and other) <sup>(1)</sup>     | 1,515                               | 1,004    | 2,208                              | 2,680    |
| Research and development <sup>(1)</sup>                                    | 1,879                               | 2,017    | 4,858                              | 5,841    |
| Sales and marketing <sup>(1)</sup>   | 1,710                               | 1,806    | 4,392                              | 5,127    |
| General and administrative <sup>(1)</sup>                                  | 1,020                               | 1,213    | 2,719                              | 3,535    |
| Total costs and expenses   | 10,564                              | 11,449   | 26,390                             | 32,923   |
| Income from operations   | 2,740                               | 3,444    | 9,366                              | 10,044   |
| Interest and other income, net   | 65                                  | 24       | 474                                | 405      |
| Income from continuing operations before income taxes                      | 2,805                               | 3,468    | 9,840                              | 10,449   |
| Provision for income taxes   | 647                                 | 513      | 1,959                              | 1,616    |
| Net income from continuing operations                                      | 2,158                               | 2,955    | 7,881                              | 8,833    |
| Net income (loss) from discontinued operations                             | 18                                  | 15       | (30)                               | ) 711    |
| Net income   | \$2,176                             | \$2,970  | \$7,851                            | \$9,544  |
| Net income (loss) per share of Class A and Class B common stock - basic:   |                                     |          |                                    |          |
| Continuing operations  | \$6.59                              | \$8.86   | \$24.14                            | \$26.59  |
| Discontinued operations  | 0.05                                | 0.04     | (0.09)                             | ) 2.14   |
| Net income (loss) per share of Class A and Class B common stock - basic    | \$6.64                              | \$8.90   | \$24.05                            | \$28.73  |
| Net income (loss) per share of Class A and Class B common stock - diluted: |                                     |          |                                    |          |
| Continuing operations  | \$6.48                              | \$8.71   | \$23.78                            | \$26.13  |
| Discontinued operations  | 0.05                                | 0.04     | (0.09)                             | ) 2.10   |
| Net income (loss) per share of Class A and Class B common stock - diluted  | \$6.53                              | \$8.75   | \$23.69                            | \$28.23  |
| Shares used in per share calculation - basic                               |                                     |          |                                    |          |
| Shares used in per share calculation - basic                               | 327,785                             | 333,616  | 326,452                            | 332,183  |
| Shares used in per share calculation - diluted                             |                                     |          |                                    |          |
| Shares used in per share calculation - diluted                             | 333,314                             | 339,235  | 331,414                            | 338,078  |

<sup>(1)</sup> Includes stock-based compensation expense as follows:

|   |       |       |         |         |
|---|-------|-------|---------|---------|
| Cost of revenues - Google (advertising and other)       | \$103 | \$133 | \$259   | \$342   |
| Cost of revenues - Motorola Mobile (hardware and other) | 6     | 4     | 10      | 14      |
| Research and development                                | 373   | 453   | 961     | 1,235   |
| Sales and marketing                                     | 152   | 160   | 367     | 419     |
| General and administrative                              | 116   | 136   | 344     | 356     |
|   | \$750 | \$886 | \$1,941 | \$2,366 |

See accompanying notes.



Table of Contents

Google Inc.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

|  | Three Months Ended<br>September 30,<br>2012 |   | 2013    |   | Nine Months Ended<br>September 30,<br>2012 |   | 2013    |   |
|--|---|---|---------|---|--|---|---------|---|
| Net income   | \$2,176                                     |   | \$2,970 |   | \$7,851                                    |   | \$9,544 |   |
| Other comprehensive income (loss):   |   |   |         |   |  |   |         |   |
| Change in foreign currency translation adjustment                                  | 220   |   | 261     |   | (98  | ) | 57      |   |
| Available-for-sale investments:  |   |   |         |   |  |   |         |   |
| Change in net unrealized gains (losses)  | 198   |   | 257     |   | 408  |   | (402    | ) |
| Reclassification adjustment for net (gains) losses<br>included in net income       | (21   | ) | 21      |   | (169                                       | ) | (133    | ) |
| Net change (net of tax effect of \$73, \$31, \$83, and \$208)                      | 177   |   | 278     |   | 239  |   | (535    | ) |
| Cash flow hedges:  |   |   |         |   |  |   |         |   |
| Change in net unrealized gains (losses)  | (74   | ) | (28     | ) | 65   |   | 97      |   |
| Less: reclassification adjustment for net (gains) losses<br>included in net income | (39   | ) | (14     | ) | (114                                       | ) | (58     | ) |
| Net change (net of tax effect of \$67, \$24, \$29, and \$23)                       | (113  | ) | (42     | ) | (49  | ) | 39      |   |
| Other comprehensive income (loss)  | 284   |   | 497     |   | 92   |   | (439    | ) |
| Comprehensive income   | \$2,460                                     |   | \$3,467 |   | \$7,943                                    |   | \$9,105 |   |
| See accompanying notes.  |   |   |         |   |  |   |         |   |

Table of Contents

Google Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

|   | Nine Months Ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2012                               | 2013     |
|   | (unaudited)                        |          |
| Operating activities  |                                    |          |
| Net income  | \$7,851                            | \$9,544  |
| Adjustments:  |                                    |          |
| Depreciation and amortization of property and equipment                           | 1,358                              | 2,024    |
| Amortization of intangible and other assets                                       | 651                                | 879      |
| Stock-based compensation expense  | 1,976                              | 2,441    |
| Excess tax benefits from stock-based award activities                             | (113)                              | (302)    |
| Deferred income taxes   | 23                                 | 125      |
| Gain on divestiture of businesses   | (188)                              | (705)    |
| Other   | (24)                               | 44       |
| Changes in assets and liabilities, net of effects of acquisitions:                |                                    |          |
| Accounts receivable   | (228)                              | (454)    |
| Income taxes, net   | 1,336                              | (79)     |
| Inventories   | 188                                | (46)     |
| Prepaid revenue share, expenses and other assets                                  | (1,215)                            | (149)    |
| Accounts payable  | (274)                              | 285      |
| Accrued expenses and other liabilities  | 484                                | (270)    |
| Accrued revenue share   | (57)                               | 8        |
| Deferred revenue  | 182                                | 76       |
| Net cash provided by operating activities   | 11,950                             | 13,421   |
| Investing activities  |                                    |          |
| Purchases of property and equipment   | (2,253)                            | (5,103)  |
| Purchases of marketable securities  | (24,246)                           | (31,746) |
| Maturities and sales of marketable securities                                     | 29,800                             | 23,241   |
| Investments in non-marketable equity investments                                  | (246)                              | (471)    |
| Cash collateral related to securities lending                                     | (321)                              | 220      |
| Investments in reverse repurchase agreements                                      | 195                                | 600      |
| Proceeds from divestiture of businesses   | 201                                | 2,525    |
| Acquisitions, net of cash acquired, and purchases of intangibles and other assets | (10,672)                           | (1,328)  |
| Net cash used in investing activities   | (7,542)                            | (12,062) |
| Financing activities  |                                    |          |
| Net payments related to stock-based award activities                              | (189)                              | (637)    |
| Excess tax benefits from stock-based award activities                             | 113                                | 302      |
| Proceeds from issuance of debt, net of costs                                      | 12,125                             | 8,350    |
| Repayments of debt  | (10,128)                           | (8,904)  |
| Net cash provided by (used in) financing activities                               | 1,921                              | (889)    |
| Effect of exchange rate changes on cash and cash equivalents                      | (52)                               | (6)      |
| Net increase in cash and cash equivalents   | 6,277                              | 464      |
| Cash and cash equivalents at beginning of period                                  | 9,983                              | 14,778   |
| Cash and cash equivalents at end of period  | \$16,260                           | \$15,242 |

Supplemental disclosures of cash flow information

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|   |         |         |
|---|---------|---------|
| Cash paid for taxes   | \$1,684 | \$1,304 |
| Cash paid for interest  | \$38    | \$36    |
| Non-cash investing and financing activities:  |         |         |
| Receipt of Arris shares in connection with divestiture of Motorola Home             | \$0     | \$175   |
| Fair value of stock-based awards assumed in connection with acquisition of Motorola | \$41    | \$0     |
| Property under capital lease  | \$0     | \$258   |
| See accompanying notes.   |         |         |

Table of Contents

Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

We were incorporated in California in September 1998 and 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. To a lesser extent, we generate revenues primarily from sales of mobile devices in our Motorola Mobile segment. In April 2013, we completed the sale of our Motorola Home segment to Arris Group, Inc. (Arris) and certain other persons. See Note 8 for further discussion of the sale of Motorola Home.

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, 2013, the Consolidated Statements of Income for the three and nine months ended September 30, 2012 and 2013, the Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012 and 2013, and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2013 are unaudited. These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (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, 2013, our results of operations for the three and nine months ended September 30, 2012 and 2013, and our cash flows for the nine months ended September 30, 2012 and 2013. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013. 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, 2012 filed with the SEC on January 29, 2013.

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, intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of stock-based awards, inventory valuations, 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.

In the second quarter of 2013, we revised the estimated useful lives of certain types of property and equipment which resulted in an additional depreciation expense of \$48 million and \$169 million during the three and nine months ended September 30, 2013.

Prior Period Reclassifications

Certain reclassifications of prior period amounts have been made to conform to the current period presentation.

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):

Table of Contents

|   | Three Months Ended<br>September 30,<br>2012<br>(unaudited) |         |         |         | Nine Months Ended<br>September 30,<br>2012 |         |         |         |
|---|--|---------|---------|---------|--|---------|---------|---------|
|   | Class A  | Class B | Class A | Class B | Class A                                    | Class B | Class A | Class B |
| Basic net income (loss) per share:  |  |         |         |         |  |         |         |         |
| Numerator   |  |         |         |         |  |         |         |         |
| Allocation of undistributed earnings - continuing operations                                  | \$1,732  | \$426   | \$2,438 | \$517   | \$6,293                                    | \$1,588 | \$7,237 | \$1,596 |
| Allocation of undistributed earnings - discontinued operations                                | 14   | 4       | 12      | 3       | (24 )                                      | (6 )    | 582     | 129     |
| Total   | \$1,746  | \$430   | \$2,450 | \$520   | \$6,269                                    | \$1,582 | \$7,819 | \$1,725 |
| Denominator   |  |         |         |         |  |         |         |         |
| Number of shares used in per share computation  | 263,086  | 64,699  | 275,237 | 58,379  | 260,666                                    | 65,786  | 272,150 | 60,033  |
| Basic net income (loss) per share:  |  |         |         |         |  |         |         |         |
| Continuing operations   | \$6.59   | \$6.59  | \$8.86  | \$8.86  | \$24.14                                    | \$24.14 | \$26.59 | \$26.59 |
| Discontinued operations   | 0.05   | 0.05    | 0.04    | 0.04    | (0.09 )                                    | (0.09 ) | 2.14    | 2.14    |
| Basic net income per share  | \$6.64   | \$6.64  | \$8.90  | \$8.90  | \$24.05                                    | \$24.05 | \$28.73 | \$28.73 |
| Diluted net income (loss) per share:  |  |         |         |         |  |         |         |         |
| Numerator   |  |         |         |         |  |         |         |         |
| Allocation of undistributed earnings for basic computation - continuing operations            | \$1,732  | \$426   | \$2,438 | \$517   | \$6,293                                    | \$1,588 | \$7,237 | \$1,596 |
| Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares | 426  | 0       | 517     | 0       | 1,588                                      | 0       | 1,596   | 0       |
| Reallocation of undistributed earnings to Class B shares                                      | 0  | (7 )    | 0       | (8 )    | 0  | (23 )   | 0       | (27 )   |
| Allocation of undistributed earnings - continuing operations                                  | \$2,158  | \$419   | \$2,955 | \$509   | \$7,881                                    | \$1,565 | \$8,833 | \$1,569 |
| Allocation of undistributed earnings for basic computation - discontinued operations          | \$14   | \$4     | \$12    | \$3     | \$(24 )                                    | \$(6 )  | \$582   | \$129   |
| Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares | 4  | 0       | 3       | 0       | (6 )                                       | 0       | 129     | 0       |
| Reallocation of undistributed earnings to Class B shares                                      | 0  | 0       | 0       | 0       | 0  | 0       | 0       | (3 )    |
| Allocation of undistributed earnings - discontinued operations                                | \$18   | \$4     | \$15    | \$3     | \$(30 )                                    | \$(6 )  | \$711   | \$126   |
| Denominator   |  |         |         |         |  |         |         |         |
| Number of shares used in basic computation  | 263,086  | 64,699  | 275,237 | 58,379  | 260,666                                    | 65,786  | 272,150 | 60,033  |

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Weighted-average effect of dilutive securities

Add:

Conversion of Class B to Class A common shares outstanding

|        |   |        |   |        |   |        |   |
|--------|---|--------|---|--------|---|--------|---|
| 64,699 | 0 | 58,379 | 0 | 65,786 | 0 | 60,033 | 0 |
|--------|---|--------|---|--------|---|--------|---|

Employee stock options, including warrants issued under Transferable Stock Option program

|       |    |       |   |       |    |       |   |
|-------|----|-------|---|-------|----|-------|---|
| 3,015 | 36 | 2,607 | 1 | 2,943 | 39 | 2,800 | 5 |
|-------|----|-------|---|-------|----|-------|---|

Restricted stock units

|       |   |       |   |       |   |       |   |
|-------|---|-------|---|-------|---|-------|---|
| 2,514 | 0 | 3,012 | 0 | 2,019 | 0 | 3,095 | 0 |
|-------|---|-------|---|-------|---|-------|---|

Number of shares used in per share computation

|         |        |         |        |         |        |         |        |
|---------|--------|---------|--------|---------|--------|---------|--------|
| 333,314 | 64,735 | 339,235 | 58,380 | 331,414 | 65,825 | 338,078 | 60,038 |
|---------|--------|---------|--------|---------|--------|---------|--------|

Diluted net income (loss) per share:

|                       |        |        |        |        |         |         |         |         |
|-----------------------|--------|--------|--------|--------|---------|---------|---------|---------|
| Continuing operations | \$6.48 | \$6.48 | \$8.71 | \$8.71 | \$23.78 | \$23.78 | \$26.13 | \$26.13 |
|-----------------------|--------|--------|--------|--------|---------|---------|---------|---------|

|                         |      |      |      |      |         |         |      |      |
|-------------------------|------|------|------|------|---------|---------|------|------|
| Discontinued operations | 0.05 | 0.05 | 0.04 | 0.04 | (0.09 ) | (0.09 ) | 2.10 | 2.10 |
|-------------------------|------|------|------|------|---------|---------|------|------|

|                              |        |        |        |        |         |         |         |         |
|------------------------------|--------|--------|--------|--------|---------|---------|---------|---------|
| Diluted net income per share | \$6.53 | \$6.53 | \$8.75 | \$8.75 | \$23.69 | \$23.69 | \$28.23 | \$28.23 |
|------------------------------|--------|--------|--------|--------|---------|---------|---------|---------|

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.



Table of Contents

Note 3. Financial Instruments

Fair Value Measurements

We measure our cash equivalents, marketable securities, and foreign currency and interest rate derivative contracts at fair value on a recurring basis. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. A three-tier fair value hierarchy is established as a basis for considering such assumptions and for inputs used in the valuation methodologies in measuring fair value:

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

Level 2—Include other inputs that are 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.

Based on the fair value hierarchy, 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 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.

Cash, Cash Equivalents and Marketable Securities

The following tables summarize our cash, cash equivalents and marketable securities by significant investment categories as of December 31, 2012 and September 30, 2013 (in millions):

Table of Contents

|  | As of December 31, 2012  |                              |                               |               |                                 |                          |
|--|--------------------------|------------------------------|-------------------------------|---------------|---------------------------------|--------------------------|
|  | Adjusted<br>Cost         | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value | Cash and<br>Cash<br>Equivalents | Marketable<br>Securities |
| Cash   | \$8,066                  | \$0                          | \$0                           | \$8,066       | \$8,066                         | \$0                      |
| Level 1:   |                          |                              |                               |               |                                 |                          |
| Money market and other funds                     | 5,221                    | 0                            | 0                             | 5,221         | 5,221                           | 0                        |
| U.S. government notes                            | 10,853                   | 77                           | (1                            | ) 10,929      | 0                               | 10,929                   |
| Marketable equity securities                     | 12                       | 88                           | 0                             | 100           | 0                               | 100                      |
|  | 16,086                   | 165                          | (1                            | ) 16,250      | 5,221                           | 11,029                   |
| Level 2:   |                          |                              |                               |               |                                 |                          |
| Time deposits                                    | 984                      | 0                            | 0                             | 984           | 562                             | 422                      |
| Money market and other funds<br>(1)              | 929                      | 0                            | 0                             | 929           | 929                             | 0                        |
| U.S. government agencies                         | 1,882                    | 20                           | 0                             | 1,902         | 0                               | 1,902                    |
| Foreign government bonds                         | 1,996                    | 81                           | (3                            | ) 2,074       | 0                               | 2,074                    |
| Municipal securities                             | 2,249                    | 23                           | (6                            | ) 2,266       | 0                               | 2,266                    |
| Corporate debt securities                        | 7,200                    | 414                          | (14                           | ) 7,600       | 0                               | 7,600                    |
| Agency residential<br>mortgage-backed securities | 7,039                    | 136                          | (6                            | ) 7,169       | 0                               | 7,169                    |
| Asset-backed securities                          | 847                      | 1                            | 0                             | 848           | 0                               | 848                      |
|  | 23,126                   | 675                          | (29                           | ) 23,772      | 1,491                           | 22,281                   |
| Total  | \$47,278                 | \$840                        | \$(30                         | ) \$48,088    | \$14,778                        | \$33,310                 |
|  | As of September 30, 2013 |                              |                               |               |                                 |                          |
|  | Adjusted<br>Cost         | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value | Cash and<br>Cash<br>Equivalents | Marketable<br>Securities |
|  | (unaudited)              |                              |                               |               |                                 |                          |
| Cash   | \$7,822                  | \$0                          | \$0                           | \$7,822       | \$7,822                         | \$0                      |
| Level 1:   |                          |                              |                               |               |                                 |                          |
| Money market and other funds                     | 3,940                    | 0                            | 0                             | 3,940         | 3,940                           | 0                        |
| U.S. government notes                            | 13,567                   | 38                           | (30                           | ) 13,575      | 402                             | 13,173                   |
| Marketable equity securities                     | 241                      | 173                          | 0                             | 414           | 0                               | 414                      |
|  | 17,748                   | 211                          | (30                           | ) 17,929      | 4,342                           | 13,587                   |
| Level 2:   |                          |                              |                               |               |                                 |                          |
| Time deposits                                    | 1,753                    | 0                            | 0                             | 1,753         | 1,294                           | 459                      |
| Money market and other<br>funds <sup>(1)</sup>   | 1,784                    | 0                            | 0                             | 1,784         | 1,784                           | 0                        |
| U.S. government agencies                         | 2,330                    | 5                            | (3                            | ) 2,332       | 0                               | 2,332                    |
| Foreign government bonds                         | 2,408                    | 13                           | (49                           | ) 2,372       | 0                               | 2,372                    |
| Municipal securities                             | 3,579                    | 13                           | (48                           | ) 3,544       | 0                               | 3,544                    |
| Corporate debt securities                        | 9,323                    | 163                          | (140                          | ) 9,346       | 0                               | 9,346                    |
| Agency residential<br>mortgage-backed securities | 8,597                    | 80                           | (152                          | ) 8,525       | 0                               | 8,525                    |
| Asset-backed securities                          | 1,118                    | 0                            | (2                            | ) 1,116       | 0                               | 1,116                    |
|  | 30,892                   | 274                          | (394                          | ) 30,772      | 3,078                           | 27,694                   |
| Total  | \$56,462                 | \$485                        | \$(424                        | ) \$56,523    | \$15,242                        | \$41,281                 |

(1)

The balances at December 31, 2012 and September 30, 2013 were related to 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 of this program.

Table of Contents

During the second quarter of 2013, we received approximately \$175 million in Arris' common stock (10.6 million shares) in connection with the sale of the Motorola Home segment (see details in Note 8). These shares are accounted for as available-for sale marketable equity securities.

We determine realized gains or losses on the sale of marketable securities on a specific identification method. We recognized gross realized gains of \$82 million and \$290 million for the three and nine months ended September 30, 2012 and \$35 million and \$295 million for the three and nine months ended September 30, 2013. We recognized gross realized losses of \$46 million and \$79 million for the three and nine months ended September 30, 2012 and \$61 million and \$117 million for the three and nine months ended September 30, 2013. We reflect these 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<br>September 30,<br>2013<br>(unaudited) |
| Due in 1 year                   | \$4,809                                       |
| Due in 1 year through 5 years   | 18,819  |
| Due in 5 years through 10 years | 8,375   |
| Due after 10 years              | 8,864   |
| Total                           | \$40,867                                      |

The following tables present gross unrealized losses and fair values for those investments that were in an unrealized loss position as of December 31, 2012 and September 30, 2013, 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, 2012  |                 |                      |                 |            |                 |
|---|--------------------------|-----------------|----------------------|-----------------|------------|-----------------|
|   | Less than 12 Months      |                 | 12 Months or Greater |                 | Total      |                 |
|   | Fair Value               | Unrealized Loss | Fair Value           | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. government notes                         | \$842                    | \$(1)           | \$0                  | \$0             | \$842      | \$(1)           |
| Foreign government bonds                      | 509                      | (2)             | 12                   | (1)             | 521        | (3)             |
| Municipal securities                          | 686                      | (6)             | 9                    | 0               | 695        | (6)             |
| Corporate debt securities                     | 820                      | (10)            | 81                   | (4)             | 901        | (14)            |
| Agency residential mortgage-backed securities | 1,300                    | (6)             | 0                    | 0               | 1,300      | (6)             |
| Total   | \$4,157                  | \$(25)          | \$102                | \$(5)           | \$4,259    | \$(30)          |
|   | As of September 30, 2013 |                 |                      |                 |            |                 |
|   | Less than 12 Months      |                 | 12 Months or Greater |                 | Total      |                 |
|   | Fair Value               | Unrealized Loss | Fair Value           | Unrealized Loss | Fair Value | Unrealized Loss |
|   |                          |                 | (unaudited)          |                 |            |                 |
| U.S. government notes                         | \$4,329                  | \$(30)          | \$0                  | \$0             | \$4,329    | \$(30)          |
| U.S. government agencies                      | 849                      | (3)             | 0                    | 0               | 849        | (3)             |
| Foreign government bonds                      | 1,563                    | (47)            | 38                   | (2)             | 1,601      | (49)            |
| Municipal securities                          | 1,845                    | (47)            | 9                    | (1)             | 1,854      | (48)            |
| Corporate debt securities                     | 4,667                    | (136)           | 48                   | (4)             | 4,715      | (140)           |
| Agency residential mortgage-backed securities | 4,974                    | (149)           | 224                  | (3)             | 5,198      | (152)           |
| Asset-backed securities                       | 734                      | (2)             | 0                    | 0               | 734        | (2)             |
| Total   | \$18,961                 | \$(414)         | \$319                | \$(10)          | \$19,280   | \$(424)         |



## Table of Contents

We periodically review our marketable debt and equity securities for other-than-temporary impairment. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and our intent to sell. For marketable debt securities, we also consider whether (i) it is more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis, and (ii) the amortized cost basis cannot be recovered as a result of credit losses. During the three and nine months ended September 30, 2013, we did not recognize any other-than-temporary impairment loss.

### 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 collateralized in the form of cash or securities. Cash collateral is invested in reverse repurchase agreements which are collateralized in the form of securities.

We classify loaned securities as cash equivalents or marketable securities and record the cash collateral as an asset with a corresponding liability in the accompanying Consolidated Balance Sheets. 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 security collateral received, we do not record an asset or liability except in the event of counterparty default.

### Derivative Financial Instruments

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 as a component of accumulated other comprehensive income (AOCI) in the accompanying Consolidated Balance Sheets, as discussed below.

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 used for trading or speculative purposes.

We enter into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. To further reduce credit risk, we enter into collateral security arrangements under which the counterparty is required to provide collateral when the net fair value of certain financial instruments fluctuates from contractually established thresholds. We can take possession of the collateral in the event of counterparty default. As of December 31, 2012 and September 30, 2013, we received cash collateral related to the derivative instruments under our collateral security arrangements of \$43 million and \$12 million.

### Cash Flow Hedges

We use options designated as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar. The notional principal of these contracts was approximately \$9.5 billion and \$7.0 billion as of December 31, 2012 and September 30, 2013. These foreign exchange contracts have maturities of 36 months or less.

In 2012, we entered into forward-starting interest rate swaps that effectively locked in an interest rate on our anticipated debt issuance of \$1.0 billion in 2014. The total notional amount of these forward-starting interest swaps was \$1.0 billion as of December 31, 2012 and September 30, 2013 with terms calling for us to receive interest at a variable rate and to pay interest at a fixed rate.

We initially report any gain or loss on the effective portion of a cash flow hedge as a component of AOCI and subsequently reclassify cumulative gains and losses 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.

As of September 30, 2013, the effective portion of our cash flow hedges before tax effect was \$73 million, of which \$7 million is expected to be reclassified from AOCI into earnings within the next 12 months.



Table of Contents

## 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. The notional principal of these contracts was \$1.1 billion and \$1.6 billion as of December 31, 2012 and September 30, 2013.

## 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 foreign currency gains and losses on monetary assets and liabilities. The notional principal of foreign exchange contracts outstanding was \$6.6 billion and \$6.1 billion at December 31, 2012 and September 30, 2013.

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 \$25 million at December 31, 2012 and \$75 million at September 30, 2013.

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

|                            | Balance Sheet Location  | As of December 31, 2012                                     |   | Total Fair Value |
|----------------------------|---|---|---|------------------|
|                            |   | Fair Value of Derivatives Designated as Hedging Instruments | Fair Value of Derivatives Not Designated as Hedging Instruments |                  |
| Derivative Assets:         |   |   |   |                  |
| Level 2:                   |   |   |   |                  |
| Foreign exchange contracts | Prepaid revenue share, expenses and other assets, current and non-current | \$ 164  | \$ 13   | \$ 177           |
| Interest rate contracts    | Prepaid revenue share, expenses and other assets, current and non-current | 1   | 0   | 1                |
| Total                      |   | \$ 165  | \$ 13   | \$ 178           |
| Derivative Liabilities:    |   |   |   |                  |
| Level 2:                   |   |   |   |                  |
| Foreign exchange contracts | Accrued expenses and other current liabilities                            | \$ 3  | \$ 4  | \$ 7             |



Table of Contents

|                            |  | As of September 30, 2013  |  |                     |
|----------------------------|--|---|--|---------------------|
|                            | Balance Sheet Location   | Fair Value of<br>Derivatives<br>Designated as<br>Hedging Instruments<br>(unaudited) | Fair Value of<br>Derivatives Not<br>Designated as<br>Hedging Instruments | Total Fair<br>Value |
| Derivative Assets:         |  |   |  |                     |
| Level 2:                   |  |   |  |                     |
| Foreign exchange contracts | Prepaid revenue share,<br>expenses and other<br>assets, current and<br>non-current | \$67  | \$3  | \$70                |
| Interest rate contracts    | Prepaid revenue share,<br>expenses and other<br>assets, current and<br>non-current | 68  | 0  | 68                  |
| Total                      |  | \$135   | \$3  | \$138               |
| Derivative Liabilities:    |  |   |  |                     |
| Level 2:                   |  |   |  |                     |
| Foreign exchange contracts | Accrued expenses and<br>other current liabilities                                  | \$15  | \$0  | \$15                |
| Total                      |  | \$15  | \$0  | \$15                |

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

| Derivatives in Cash Flow Hedging<br>Relationship | Gains (Losses) Recognized in OCI<br>on Derivatives Before Tax Effect (Effective Portion) |          |                                 |       |
|--|--|----------|---------------------------------|-------|
|  | Three Months Ended September 30,   |          | Nine Months Ended September 30, |       |
|  | 2012   | 2013     | 2012                            | 2013  |
|  | (unaudited)  |          |                                 |       |
| Foreign exchange contracts                       | \$(110)  | ) \$(43) | ) \$110                         | \$87  |
| Interest rate contracts                          | (8)  | ) (1)    | ) (8)                           | ) 67  |
| Total  | \$(118)  | ) \$(44) | ) \$102                         | \$154 |

| Derivatives in Cash Flow<br>Hedging Relationship | Location | Gains Reclassified from AOCI into Income (Effective Portion) |      |                                    |      |
|--|----------|--|------|------------------------------------|------|
|  |          | Three Months Ended<br>September 30,                          |      | Nine Months Ended<br>September 30, |      |
|  |          | 2012   | 2013 | 2012                               | 2013 |
|  |          | (unaudited)  |      |                                    |      |
| Foreign exchange contracts                       | Revenues | \$62   | \$22 | \$180                              | \$92 |

Table of Contents

|   |                                | Gains (Losses) Recognized in Income on Derivatives (Amount Excluded from Effectiveness Testing and Ineffective Portion) <sup>(1)</sup> |          |                                 |          |
|---|--------------------------------|--|----------|---------------------------------|----------|
|   |                                | Three Months Ended September 30,   |          | Nine Months Ended September 30, |          |
| Derivatives in Cash Flow Hedging Relationship | Location                       | 2012   | 2013     | 2012                            | 2013     |
|   |                                | (unaudited)  |          |                                 |          |
| Foreign exchange contracts                    | Interest and other income, net | \$(124 )   | \$(135 ) | \$(370 )                        | \$(224 ) |

<sup>(1)</sup> 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 relationships on income is summarized below (in millions):

|  |                                | Gains (Losses) Recognized in Income on Derivatives <sup>(2)</sup> |         |                                 |        |
|--|--------------------------------|---|---------|---------------------------------|--------|
|  |                                | Three Months Ended September 30,                                  |         | Nine Months Ended September 30, |        |
| Derivatives in Fair Value Hedging Relationship | Location                       | 2012  | 2013    | 2012                            | 2013   |
|  |                                | (unaudited)   |         |                                 |        |
| Foreign exchange contracts                     | Interest and other income, net | \$(38 )   | \$(49 ) | \$(22 )                         | \$13 ) |
| Hedged item                                    | Interest and other income, net | 36  | 46      | 15                              | (19 )  |
| Total  |                                | \$(2 )  | \$(3 )  | \$(7 )                          | \$(6 ) |

Losses related to the amount excluded from effectiveness testing of the hedges were \$2 million and \$7 million for <sup>(2)</sup> the three and nine months ended September 30, 2012 and \$3 million and \$6 million for the three and nine months ended September 30, 2013.

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

|   |                                | Gains (Losses) Recognized in Income on Derivatives |         |                                 |         |
|---|--------------------------------|--|---------|---------------------------------|---------|
|   |                                | Three Months Ended September 30,                   |         | Nine Months Ended September 30, |         |
| Derivatives Not Designated As Hedging Instruments | Location                       | 2012   | 2013    | 2012                            | 2013    |
|   |                                | (unaudited)  |         |                                 |         |
| Foreign exchange contracts                        | Interest and other income, net | \$(82 )  | \$(55 ) | \$(107 )                        | \$102 ) |
| Interest rate contracts                           | Interest and other income, net | 0  | 2       | (5 )                            | 2 )     |
| Total   |                                | \$(82 )  | \$(53 ) | \$(112 )                        | \$104 ) |

## Offsetting of Derivatives, Securities Lending and Reverse Repurchase Agreements

We present our derivatives, securities lending and reverse repurchase agreements at gross fair values in the Consolidated Balance Sheets. However, our master netting and other similar arrangements allow net settlements under certain conditions. As of December 31, 2012 and September 30, 2013, information related to these offsetting

arrangements was as follows (in millions, unaudited):

15

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Table of Contents

## Offsetting of Assets

As of December 31, 2012

| Description                   | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset |                          |                              |                    |
|-------------------------------|------------------------------------|---|--|--|--------------------------|------------------------------|--------------------|
|                               |                                    |   |  | Financial Instruments  | Cash Collateral Received | Non-Cash Collateral Received | Net Assets Exposed |
| Derivatives                   | \$178                              | \$ 0  | \$ 178   | \$(4 )   | \$(40 )                  | \$(12 )                      | \$122              |
| Reverse repurchase agreements | 1,629                              | 0   | 1,629  | 0  | 0                        | (1,629 )                     | 0                  |
| Total                         | \$1,807                            | \$ 0  | \$ 1,807   | \$(4 )   | \$(40 )                  | \$(1,641 )                   | \$122              |

As of September 30, 2013

| Description                   | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset |                          |                              |                    |
|-------------------------------|------------------------------------|---|--|--|--------------------------|------------------------------|--------------------|
|                               |                                    |   |  | Financial Instruments  | Cash Collateral Received | Non-Cash Collateral Received | Net Assets Exposed |
| Derivatives                   | \$138                              | \$ 0  | \$ 138   | \$0  | \$(8 )                   | \$(31 )                      | \$99               |
| Reverse repurchase agreements | 1,884                              | 0   | 1,884  | 0  | 0                        | (1,884 )                     | 0                  |
| Total                         | \$2,022                            | \$ 0  | \$ 2,022   | \$0  | \$(8 )                   | \$(1,915 )                   | \$99               |

(1) The balances at December 31, 2012 and September 30, 2013 were related to derivative liabilities which are allowed to be net settled against derivative assets in accordance with our master netting agreements.

(2) The balances at December 31, 2012 and September 30, 2013 included \$929 million and \$1,784 million recorded in cash and cash equivalents, respectively, and \$700 million and \$100 million recorded in receivable under reverse repurchase agreements, respectively.

Table of Contents

## Offsetting of Liabilities

As of December 31, 2012

| Description                   | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset |                         |                             |                 |
|-------------------------------|---|---|--|--|-------------------------|-----------------------------|-----------------|
|                               |   |   |  | Financial Instruments  | Cash Collateral Pledged | Non-Cash Collateral Pledged | Net Liabilities |
| Derivatives                   | \$7                                     | \$ 0  | \$ 7   | \$(4 ) <sup>(3)</sup>  | \$0                     | \$0                         | \$3             |
| Securities lending agreements | 1,673                                   | 0   | 1,673  | 0  | 0                       | (1,673 )                    | 0               |
| Total                         | \$1,680                                 | \$ 0  | \$ 1,680   | \$(4 )   | \$0                     | \$(1,673 )                  | \$3             |

As of September 30, 2013

| Description                   | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset |                         |                             |                 |
|-------------------------------|---|---|--|--|-------------------------|-----------------------------|-----------------|
|                               |   |   |  | Financial Instruments  | Cash Collateral Pledged | Non-Cash Collateral Pledged | Net Liabilities |
| Derivatives                   | \$15                                    | \$ 0  | \$ 15  | \$0 <sup>(3)</sup>   | \$0                     | \$0                         | \$15            |
| Securities lending agreements | 1,893                                   | 0   | 1,893  | 0  | 0                       | (1,877 )                    | 16              |
| Total                         | \$1,908                                 | \$ 0  | \$ 1,908   | \$0  | \$0                     | \$(1,877 )                  | \$31            |

<sup>(3)</sup> The balance at December 31, 2012 and September 30, 2013 were related to derivative assets which are allowed to be net settled against derivative liabilities in accordance with our master netting agreements.

## Note 4. Debt

## 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, 2012 and September 30, 2013, we had \$2.5 billion and \$2.0 billion, respectively, of outstanding commercial paper recorded as short-term debt with weighted-average interest rates of 0.2% and 0.1%, respectively. In conjunction with this 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, 2012 and September 30, 2013, we were in compliance with the financial covenant in the credit facility, and no amounts were outstanding under the credit facility at December 31, 2012 and September 30, 2013. The estimated fair value of the commercial paper approximated its carrying value at September 30, 2013.

Our short-term debt balance also includes the short-term portion of certain long-term debt, as described in the section below.

## Long-Term Debt

In May 2011, we issued \$3.0 billion of unsecured senior notes in three tranches (collectively, the Notes) and in August 2013, we entered into a capital lease obligation. The details of these financing arrangements are described in the table below (in millions):

17

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Table of Contents

|   | As of<br>September 30,<br>2013<br>(unaudited) |
|---|---|
| <b>Short-Term Portion of Long-Term Debt</b> |   |
| 1.25% Notes due on May 19, 2014             | \$1,000                                       |
| Capital Lease Obligation                    | 9   |
| Total                                       | \$1,009                                       |
| <b>Long-Term Debt</b>                       |   |
| 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    | (10 )   |
| Subtotal                                    | 1,990   |
| Capital Lease Obligation                    | 248   |
| Total                                       | \$2,238                                       |

The effective interest yields of the 2014, 2016, and 2021 Notes were 1.258%, 2.241% and 3.734%, respectively. 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 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 \$3.1 billion at September 30, 2013. The fair value of the Notes was determined based on observable market prices of identical instruments in less active markets and is categorized accordingly as Level 2 in the fair value hierarchy. In August 2013, we entered into a capital lease obligation on certain property expiring in 2028 with an option to purchase the property in 2016. The effective rate of the capital lease obligation approximates the market rate. At September 30, 2013, the carrying value of the assets approximated the carrying value of the borrowings.

## Note 5. Balance Sheet Components

## Inventories

Inventories consisted of the following (in millions):

|                                   | As of<br>December 31,<br>2012 | As of<br>September 30,<br>2013<br>(unaudited) |
|-----------------------------------|-------------------------------|---|
| Raw materials and work in process | \$77                          | \$64  |
| Finished goods                    | 428                           | 171   |
| Inventories                       | \$505                         | \$235   |

## Property and Equipment

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

Table of Contents

|   | As of<br>December 31,<br>2012 | As of<br>September 30,<br>2013<br>(unaudited) |
|---|-------------------------------|---|
| Information technology assets                   | \$7,717                       | \$8,371                                       |
| Land and buildings                              | 6,257                         | 6,462   |
| Construction in progress                        | 2,240                         | 5,257   |
| Leasehold improvements                          | 1,409                         | 1,553   |
| Furniture and fixtures                          | 74                            | 79  |
| Total   | 17,697                        | 21,722  |
| Less: accumulated depreciation and amortization | 5,843                         | 6,855   |
| Property and equipment, net                     | \$11,854                      | \$14,867                                      |

Property under capital lease with a cost basis of \$258 million was included in construction in progress as of September 30, 2013.

## Accumulated Other Comprehensive Income (Loss)

The components of AOCI, net of tax, were as follows (in millions, unaudited):

|  | Foreign Currency<br>Translation<br>Adjustments | Unrealized Gains<br>(Losses) on<br>Available-for-Sale<br>Investments | Unrealized<br>Gains on Cash<br>Flow Hedges | Total  |
|--|--|--|--|--------|
| Balance as of December 31, 2012                            | \$(73  | ) \$604  | \$7  | \$538  |
| Other comprehensive income (loss) before reclassifications | 57   | (402   | ) 97                                       | (248   |
| Amounts reclassified from AOCI                             | 0  | (133   | ) (58                                      | ) (191 |
| Other comprehensive income (loss)                          | 57   | (535   | ) 39                                       | (439   |
| Balance as of September 30, 2013                           | \$(16  | ) \$69   | \$46                                       | \$99   |

The effects on net income of amounts reclassified from AOCI for the nine months ended September 30, 2013 were as follows (in millions, unaudited):

| AOCI Components   | Location                       | Gains (Losses)<br>Reclassified from<br>AOCI to the<br>Consolidated Statement<br>of Income |
|---|--------------------------------|---|
| Unrealized gains on available-for-sale investments                  | Interest and other income, net | \$178   |
|   | Provision for income taxes     | (45   |
|   | Net of tax                     | \$133   |
| Unrealized gains on cash flow hedges for foreign exchange contracts | Revenue                        | \$92  |
|   | Provision for income taxes     | (34   |
|   | Net of tax                     | \$58  |
| Total amount reclassified, net of tax                               |                                | \$191   |





Table of Contents

## Note 6. Acquisitions

In June 2013, we completed our acquisition of Waze Limited (Waze), a provider of a mobile map application which provides turn-by-turn navigation and real-time traffic updates powered by incidents and route information submitted by a community of users, for a total cash consideration of \$969 million. The acquisition is expected to enhance our customers' user experience by offering real time traffic information to meet users' daily navigation needs. The fair value of assets acquired and liabilities assumed was based on 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 income taxes and residual goodwill. Of the total purchase price, \$841 million was attributed to goodwill and \$193 million was attributed to intangible assets offset by \$65 million of other net liabilities assumed. The goodwill of \$841 million is primarily attributable to the synergies expected to arise after the acquisition. Goodwill is not expected to be deductible for tax purposes.

During the nine months ended September 30, 2013, we completed 20 other acquisitions and purchases of intangible assets for a total cash consideration of approximately \$369 million, of which \$214 million was attributed to intangible assets, \$162 million to goodwill, and \$7 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 \$36 million. 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, 2013, patents and developed technology have a weighted-average useful life of 5.3 years, customer relationships have a weighted-average useful life of 5.8 years, and trade names and other have a weighted-average useful life of 4.2 years.

## Note 7. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2013 were as follows (in millions, unaudited):

|                                  |          |
|----------------------------------|----------|
| Balance as of December 31, 2012  | \$10,537 |
| Goodwill acquired                | 1,003    |
| Goodwill disposed                | (64 )    |
| Goodwill adjustment              | (50 )    |
| Balance as of September 30, 2013 | \$11,426 |

As of September 30, 2013, the amount of goodwill related to the Motorola Mobile segment was not material. See Note 14 for further discussion of segment information.

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

|                                  | As of December 31, 2012  |                          |                    |
|----------------------------------|--------------------------|--------------------------|--------------------|
|                                  | Gross Carrying Amount    | Accumulated Amortization | Net Carrying Value |
| Patents and developed technology | \$7,310                  | \$1,323                  | \$5,987            |
| Customer relationships           | 2,061                    | 847                      | 1,214              |
| Trade names and other            | 576                      | 304                      | 272                |
| Total                            | \$9,947                  | \$2,474                  | \$7,473            |
|                                  | As of September 30, 2013 |                          |                    |
|                                  | Gross Carrying Amount    | Accumulated Amortization | Net Carrying Value |

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|                                  | (unaudited) |         |         |
|----------------------------------|-------------|---------|---------|
| Patents and developed technology | \$7,211     | \$1,894 | \$5,317 |
| Customer relationships           | 1,766       | 1,007   | 759     |
| Trade names and other            | 551         | 337     | 214     |
| Total                            | \$9,528     | \$3,238 | \$6,290 |

20

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Table of Contents

Amortization expense relating to acquisition-related intangible assets was \$287 million and \$594 million for the three and nine months ended September 30, 2012 and \$281 million and \$879 million for the three and nine months ended September 30, 2013.

As of September 30, 2013, expected amortization expense relating to acquisition-related intangible assets for each of the next five years and thereafter was as follows (in millions, unaudited):

|                   |         |
|-------------------|---------|
| Remainder of 2013 | \$275   |
| 2014              | 1,072   |
| 2015              | 914     |
| 2016              | 827     |
| 2017              | 770     |
| 2018              | 726     |
| Thereafter        | 1,706   |
|                   | \$6,290 |

Note 8. Discontinued Operations

On April 17, 2013, we completed the sale of the Motorola Home segment to Arris and certain other persons for consideration of approximately \$2,412 million in cash, including cash of \$2,238 million received at the date of close and certain post-close adjustments of \$174 million received in the third quarter of 2013, and approximately \$175 million in Arris' common stock of 10.6 million shares. Subsequent to the transaction, we own approximately 7.8% of the outstanding shares of Arris. Additionally, in connection with the sale, we agreed to indemnify Arris for potential liability from certain intellectual property infringement litigation, for which we recorded an indemnification liability of \$175 million, the majority of which was settled subsequent to the sale.

The sale resulted in a net gain of \$762 million, which was presented as part of net income (loss) from discontinued operations in the Consolidated Statements of Income for the nine months ended September 30, 2013.

Table of Contents

The following table presents financial results of the Motorola Home segment included in net income (loss) from discontinued operations for the three and nine months ended September 30, 2012 and 2013 (in millions, unaudited):

|   | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |                     |
|---|-------------------------------------|------|------------------------------------|---------------------|
|   | 2012                                | 2013 | 2012                               | 2013 <sup>(1)</sup> |
| Revenues  | \$797                               | \$0  | \$1,204                            | \$804               |
| Loss from discontinued operations before income taxes | (6                                  | ) 0  | (39                                | ) (67               |
| Benefits from income taxes                            | 24                                  | 0    | 9                                  | 16                  |
| Gain on disposal                                      | 0                                   | 15   | 0                                  | 762                 |
| Net income (loss) from discontinued operations        | \$18                                | \$15 | \$(30                              | ) \$711             |

<sup>(1)</sup> The operating results of Motorola Home were included in our Consolidated Statements of Income from January 1, 2013 through the date of divestiture.

The following table presents the aggregate carrying amounts of the major classes of assets and liabilities divested (in millions, unaudited):

|  |         |
|--|---------|
| Assets:                                |         |
| Accounts receivable                    | \$424   |
| Inventories                            | 228     |
| Deferred income taxes, net             | 144     |
| Prepaid and other current assets       | 152     |
| Property and equipment, net            | 282     |
| Intangible assets, net                 | 701     |
| Other assets, non-current              | 182     |
| Total assets                           | \$2,113 |
| Liabilities:                           |         |
| Accounts payable                       | \$169   |
| Accrued expenses and other liabilities | 294     |
| Total liabilities                      | \$463   |

#### Note 9. Restructuring Charges

Subsequent to our acquisition of Motorola Mobility Holdings, Inc. (Motorola) in May 2012, we initiated a restructuring plan for Motorola, primarily in our Motorola 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 the Motorola Mobile segment to profitability. Pursuant to this restructuring plan, we have incurred cumulative charges of approximately \$850 million.

For the nine months ended September 30, 2013, changes to restructuring accruals were as follows (in millions, unaudited):

|                                  | Severance and<br>Related | Other<br>Charges | Total  |
|----------------------------------|--------------------------|------------------|--------|
| Balance as of December 31, 2012  | \$238                    | \$15             | \$253  |
| Charges                          | 166                      | 53               | 219    |
| Cash payments                    | (234                     | ) (29            | ) (263 |
| Non-cash items <sup>(1)</sup>    | (84                      | ) (14            | ) (98  |
| Balance as of September 30, 2013 | \$86                     | \$25             | \$111  |

(1) Non-cash items were primarily related to restricted stock units (RSUs) and stock options.

22

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Table of Contents

For the three and nine months ended September 30, 2012 and 2013, restructuring charges were as follows (in millions, unaudited):

|  | Three Months Ended September 30,<br>2012 |                  |       | 2013                     |                  |       |
|--|--|------------------|-------|--------------------------|------------------|-------|
|  | Severance and<br>Related                 | Other<br>Charges | Total | Severance and<br>Related | Other<br>Charges | Total |
| Cost of revenues - Motorola Mobile             | \$49                                     | \$3              | \$52  | \$0                      | \$0              | \$0   |
| Research and development                       | 101                                      | 0                | 101   | 8                        | (2)              | 6     |
| Sales and marketing                            | 88                                       | 6                | 94    | 1                        | 1                | 2     |
| General and administrative                     | 19                                       | 0                | 19    | 2                        | 1                | 3     |
| Net income (loss) from discontinued operations | 31                                       | 0                | 31    | 0                        | 0                | 0     |
| Total charges                                  | \$288                                    | \$9              | \$297 | \$11                     | \$0              | \$11  |
|  | Nine Months Ended September 30,<br>2012  |                  |       | 2013                     |                  |       |
|  | Severance and<br>Related                 | Other<br>Charges | Total | Severance and<br>Related | Other<br>Charges | Total |
| Cost of revenues - Motorola Mobile             | \$57                                     | \$3              | \$60  | \$26                     | \$13             | \$39  |
| Research and development                       | 112                                      | 0                | 112   | 33                       | 21               | 54    |
| Sales and marketing                            | 116                                      | 6                | 122   | 16                       | 13               | 29    |
| General and administrative                     | 109                                      | 0                | 109   | 28                       | 2                | 30    |
| Net income (loss) from discontinued operations | 51                                       | 0                | 51    | 63                       | 4                | 67    |
| Total charges                                  | \$445                                    | \$9              | \$454 | \$166                    | \$53             | \$219 |

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.

## Note 10. Interest and Other Income, Net

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

|  | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |       |
|--|-------------------------------------|-------|------------------------------------|-------|
|  | 2012                                | 2013  | 2012                               | 2013  |
| Interest income  | \$172                               | \$201 | \$534                              | \$570 |
| Interest expense   | (21)                                | (22)  | (63)                               | (62)  |
| Realized gains (losses) on available-for-sale investments, net | 36                                  | (26)  | 211                                | 178   |
| Foreign currency exchange gains (losses), net                  | (147)                               | (153) | (439)                              | (271) |
| Gain (loss) on divestiture of businesses                       | 0                                   | 0     | 188                                | (57)  |
| Other  | 25                                  | 24    | 43                                 | 47    |
| Interest and other income, net                                 | \$65                                | \$24  | \$474                              | \$405 |

## Note 11. Contingencies

## Legal Matters

## Antitrust Investigations

On November 30, 2010, the European Commission's (EC) Directorate General for Competition opened an investigation into various antitrust-related complaints against us. We believe we have adequately responded to all of





## Table of Contents

the allegations made against us. We continue to cooperate with the EC and are pursuing a potential resolution that would avoid a finding of infringement and a fine. 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. The EC has issued a Statement of Objections against Motorola alleging abuse of a dominant position with respect to these standards-essential patents. We have responded to the Statement of Objections and are defending the case.

The Comision Nacional de Defensa de la Competencia in Argentina, the Competition Commission of India, the Taiwan Fair Trade Commission and Brazil's Council for Economic Defense have also opened investigations into certain of our business practices.

State attorneys general from the states of Texas, Ohio, and Mississippi have also issued Civil Investigative Demands relating to our business practices. We are cooperating with the state attorneys general and are responding to their information requests on an ongoing basis.

### 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.

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

Table of Contents

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 that 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 12. 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<br>September 30, |      | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|------|------------------------------------|----------|
|  | 2012<br>(unaudited)                 | 2013 | 2012                               | 2013     |
| Risk-free interest rate  | N/A                                 | N/A  | 1.0%                               | 0.9%     |
| Expected volatility  | N/A                                 | N/A  | 29%                                | 29%      |
| Expected life (in years)   | N/A                                 | N/A  | 5.3                                | 5.8      |
| Dividend yield   | N/A                                 | N/A  | 0%                                 | 0%       |
| Weighted-average estimated fair value of options granted during the period | N/A                                 | N/A  | \$193.80                           | \$214.39 |

There were no stock options granted during the three months ended September 30, 2012 and 2013.

The following table summarizes the activities for our stock options for the nine months ended September 30, 2013:

|   | Options Outstanding |                                 | Weighted-Average Remaining Contractual Term<br>(in years) | Aggregate Intrinsic Value<br>(in millions) <sup>(1)</sup> |
|---|---------------------|---------------------------------|---|---|
|   | Number of Shares    | Weighted-Average Exercise Price |   |   |
|   | (unaudited)         |                                 |   |   |
| Balance as of December 31, 2012   | 8,551,395           | \$405.98                        |   |   |
| Granted   | 1,571               | \$723.25                        |   |   |
| Exercised   | (2,233,984 )        | \$324.38                        |   |   |
| Forfeited/canceled  | (215,606 )          | \$598.39                        |   |   |
| Balance as of September 30, 2013  | 6,103,376           | \$429.29                        | 4.9   | \$ 2,725  |
| Exercisable as of September 30, 2013  | 4,715,082           | \$383.87                        | 4.0   | \$ 2,320  |
| Exercisable as of September 30, 2013 and expected to vest thereafter <sup>(2)</sup> | 5,932,616           | \$425.06                        | 4.9   | \$ 2,675  |

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of \$875.91 of our Class A common stock on September 30, 2013.

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

The following table summarizes additional information regarding outstanding and vested and exercisable stock options as of September 30, 2013:



Table of Contents

| Range of Exercise Prices | Options Outstanding |  |                                 | Options Exercisable |                                 |
|--------------------------|---------------------|--|---------------------------------|---------------------|---------------------------------|
|                          | Number of Shares    | Weighted-Average Remaining Life (in years) | Weighted-Average Exercise Price | Number of Shares    | Weighted-Average Exercise Price |
|                          |                     |  | (unaudited)                     |                     |                                 |
| \$3.75–\$94.80           | 38,379              | 1.9  | \$69.84                         | 38,379              | \$69.84                         |
| \$117.84–\$198.41        | 149,902             | 1.3  | \$179.54                        | 149,902             | \$179.54                        |
| \$205.96–\$298.86        | 188,866             | 1.7  | \$276.39                        | 188,866             | \$276.39                        |
| \$300.97–\$399.00        | 2,427,221           | 3.6  | \$309.76                        | 2,391,774           | \$309.77                        |
| \$401.78–\$499.07        | 773,929             | 5.0  | \$443.13                        | 733,740             | \$441.95                        |
| \$501.27–\$595.35        | 1,614,947           | 5.8  | \$537.96                        | 1,021,897           | \$533.01                        |
| \$601.17–\$675.82        | 890,947             | 8.0  | \$628.71                        | 186,122             | \$617.70                        |
| \$723.25–\$762.50        | 19,185              | 9.0  | \$759.29                        | 4,402               | \$762.50                        |
| \$3.75–\$762.50          | 6,103,376           | 4.9  | \$429.29                        | 4,715,082           | \$383.87                        |

The above tables include 820,714 warrants held by selected financial institutions that were options purchased from employees under our Transferable Stock Option (TSO) program, with a weighted-average exercise price of \$440.21 and a weighted-average remaining life of 0.8 years.

During the nine months ended September 30, 2013, the number of shares underlying TSOs sold to selected financial institutions under the TSO program was 541,465 at a total value of \$241 million, or an average price of \$445.06 per share, including an average premium of \$2.80 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. In August 2013, we announced that the TSO program would be discontinued as of November 29, 2013. We do not believe this will have a material impact on our consolidated financial statements.

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 total grant date fair value of stock options vested during the three and nine months ended September 30, 2013 was \$44 million and \$194 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. The aggregate intrinsic value of all stock options and warrants exercised during the three and nine months ended September 30, 2013 was \$189 million and \$1,125 million. These amounts do not include the aggregate sales price of options sold under our TSO program.

As of September 30, 2013, there was \$220 million of unrecognized compensation cost related to outstanding employee stock options. This amount is expected to be recognized over a weighted-average period of 2.0 years. To the extent the actual forfeiture rate is different from what we have estimated, stock-based compensation related to these awards will be different from our expectations.

The following table summarizes the activities for our unvested RSUs for the nine months ended September 30, 2013:

|                                   | Unvested Restricted Stock Units |  |
|-----------------------------------|---------------------------------|--|
|                                   | Number of Shares                | Weighted-Average Grant-Date Fair Value |
|                                   | (unaudited)                     |  |
| Unvested as of December 31, 2012  | 10,994,927                      | \$566.32                               |
| Granted                           | 5,186,109                       | \$876.30                               |
| Vested                            | (3,828,201)                     | \$575.65                               |
| Forfeited/canceled                | (524,549)                       | \$611.90                               |
| Unvested as of September 30, 2013 | 11,828,286                      | \$697.35                               |

Expected to vest after September 30, 2013 <sup>(1)</sup>

10,373,407

\$ 697.35

26

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Table of Contents

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

As of September 30, 2013, there was \$6.5 billion of unrecognized compensation cost related to unvested employee 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 estimated, stock-based compensation related to these awards will be different from our expectations.

**Stock Split Effected In Form of 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 stock split effected in the form of a dividend to our holders of Class A and Class B common stock (Stock Split). 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 Stock Split. On the effective date of the Stock Split, 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 Stock Split, such that prior periods are comparable to current period presentation.

**Note 13. 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 \$1,933 million and \$2,353 million as of December 31, 2012 and September 30, 2013. Our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were \$1,749 million and \$2,160 million as of December 31, 2012 and September 30, 2013. Our existing tax positions will continue to generate an increase in liabilities for unrecognized tax benefits.

Our provision for income taxes and effective tax rate decreased from the three months ended September 30, 2012 to the three months ended September 30, 2013, largely attributed to the effect of the 2013 annual federal research and development credit, whereas this credit was not available during 2012. Our provision for income taxes and effective tax rate decreased from the nine months ended September 30, 2012 to the nine months ended September 30, 2013, primarily as a result of a discrete tax benefit related to the federal research and development credit recognized in the first quarter of 2013. This discrete tax benefit was as a result of a retroactive extension of the 2012 federal research and development credit in accordance with the American Taxpayer Act of 2012, which was signed into law on January 2, 2013.

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.



Table of Contents

## Note 14. Information about Segments and Geographic Areas

Subsequent to the completion of our sale of the Motorola Home segment on April 17, 2013, we operate in the following two segments:

Google - includes our advertising and other non-advertising businesses

Motorola Mobile - includes our mobile devices business acquired from Motorola

Our chief operating decision maker does not evaluate operating segments using asset information.

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

|                                  | Three Months Ended September 30, 2012 |                    |                                     |          | Three Months Ended September 30, 2013<br>Elimination |                    |  |          |
|----------------------------------|---------------------------------------|--------------------|-------------------------------------|----------|--|--------------------|--|----------|
|                                  | Google                                | Motorola<br>Mobile | Unallocated<br>items <sup>(2)</sup> | Total    | Google   | Motorola<br>Mobile | and<br>unallocated<br>items <sup>(1) (2)</sup> | Total    |
| Revenues                         | \$11,526                              | \$1,778            | \$—                                 | \$13,304 | \$13,772   | \$1,184            | \$(63)   | \$14,893 |
| Income (loss)<br>from operations | 3,951                                 | (192)              | (1,019)                             | 2,740    | 4,635  | (248)              | (943)  | 3,444    |
|                                  | Nine Months Ended September 30, 2012  |                    |                                     |          | Nine Months Ended September 30, 2013<br>Elimination  |                    |  |          |
|                                  | Google                                | Motorola<br>Mobile | Unallocated<br>items <sup>(2)</sup> | Total    | Google   | Motorola<br>Mobile | and<br>unallocated<br>items <sup>(1) (2)</sup> | Total    |
| Revenues                         | \$33,135                              | \$2,621            | \$—                                 | \$35,756 | \$39,830   | \$3,200            | \$(63)   | \$42,967 |
| Income (loss) from<br>operations | 11,884                                | (241)              | (2,277)                             | 9,366    | 13,246   | (645)              | (2,557)  | 10,044   |

<sup>(1)</sup> Beginning in the quarter ended September 30, 2013, Google and Motorola Mobile segment revenues are impacted by intersegment transactions that are eliminated in consolidation. Additionally, segment revenues associated with certain products were recognized in the quarter ended September 30, 2013 in our segment results, but deferred to future periods in our consolidated financial statements. This presentation is consistent with what is provided to the chief operating decision maker for purposes of making decisions about allocating resources to each segment and assessing its performance.

<sup>(2)</sup> Unallocated items, including stock-based compensation expense, as well as restructuring and other charges are not allocated to each segment because we do not include this information in our measurement of the performance of our operating segments.

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 Motorola Mobile segment. The following tables set forth revenues and long-lived assets by geographic area (in millions):

|                   | Three Months Ended<br>September 30,<br>2012 |          | Nine Months Ended<br>September 30,<br>2012 |          |
|-------------------|---|----------|--|----------|
|                   | 2012  | 2013     | 2012                                       | 2013     |
| Revenues:         |   |          |  |          |
| United States     | \$6,473                                     | \$6,660  | \$16,746                                   | \$19,357 |
| United Kingdom    | 1,220                                       | 1,390    | 3,548                                      | 4,114    |
| Rest of the world | 5,611                                       | 6,843    | 15,462                                     | 19,496   |
| Total revenues    | \$13,304                                    | \$14,893 | \$35,756                                   | \$42,967 |



Table of Contents

|                                    | As of<br>December 31,<br>2012 | As of<br>September 30,<br>2013<br>(unaudited) |
|------------------------------------|-------------------------------|---|
| Long-lived assets <sup>(1)</sup> : |                               |   |
| United States                      | \$20,985                      | \$22,579                                      |
| International                      | 12,359                        | 13,631  |
| Total long-lived assets            | \$33,344                      | \$36,210                                      |

<sup>(1)</sup> Includes Motorola Home segment as of December 31, 2012.

## 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. We aspire to build products and provide services that improve the lives of billions of people globally. Our mission is to organize the world's information and make it universally accessible and useful. 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 Google segment generates revenues primarily by delivering relevant, cost-effective online advertising. Businesses use our AdWords program to promote their products and services with targeted advertising. In addition, the third parties that comprise the Google Network use our AdSense program to deliver relevant ads that generate revenues and enhance the user experience.

Our Motorola Mobile business is focused on mobile wireless devices and related products and services and generates revenues primarily by selling hardware products.

### 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.

## Table of Contents

Our users are increasingly connected to the internet and using multiple devices to access our products and services, a trend that has increased our global search queries and changed our platform mix. 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 users of our products and services as they are delivered on diverse devices, and our ability to create a seamless experience for both users and advertisers in this multi-screen environment.

The main focus of our advertising programs is to help businesses reach people in the moments that matter across all devices with smarter ads that are relevant to their intent and context, 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, updating our advertising policies and ensuring their compliance, 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 clicks 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 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 Mobile 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 areas of strategic focus, our systems, data centers, corporate facilities, information technology infrastructure, and employees. We expect to increase our hiring for the remainder of 2013 and provide competitive compensation programs to our employees. Our full-time employee headcount was 53,546 (including 12,433 headcount from Motorola Mobile and 4,995 from Motorola Home) at September 30, 2012, and 46,421 (which includes 4,259 headcount from Motorola Mobile) at September 30, 2013. Acquisitions will also remain an important component of our strategy and use of capital, and we expect our current pace of acquisitions to continue to increase. 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, manufacturing and inventory-related costs, data center costs, content acquisition costs, credit card and other transaction fees, 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

30

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Table of Contents

We completed our acquisition of Motorola on May 22, 2012 (the acquisition date). In December 2012, we entered into an agreement for the disposition of the Motorola Home segment, and, consequently, the related financial results are presented as net income (loss) from discontinued operations in the Consolidated Statements of Income in all periods presented. In April 2013, we completed the sale of the Motorola Home segment.

Subsequent to the acquisition in May 2012, we initiated a restructuring plan in our Motorola business. See Note 9 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.

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

|   | Three Months Ended                   |        | Nine Months Ended     |        |   |
|---|--------------------------------------|--------|-----------------------|--------|---|
|   | September 30,<br>2012<br>(unaudited) | 2013   | September 30,<br>2012 | 2013   |   |
| <b>Consolidated Statements of Income Data:</b>        |                                      |        |                       |        |   |
| <b>Revenues:</b>                                      |                                      |        |                       |        |   |
| Google (advertising and other)                        | 86.6                                 | % 92.4 | % 92.7                | % 92.7 | % |
| Motorola Mobile (hardware and other)                  | 13.4                                 | 7.6    | 7.3                   | 7.3    |   |
| Total revenues  | 100.0                                | 100.0  | 100.0                 | 100.0  |   |
| <b>Costs and expenses:</b>                            |                                      |        |                       |        |   |
| Cost of revenues—Google (advertising and other)       | 33.4                                 | 36.3   | 34.2                  | 36.6   |   |
| Cost of revenues—Motorola Mobile (hardware and other) | 11.4                                 | 6.7    | 6.2                   | 6.2    |   |
| Research and development                              | 14.1                                 | 13.5   | 13.6                  | 13.6   |   |
| Sales and marketing                                   | 12.9                                 | 12.1   | 12.3                  | 11.9   |   |
| General and administrative                            | 7.6                                  | 8.3    | 7.5                   | 8.3    |   |
| Total costs and expenses                              | 79.4                                 | 76.9   | 73.8                  | 76.6   |   |
| Income from operations                                | 20.6                                 | 23.1   | 26.2                  | 23.4   |   |
| Interest and other income, net                        | 0.5                                  | 0.2    | 1.3                   | 0.9    |   |
| Income from continuing operations before income taxes | 21.1                                 | 23.3   | 27.5                  | 24.3   |   |
| Provision for income taxes                            | 4.9                                  | 3.4    | 5.5                   | 3.8    |   |
| Net income from continuing operations                 | 16.2                                 | 19.9   | 22.0                  | 20.5   |   |
| Net income (loss) from discontinued operations        | 0.1                                  | 0.1    | (0.1                  | ) 1.7  |   |
| Net income  | 16.3                                 | % 20.0 | % 21.9                | % 22.2 | % |

**Revenues by Segment**

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

Table of Contents

|                                  | Three Months Ended<br>September 30,<br>2012 |           | September 30,<br>2013 |           |
|----------------------------------|---|-----------|-----------------------|-----------|
|                                  | (unaudited)                                 |           | (unaudited)           |           |
| Google segment                   |   |           |                       |           |
| Advertising revenues:            |   |           |                       |           |
| Google websites                  | \$ 7,727                                    | \$ 9,394  | \$ 22,581             | \$ 26,902 |
| Google Network Members' websites | 3,133                                       | 3,148     | 9,029                 | 9,603     |
| Total advertising revenues       | 10,860                                      | 12,542    | 31,610                | 36,505    |
| Other revenues                   | 666   | 1,230     | 1,525                 | 3,325     |
| Google segment revenues          | 11,526                                      | 13,772    | 33,135                | 39,830    |
| Motorola Mobile segment          |   |           |                       |           |
| Total Motorola Mobile revenues   | 1,778                                       | 1,184     | 2,621                 | 3,200     |
| Elimination and other (1)        | —   | (63       | ) —                   | (63       |
| Total consolidated revenues      | \$ 13,304                                   | \$ 14,893 | \$ 35,756             | \$ 42,967 |

(1) Beginning in the quarter ended September 30, 2013, Google and Motorola Mobile segment revenues are impacted by intersegment transactions that are eliminated in consolidation. Additionally, segment revenues associated with certain products were recognized in the quarter ended September 30, 2013 in our segment results, but deferred to future periods in our consolidated financial statements. This presentation is consistent with what is provided to the chief operating decision maker for purposes of making decisions about allocating resources to each segment and assessing its performance.

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

|   | Three Months Ended<br>September 30,<br>2012 |        | September 30,<br>2013 |        |
|---|---|--------|-----------------------|--------|
|   | (unaudited)                                 |        | (unaudited)           |        |
| Advertising revenues:   |   |        |                       |        |
| Google websites   | 67.0  | % 68.2 | % 68.1                | % 67.5 |
| Google Network Members' websites                              | 27.2  | % 22.9 | % 27.3                | % 24.1 |
| Total advertising revenues                                    | 94.2  | % 91.1 | % 95.4                | % 91.6 |
| Google websites as % of advertising revenues                  | 71.2  | 74.9   | 71.4                  | 73.7   |
| Google Network Members' websites as % of advertising revenues | 28.8  | 25.1   | 28.6                  | 26.3   |
| Other revenues  | 5.8   | % 8.9  | % 4.6                 | % 8.4  |

Our Google segment revenues increased \$2,246 million and \$6,695 million from the three and nine months ended September 30, 2012 to the three and nine months ended September 30, 2013. The increase from the three months ended September 30, 2012 to the three months ended September 30, 2013 resulted primarily from an increase in advertising revenues generated by Google websites and an increase in other revenues driven by higher sales related to digital content and hardware products. The increase from the nine months ended September 30, 2012 to the nine months ended September 30, 2013 resulted primarily from an increase in advertising revenues generated by Google websites and Google Network Members' websites and an increase in other revenues driven by higher sales related to digital content and hardware products. 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 and richer ad formats, the continued global expansion of

our products,

32

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Table of Contents

advertisers, and user base, as well as an increase in the number of Google Network Members, partially offset by certain advertising policy changes. The decrease in the average cost-per-click paid by our advertisers was driven by various factors, such as 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, 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, and to a lesser extent, the general strengthening of the U.S. dollar compared to certain foreign currencies. These decreases were partially offset by the revenue shift mix between Google websites and Google Network Members' websites and certain advertising policy changes.

Aggregate paid clicks on Google websites and Google Network Members' websites increased approximately 26% from the three months ended September 30, 2012 to the three months ended September 30, 2013 and 23% from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. Average cost-per-click on Google websites and Google Network Members' websites decreased approximately 8% from the three months ended September 30, 2012 to the three months ended September 30, 2013 and 6% from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. 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, 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.

Improvements in our ability to 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 displaying advertiser-nominated images that are relevant to the user query and creating a more engaging user shopping experience by enhancing search ads to include richer product information, such as product image, price, and merchant name.

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.

Our Motorola Mobile segment revenues decreased \$594 million from the three months ended September 30, 2012 to the three months ended September 30, 2013. The decrease is due to a more streamlined product portfolio as a result of the various restructuring activities that have occurred in our Motorola Mobile segment.

Our Motorola Mobile segment revenues increased \$579 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily because approximately four months of results were included in the nine months ended September 30, 2012 while full period results were included in the nine months ended September 30, 2013. This increase was partially offset by the impact of our restructuring activities aimed at simplifying our Motorola Mobile product portfolio.

Revenues by Geography

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

|                   | Three Months Ended |      | Nine Months Ended |      |   |
|-------------------|--------------------|------|-------------------|------|---|
|                   | September 30,      |      | September 30,     |      |   |
|                   | 2012               | 2013 | 2012              | 2013 |   |
|                   | (unaudited)        |      |                   |      |   |
| United States     | 47                 | % 44 | % 46              | % 45 | % |
| United Kingdom    | 11                 | % 10 | % 11              | % 10 | % |
| Rest of the world | 42                 | % 46 | % 43              | % 45 | % |



Table of Contents

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 segment, and ship-to addresses of our customers for our Motorola Mobile segment:

|                   | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |   |
|-------------------|-------------------------------------|------|------------------------------------|------|---|
|                   | 2012                                | 2013 | 2012                               | 2013 |   |
|                   | (unaudited)                         |      |                                    |      |   |
| United States     | 49                                  | % 45 | % 47                               | % 45 | % |
| United Kingdom    | 9                                   | % 9  | % 10                               | % 10 | % |
| Rest of the world | 42                                  | % 46 | % 43                               | % 45 | % |

The growth in revenues from the rest of the world (other than the United Kingdom) as a percentage of the Google segment and consolidated revenues from the three and nine months ended September 30, 2012 to the three and nine months ended September 30, 2013 resulted largely from increased acceptance of our advertising programs, and our continued progress in developing localized versions of our products for the international markets.

In addition, the general strengthening of the U.S. dollar relative to certain foreign currencies (primarily the Japanese yen and the Brazilian real) had an unfavorable impact on our consolidated international revenues, which was partially offset by the general weakening of the U.S. dollar relative to other foreign currencies (primarily the Euro), from the three months ended September 30, 2012 to the three months ended September 30, 2013. Had foreign exchange rates remained constant in these periods, our revenues from the rest of the world would have been approximately \$136 million, or 2.0%, higher in the three months ended September 30, 2013 and our consolidated revenues from the United Kingdom would have been \$19 million, or 1.4%, higher. This is before consideration of hedging gains of \$5 million and \$17 million recognized to revenues from the rest of the world and the United Kingdom in the three months ended September 30, 2013.

The general strengthening of the U.S. dollar relative to certain foreign currencies (primarily the Japanese yen and the Brazilian real) had an unfavorable impact on our consolidated international revenues, which was partially offset by the general weakening of the U.S. dollar relative to other foreign currencies (primarily the Euro), from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. Had foreign exchange rates remained constant in these periods, our revenues from the rest of the world would have been approximately \$441 million, or 2.3%, higher in the nine months ended September 30, 2013 and our consolidated revenues from the United Kingdom would have been \$72 million, or 1.8%, higher. This is before consideration of hedging gains of \$31 million and \$61 million recognized to revenues from the rest of the world and the United Kingdom in the nine months ended September 30, 2013.

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 the remainder of 2013 or thereafter. See Note 14 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.

Table of Contents

Cost of revenues also includes the expenses associated with the operation of our data centers, including depreciation, labor, energy, and bandwidth costs, hardware inventory costs, credit card and other transaction fees related to processing customer transactions, amortization of acquisition-related intangible assets, as well as content acquisition costs. We have entered into arrangements with certain content providers under which we distribute or license their video and other content. In a number of these arrangements, we display ads on the pages of our websites from which the content is viewed and share most of the fees these ads generate with the content providers. We also license content on the pages of our web sites from which the content is sold and share most of the fees these sales generate with 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 amount determined 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 primarily from our Motorola Mobile segment.

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

|   | Three Months Ended<br>September 30,<br>2012 |         | Nine Months Ended<br>September 30,<br>2012 |          |
|---|---|---------|--|----------|
|   | 2013  | 2013    | 2013                                       | 2013     |
|   | (unaudited)                                 |         |  |          |
| Cost of revenues – Google (advertising and other)       | \$4,440                                     | \$5,409 | \$12,213                                   | \$15,740 |
| Cost of revenues – Motorola Mobile (hardware and other) | 1,515                                       | 1,004   | 2,208                                      | 2,680    |
| Total cost of revenues <sup>(1)</sup>                   | \$5,955                                     | \$6,413 | \$14,421                                   | \$18,420 |

<sup>(1)</sup> Total cost of revenues includes stock-based compensation expense, as well as restructuring and other charges.

|  | Three Months Ended<br>September 30,<br>2012 |         | Nine Months Ended<br>September 30,<br>2012 |         |   |
|--|---|---------|--|---------|---|
|  | 2013  | 2013    | 2013                                       | 2013    |   |
|  | (unaudited)                                 |         |  |         |   |
| Traffic acquisition costs related to AdSense arrangements                        | \$2,214                                     | \$2,217 | \$6,349                                    | \$6,806 |   |
| Traffic acquisition costs related to distribution arrangements                   | 556   | 755     | 1,531                                      | 2,141   |   |
| Traffic acquisition costs  | \$2,770                                     | \$2,972 | \$7,880                                    | \$8,947 |   |
| Traffic acquisition costs as a percentage of Google segment advertising revenues | 25.5  | % 23.7  | % 24.9                                     | % 24.5  | % |

Cost of revenues from Google increased \$969 million and \$3,527 million from the three and nine months ended September 30, 2012 to the three and nine months ended September 30, 2013. The increase was primarily related to a \$767 million and \$2,460 million increase in costs attributable to data center costs, content acquisition costs, revenue share payments to mobile carriers, and hardware inventory costs from the three and nine months ended September 30, 2012 to the three and nine months ended September 30, 2013. The remaining increase was due to increases in traffic acquisition costs of \$202 million and \$1,067 million from the three and nine months ended September 30, 2012 to the three and nine months ended September 30, 2013 resulting from more distribution fees paid, more fees paid for additional traffic directed to our websites, as well as more advertiser fees generated through our AdSense program.

Cost of revenues from Motorola Mobile decreased \$511 million from the three months ended September 30, 2012 to the three months ended September 30, 2013. The decrease is due to a more streamlined product portfolio as a result of the various restructuring activities that have occurred in our Motorola Mobile segment.

Cost of revenues from Motorola Mobile increased \$472 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily due to approximately four months of results

being included in the nine months ended September 30, 2012 while full period results were included in the nine months ended September 30, 2013. This increase was partially offset by the impact of our restructuring activities aimed at simplifying our Motorola Mobile product portfolio.

Table of Contents

We expect cost of revenues will increase in dollar amount and may increase as a percentage of total revenues in the remainder of 2013 and in future periods, primarily as a result of increases in traffic acquisition costs, data center costs, hardware and inventory 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 for the periods presented (dollars in millions):

|  | Three Months Ended<br>September 30,<br>2012 |          | Nine Months Ended<br>September 30,<br>2012 |          |
|--|---|----------|--|----------|
|  | 2013  | 2013     | 2013                                       | 2013     |
|  | (unaudited)                                 |          |  |          |
| Research and development expenses <sup>(1)</sup> | \$ 1,879                                    | \$ 2,017 | \$ 4,858                                   | \$ 5,841 |

<sup>(1)</sup> Total research and development expenses include stock-based compensation expense, as well as restructuring and other charges.

Research and development expenses consist primarily of compensation and related costs for personnel responsible for the research and development activities relating to new and existing products and services, as well as depreciation and equipment-related costs. We expense research and development costs as incurred.

Research and development expenses for Google increased \$281 million from the three months ended September 30, 2012 to the three months ended September 30, 2013. The increase was primarily due to an increase in labor and facilities-related costs of \$158 million, largely as a result of a 19% increase in research and development headcount, and an increase in stock-based compensation expense of \$86 million.

Research and development expenses for Google increased \$781 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily due to an increase in labor and facilities-related costs of \$405 million, largely as a result of an 18% increase in research and development headcount, and an increase in stock-based compensation expense of \$247 million.

Research and development expenses for Motorola Mobile decreased \$143 million from the three months ended September 30, 2012 to three months ended September 30, 2013. The decrease was primarily due to the restructuring and related charges in the prior year aimed at simplifying our Motorola Mobile product portfolio.

Research and development expenses for Motorola Mobile increased \$202 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily due to approximately four months of results included in the nine months ended September 30, 2012 compared to full period of results included in the nine months ended September 30, 2013. This increase was partially offset by the impact of our restructuring and related charges aimed at simplifying our Motorola Mobile product portfolio.

We expect that research and development expenses will increase in dollar amount and may increase as a percentage of total revenues in the remainder of 2013 and in future periods because we expect to continue to invest





Table of Contents

in building the necessary employee and system infrastructure required to support the development of new, and to improve existing, products and services.

## Sales and Marketing

The following table presents our sales and marketing expenses for the periods presented (dollars in millions):

|   | Three Months Ended |          | Nine Months Ended |          |
|---|--------------------|----------|-------------------|----------|
|   | September 30,      |          | September 30,     |          |
|   | 2012               | 2013     | 2012              | 2013     |
|   | (unaudited)        |          |                   |          |
| Sales and marketing expenses <sup>(1)</sup> | \$ 1,710           | \$ 1,806 | \$ 4,392          | \$ 5,127 |

<sup>(1)</sup> Total sales and marketing expenses include stock-based compensation expense, as well as restructuring and other charges.

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 for Google increased \$243 million from the three months ended September 30, 2012 to the three months ended September 30, 2013. The increase was primarily due to an increase in advertising and promotional expenses of \$195 million, as well as an increase in stock-based compensation expense of \$29 million.

Sales and marketing expenses for Google increased \$706 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily due to an increase in advertising and promotional expenses of \$390 million, as well as an increase in labor and facilities-related costs of \$167 million, largely as a result of a 14% increase in sales and marketing headcount. In addition, there was an increase in stock-based compensation expense of \$74 million.

Sales and marketing expenses for Motorola Mobile decreased \$147 million from the three months ended September 30, 2012 to three months ended September 30, 2013. The decrease was primarily due to the restructuring and related charges in the prior year aimed at simplifying our Motorola Mobile product portfolio, partially offset by an increase in marketing expenses related to release of new products.

Sales and marketing expenses for Motorola Mobile increased \$29 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily due to approximately four months of results included in the nine months ended September 30, 2012 compared to full period of results included in the nine months ended September 30, 2013. This increase was partially offset by the impact of our restructuring and related charges aimed at simplifying our Motorola Mobile product portfolio.

We expect that sales and marketing expenses will increase in dollar amount and may increase as a percentage of total revenues in the remainder of 2013 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 for the periods presented (dollars in millions):

|  | Three Months Ended |          | Nine Months Ended |          |
|--|--------------------|----------|-------------------|----------|
|  | September 30,      |          | September 30,     |          |
|  | 2012               | 2013     | 2012              | 2013     |
|  | (unaudited)        |          |                   |          |
| General and administrative expenses <sup>(1)</sup> | \$ 1,020           | \$ 1,213 | \$ 2,719          | \$ 3,535 |

Table of Contents

(1) Total general and administrative expenses include stock-based compensation expense, as well as restructuring and other charges.

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 acquisition-related intangible assets.

General and administrative expenses for Google increased \$237 million from the three months ended September 30, 2012 to the three months ended September 30, 2013. The increase was primarily due to an increase in labor and facilities-related costs of \$107 million, largely as a result of a 16% increase in general and administrative headcount, as well as an increase in depreciation and equipment-related expense of \$59 million. In addition, there was an increase in stock-based compensation expense of \$23 million.

General and administrative expenses for Google increased \$777 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily due to an increase in labor and facilities-related costs of \$290 million, largely as a result of a 13% increase in general and administrative headcount, as well as an increase in depreciation and equipment-related expense of \$178 million. In addition, there was an increase of \$157 million in amortization of Motorola-acquisition related intangible assets and an increase in stock-based compensation expense of \$53 million.

General and administrative expenses for Motorola Mobile decreased \$44 million from the three months ended September 30, 2012 to the three months ended September 30, 2013. The decrease was primarily due to the restructuring and related charges in the prior year aimed at simplifying our Motorola Mobile product portfolio.

General and administrative expenses for Motorola Mobile increased \$39 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. The increase was primarily due to approximately four months of results included in the nine months ended September 30, 2012 compared to full period results included in the nine months ended September 30, 2013. This increase was partially offset by the impact of our restructuring and related charges aimed at simplifying our Motorola Mobile product portfolio.

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 total revenues in the remainder of 2013 and in future periods.

**Stock-Based Compensation**

The following table presents our aggregate stock-based compensation expense reflected in our consolidated results for the periods presented (dollars in millions):

|   | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|--------|------------------------------------|----------|
|   | 2012                                | 2013   | 2012                               | 2013     |
|   | (unaudited)                         |        |                                    |          |
| Stock-based compensation <sup>(1)</sup> | \$ 750                              | \$ 886 | \$ 1,941                           | \$ 2,366 |

(1) These amounts are included in the previously discussed sections above related to cost of revenues, research and development, sales and marketing, and general and administrative expenses.

Stock-based compensation increased \$136 million and \$425 million from the three and nine months ended September 30, 2012 to the three and nine months ended September 30, 2013. These increases were primarily due to additional stock awards issued to existing and new employees.

We estimate stock-based compensation to be approximately \$3.3 billion in 2013 and \$5.9 billion thereafter. This estimate does not include expenses to be recognized related to employee stock awards that are granted after September 30, 2013 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.



Table of Contents

## Interest and Other Income, Net

Interest and other income, net, decreased \$41 million from the three months ended September 30, 2012 to the three months ended September 30, 2013. This decrease was primarily driven by a \$62 million decrease in realized gains on available-for-sale investments and \$6 million increase in foreign currency exchange losses, partially offset by an increase in interest income of \$29 million.

Interest and other income, net, decreased \$69 million from the nine months ended September 30, 2012 to the nine months ended September 30, 2013. This decrease was primarily driven by a \$245 million decrease in the gain on divestiture of businesses and a \$33 million decrease in the realized gains on available-for-sale investments, partially offset by a decrease in foreign currency exchange losses of \$168 million and an increase in interest income of \$36 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.

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 2013 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                   |        | Nine Months Ended     |          |   |
|----------------------------|--------------------------------------|--------|-----------------------|----------|---|
|                            | September 30,<br>2012<br>(unaudited) | 2013   | September 30,<br>2012 | 2013     |   |
| Provision for income taxes | \$ 647                               | \$ 513 | \$ 1,959              | \$ 1,616 |   |
| Effective tax rate         | 23.1                                 | % 14.8 | % 19.9                | % 15.5   | % |

Our provision for income taxes and effective tax rate decreased from the three months ended September 30, 2012 to the three months ended September 30, 2013, largely attributed to the effect of the 2013 annual federal research and development credit, whereas this credit was not available during 2012.

Our provision for income taxes and effective tax rate decreased from the nine months ended September 30, 2012 to the nine months ended September 30, 2013, primarily as a result of a discrete tax benefit related to the federal research and development credit recognized in the first quarter of 2013. This discrete tax benefit was as a result of a retroactive extension of the 2012 federal research and development credit in accordance with the American Taxpayer Act of 2012, which was signed into law on January 2, 2013.

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.

See Critical Accounting Policies and Estimates below for additional information about our provision for income taxes. Net Income (Loss) from Discontinued Operations

Table of Contents

On April 17, 2013, we completed the sale of the Motorola Home segment to Arris and certain other persons for consideration of approximately \$2,412 million in cash, including cash of \$2,238 million received on the closing date and certain post-closing adjustments of \$174 million received in the third quarter of 2013, and approximately \$175 million in Arris' common stock (10.6 million shares). Subsequent to the transaction, we own approximately 7.8% of the outstanding shares of Arris. Additionally, in connection with the sale, we agreed to indemnify Arris for potential liability from certain intellectual property infringement litigation, for which we recorded an indemnification liability of \$175 million, the majority of which was settled subsequent to the sale.

The sale resulted in a net gain of \$762 million, which was presented as part of net income (loss) from discontinued operations in the Consolidated Statements of Income for the nine months ended September 30, 2013.

The following table presents financial results of the Motorola Home segment included in net income (loss) from discontinued operations for the three and nine months ended September 30, 2012 and 2013 (in millions, unaudited):

|   | Three Months Ended |      | Nine Months Ended |                     |
|---|--------------------|------|-------------------|---------------------|
|   | September 30,      |      | September 30,     |                     |
|   | 2012               | 2013 | 2012              | 2013 <sup>(1)</sup> |
| Revenues  | \$797              | \$0  | \$1,204           | \$804               |
| Loss from discontinued operations before income taxes | (6                 | ) 0  | (39               | ) (67               |
| Benefits from income taxes                            | 24                 | 0    | 9                 | 16                  |
| Gain on disposal                                      | 0                  | 15   | 0                 | 762                 |
| Net income (loss) from discontinued operations        | \$18               | \$15 | \$(30             | ) \$711             |

<sup>(1)</sup> The operating results of Motorola Home were included in our Consolidated Statements of Income from January 1, 2013 through the date of divestiture.

### Liquidity and Capital Resources

At September 30, 2013, we had \$56.5 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 security lending program, highly liquid debt instruments of the U.S. government and its agencies, debt instruments issued by foreign governments, U.S. municipal bonds, corporate debt securities, mortgage-backed securities, asset-backed securities, and marketable equity securities.

At September 30, 2013, \$32.2 billion of the \$56.5 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. Our intent is to indefinitely reinvest these funds outside of the U.S. to support our foreign operations and our current plans do not demonstrate a need to repatriate these funds to support 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, 2013, we had unused letters of credit for approximately \$165 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 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. As of September 30, 2013, we had \$2.0 billion of commercial paper outstanding recorded as short-term debt, with a weighted-average interest rate of 0.1% that mature at various dates through March 2014. Average commercial paper borrowings during the quarter were \$2.0 billion and the

maximum amount outstanding during the quarter was \$2.0 billion. In conjunction with this 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. As of September 30, 2013, we were in compliance with the financial covenant in the credit facility and no amounts were outstanding.

Table of Contents

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. In May 2013, we reclassified the first tranche of the \$1.0 billion unsecured senior notes due in May 2014 as short-term debt. We plan to issue \$1.0 billion of long-term debt when this note matures in 2014. As of September 30, 2013, the total carrying value and estimated fair value of these three notes were \$3.0 billion and \$3.1 billion. The estimated fair value was based on quoted prices for our publicly-traded debt as of September 30, 2013. We are not subject to any financial covenants under the notes.

In August 2013, we entered into a \$258 million capital lease obligation on certain property expiring in 2028 with an option to purchase in 2016. The effective rate of the capital lease obligation approximates the market rate. At September 30, 2013, the carrying value of the assets approximated the carrying value of the borrowings.

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

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2012                               | 2013      |
|   | (unaudited)                        |           |
| Net cash provided by operating activities           | \$ 11,950                          | \$ 13,421 |
| Net cash used in investing activities               | (7,542                             | ) (12,062 |
| Net cash provided by (used in) financing activities | 1,921                              | (889      |
| Cash Provided by Operating Activities               |                                    |           |

Our largest source of cash provided by operating cash flows is advertising revenues generated by Google websites and Google Network Members' websites. We also generate cash from the sale of our hardware products, primarily from Motorola Mobile. Our primary uses of cash from operating activities include payments to our Google Network Members and distribution partners, which are based on the revenue share or fixed fee arrangements, as well as payments for manufacturing and inventory-related costs primarily for Motorola Mobile. In addition, uses of cash from operating activities include compensation and related costs, other general corporate expenditures and income taxes. Cash provided by operating activities consist of net income adjusted for certain non-cash items, including stock-based compensation expense, depreciation, amortization, deferred income taxes, excess tax benefits from stock-based award activities, as well as the effect of changes in working capital and other activities.

Net cash provided by operating activities increased from the nine months ended September 30, 2012 to the nine months ended September 30, 2013, primarily due to increased net income adjusted for gain on divestiture of businesses, stock-based compensation expense, depreciation and amortization expense on property and equipment and amortization of intangible assets. These increases were partially offset by the net decrease in cash from changes in working capital primarily as a result of a decrease in income taxes and accrued expenses and other liabilities, offset by a decrease in prepaid revenue share, expenses and other assets.

**Cash Used In Investing Activities**

Cash provided by or used in investing activities primarily consist of purchases, maturities, and sales of marketable securities, acquisitions of businesses and intangible assets, divestiture of businesses, and purchases of property and equipment. In addition, cash provided by or used in investing activities include our investments in reverse repurchase agreements and the cash collateral received or returned from our securities lending program.

Cash used in investing activities increased from the nine months ended September 30, 2012 to the nine months ended September 30, 2013, primarily attributable to an increase in purchases of marketable securities during the first nine months of 2013 compared to the first nine months of 2012, a decrease in maturities and sales of marketable securities, and, to a lesser extent, an increase in capital expenditures primarily related to our production equipment, data centers, and real estate purchases. This increase was offset by lower spend related to acquisitions, an increase in proceeds received from divestiture of businesses, and an increase in cash collateral received in connection with our securities

lending program. See Notes 3 and 6 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information about our securities lending program and acquisitions.



## Table of Contents

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 production equipment, our systems, data centers, corporate facilities, and information technology infrastructure in 2013 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 continue to spend cash on acquisitions and other investments. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other functional areas, our technologies, and our product and service offerings.

### Cash Provided by (Used In) Financing Activities

Cash provided by or used in financing activities consists primarily of net proceeds or payments from issuance or repayments of short-term debt under our commercial paper program and net proceeds or payments and excess tax benefits from stock-based award activities.

Cash used in financing activities increased from the nine months ended September 30, 2012 to the nine months ended September 30, 2013, primarily driven by an increase in net cash payments related to debt and, to a lesser extent, an increase in net payments for stock-based award activities.

### Contractual Obligations

We had long-term taxes payable of \$2.4 billion as of September 30, 2013 related to tax positions for which the timing of the ultimate resolution is uncertain. At this time, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing of tax audit outcomes.

### Critical Accounting Policies and Estimates

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

### Income Taxes

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

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

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-based award activities, and research and development tax credits. The effective tax rates were 23.1%, and 14.8% for the three months ended September 30, 2012 and 2013 and 19.9% and 15.5% for the nine months ended September 30, 2012 and 2013. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries that have lower statutory rates and higher than anticipated in countries that 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 which may assert assessments against us. We regularly

assess the likelihood of adverse outcomes resulting from these examinations and assessments to determine the adequacy of our provision for income taxes.

42

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## Table of Contents

### 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, commercial disputes, content generated by our users, goods and services offered by advertisers or publishers using our platforms, 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 11 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.

### Impairment of Marketable and Non-Marketable Securities

We periodically review our marketable and non-marketable securities for impairment. If we conclude that any of these investments are impaired, we determine whether such impairment is other-than-temporary. Factors we consider to make such determination include the duration and severity of the impairment, the reason for the decline in value and the potential recovery period and our intent to sell. For marketable debt securities, we also consider whether (1) it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, and (2) the amortized cost basis cannot be recovered as a result of credit losses. If any impairment is considered other-than-temporary, we will write down the asset to its fair value and record the corresponding charge as interest and other income, net.

### Available Information

Our website is located at [www.google.com](http://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](http://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.

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 announce investor information, including news and commentary about our business and financial performance, SEC filings, notices of investor events and our press and earnings releases, on our investor relations website and our investor relations Google+ page (<https://plus.google.com/+GoogleInvestorRelations/posts>). 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 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.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

We transact business globally in multiple currencies. Our international revenues, as well as costs and expenses denominated in foreign currencies, expose us to the risk of fluctuations in foreign currency exchange rates against the US dollar. Our most significant currency exposures are the Euro, the British pound, and Japanese Yen. We are a net receiver of foreign currencies and therefore benefit from a weakening of the U.S. dollar and are adversely affected by a strengthening of the U.S. dollar relative to the foreign currency.

We use foreign exchange option contracts to protect our forecasted U.S. dollar-equivalent earnings from adverse changes in foreign currency exchange rates. These hedging contracts reduce, but do not entirely eliminate the impact of adverse currency exchange rate movements. We designate these option contracts as cash flow hedges for accounting purposes. The fair value of the option contract is separated into its intrinsic and time values. Changes in the time value are recorded in interest and other income, net. Changes in the intrinsic value are recorded as a component of accumulated other comprehensive income (AOCI) and subsequently reclassified into revenues to offset the hedged exposures as they occur.

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 currency options 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 \$2 million lower at September 30, 2013, and the total amount of expense recorded as interest and other income, net, would have been approximately \$64 million higher at September 30, 2013. If the U.S. dollar strengthened by 20%, the amount recorded in accumulated AOCI before tax effect would have been approximately \$1.1 billion higher at September 30, 2013, and the total amount of expense recorded as interest and other income, net, would have been approximately \$64 million higher at September 30, 2013. The impact in AOCI would offset our hedged exposures as they occur.

In addition, we use foreign exchange forward contracts to offset the foreign exchange risk on our assets and liabilities denominated in currencies other than the local currency of the subsidiary. These forward contracts reduce, but do not entirely eliminate the impact of currency exchange rate movements on our assets and liabilities. The foreign currency gains and losses on the assets and liabilities are recorded in interest and other income, net, which are offset by the gains and losses on the forward contracts.

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 \$8.6 million at September 30, 2013. The adverse impact at September 30, 2013 is after consideration of the offsetting effect of approximately \$867 million from foreign exchange contracts in place for the month of September 30, 2013. 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

Our investment strategy is to achieve a return that will allow us to preserve capital and maintain liquidity requirements. We invest 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 one issuer. Our 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. We account for both fixed and variable rate securities at fair value with changes on gains and losses recorded in AOCI until the securities are sold. We use interest rate derivative contracts to hedge realized gains and losses on our securities. These derivative contracts are accounted for at fair value with changes in fair value recorded in Interest and other income, net. 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)

Table of Contents

increase in interest rates would have resulted in a decrease in the fair values of our marketable securities and interest rate derivative contracts of approximately \$1.4 billion at September 30, 2013.

We plan to issue a \$1.0 billion fixed rate long-term debt when the first tranche of our outstanding unsecured senior notes matures in May 2014. To effectively lock in the interest rate on the anticipated debt issuance, we use forward-starting interest rate swaps with terms calling for us to receive interest at a variable rate and to pay interest at a fixed rate. These swaps are designated as cash flow hedges, with changes in the fair values of the swaps recorded in AOCI. The amount in AOCI will be recognized as interest expense to offset the future interest payments upon 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) decrease in interest rates would have resulted in a decrease in the fair values of our forward-starting interest swaps of approximately \$96 million at September 30, 2013, which would offset our hedged exposure on interest rates.

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, 2013, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2013 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 our 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.

Table of Contents

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a description of our material pending legal proceedings, please refer to Note 11 “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 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. As our business has evolved, 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 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 businesses and new products, services, and technologies is inherently risky, and could disrupt our ongoing businesses.





## Table of Contents

We have invested and expect to continue to invest in new businesses, 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.

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, is increasing dramatically. 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 products and services across multiple platforms. 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.

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

We generated 95% of Google revenues from our advertisers in 2012 and 92% in the nine months ended September 30, 2013. 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 as a result of:

- 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 businesses, products, services, and technologies.



## Table of Contents

The revenue growth rate of our Motorola Mobile segment will also depend on a number of factors, including the success of our new products, 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, consolidation in the telecommunications industry could negatively impact our 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 our Motorola Mobile segment 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 are 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. We continue to cooperate with the European Commission (EC), other international regulatory authorities, 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.

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 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. The sale of hardware products also exposes 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.

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

Table of Contents

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.

• Failure to successfully further develop the acquired business or technology.

• 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.

• 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.

Our acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, or amortization expenses, or impairment of goodwill and purchased long-lived assets, 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.

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.

## Table of Contents

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, current and new patent laws such as U.S. patent laws and European 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.

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, media, and other 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 products, Google Maps, Google Books, Google News, Google Image Search, Google Chrome, Google Talk, Google Voice, and YouTube, among others, infringe the intellectual property rights of others. Third parties have also sought broad injunctive relief against us by filing claims in U.S. and international courts and 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,

50

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Table of Contents

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.

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 that 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 U.S. and non-U.S. law.

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.

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

From time to time, concerns have been expressed about whether our products, services, or processes compromise the privacy of users and others. Concerns about our practices with regard to the collection, use, disclosure, or security of personal information or other privacy related matters, even if unfounded, could damage our reputation and adversely affect our operating results.

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.





Table of Contents

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.

We face a number of manufacturing and supply chain risks that, if not properly managed, could adversely impact our financial results and prospects.

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 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 our assemblies and finished products, and we have third-party arrangements for the design of some components and parts. Our 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.

In the past, Motorola, like many electronics manufacturers, has experienced supply shortages and price increases 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 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 hardware sales decreases or does not reach projected targets, we could face increased materials and manufacturing costs or other financial liabilities that could make our hardware 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.

We also require our suppliers and business partners to comply with law and company policies regarding workplace and employment practices, environmental compliance and intellectual property licensing, but we do not control them or their practices. If any of them violates laws or implements practices regarded as unethical, we could experience supply chain disruptions, canceled orders, terminations of or damage to key relationships, and damage to our reputation. If any of them 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. 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. SEC rules implementing these requirements 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.

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.

52

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Table of Contents

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 certain 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 55% of our consolidated revenues in the nine months ended September 30, 2013, 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.

Most of our Motorola products are manufactured outside the U.S., primarily in China, Taiwan and Brazil. If our manufacturing in these countries is disrupted, our overall capacity could be reduced and sales or profitability could be negatively impacted. We require suppliers and business partners to comply with law and company policies regarding workplace and employment practices, environmental compliance and intellectual property licensing, but we do not

Table of Contents

control them or their practices. If any of them violates laws or implements practices regarded as unethical, we could experience supply chain disruptions, canceled orders, terminations of or damage to key relationships, and damage to our reputation. If any of them 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. 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. 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.

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



Table of Contents

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 businesses, 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. 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 cyclicity and seasonality of our business. As our growth rate has slowed, the cyclicity and seasonality in our business has become more pronounced and caused our operating results to fluctuate. 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.



## Table of Contents

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.

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.

### 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, 2012 through September 30, 2013, the closing price of our Class A common stock ranged from \$647.18 per share to \$924.69 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.

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Announcements by our competitors of their earnings that are not in line with analyst expectations.

## Table of Contents

• 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 Transferable Stock Option program).

In addition, we have announced the intention of our board of directors to consider a distribution of shares of our non-voting Class C capital stock as a dividend to our holders of Class A and Class B common stock - effectively a two-for-one stock split. We recently entered into a memorandum of understanding (MOU) with the plaintiffs in pending litigation involving the authorization of the Class C capital stock. The MOU is intended to be the basis for a settlement of the litigation, subject to stockholder review and court approval.

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, 2013, Larry, Sergey, and Eric beneficially owned approximately 92.1% of our outstanding Class B common stock, representing approximately 62.2% 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, because our 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 tri-class capital 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

57

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Table of Contents

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.

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. In August 2013, we announced that the TSO program would be discontinued as of November 29, 2013.

The following table provides information with respect to sales by our employees of TSOs during the three months ended September 30, 2013 (unaudited):

| Period <sup>(1)</sup>                             | Aggregate Amounts                     |  |                            | Weighted-Average Per Share Amounts |                         |                            |
|---|---------------------------------------|--|----------------------------|------------------------------------|-------------------------|----------------------------|
|   | Number of Shares Underlying TSOs Sold | Sale Price of TSOs Sold (in thousands) | TSO Premium <sup>(2)</sup> | Exercise Price of TSOs Sold        | Sale Price of TSOs Sold | TSO Premium <sup>(2)</sup> |
| July 1-31   | 37,748                                | \$18,557                               | \$49                       | \$410.86                           | \$491.59                | \$1.29                     |
| August 1-31                                       | 36,269                                | 16,939                                 | 66                         | 417.48                             | 467.04                  | 1.82                       |
| September 1-30                                    | 0                                     | 0                                      | 0                          | 0                                  | 0                       | 0                          |
| Total (except weighted-average per share amounts) | 74,017                                | \$35,496                               | \$115                      | \$414.11                           | \$479.56                | \$1.55                     |

(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.

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, 2013 (unaudited):



Table of Contents

| Executive Officer | Aggregate Amounts                     |  |             |
|-------------------|---------------------------------------|--|-------------|
|                   | Number of Shares Underlying TSOs Sold | Sale Price of TSOs Sold (in thousands) | TSO Premium |
| Patrick Pichette  | 5,025                                 | \$ 1,845                               | \$9         |
| Total             | 5,025                                 | \$ 1,845                               | \$9         |

ITEM 6. EXHIBITS

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

Table of Contents

SIGNATURE

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

Date: October 24, 2013

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



Table of Contents

## EXHIBIT INDEX

| Exhibit<br>Number | Description   | Incorporated by reference herein<br>Form | Date |
|-------------------|---|--|------|
| 12                | * Computation of Ratio of Earnings to Fixed Charges<br>Certification of Chief Executive Officer pursuant to<br>Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted<br>pursuant to Section 302 of the Sarbanes-Oxley Act of<br>2002 |  |      |
| 31.01             | * Certification of Chief Financial Officer pursuant to<br>Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted<br>pursuant to Section 302 of the Sarbanes-Oxley Act of<br>2002  |  |      |
| 31.02             | * Certifications of Chief Executive Officer and Chief<br>Financial Officer pursuant to 18 U.S.C. Section 1350, as<br>adopted pursuant to Section 906 of the Sarbanes-Oxley<br>Act of 2002   |  |      |
| 32.01             | ‡   |  |      |
| 101.INS           | XBRL Instance Document  |  |      |
| 101.SCH           | XBRL Taxonomy Extension Schema Document   |  |      |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase<br>Document  |  |      |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase<br>Document   |  |      |
| 101.LAB           | XBRL Taxonomy Extension Label Linkbase Document   |  |      |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase<br>Document   |  |      |

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\* Filed herewith.

‡ Furnished herewith.