Google Inc.
Form 10-Q
July 27, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2011

OR

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

Commission file number: 000-50726

Google Inc.

(Exact name of registrant as specified in its charter)

Delaware	**77-0493581**
(State or other jurisdiction of	**(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)

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

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

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

Large accelerated filer x Accelerated filer ¨

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

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

At July 21, 2011, there were 254,219,910 shares of Google s Class A common stock outstanding and 68,667,853 shares of Google s Class B common stock outstanding.

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Google Inc.

Form 10-Q

For the Quarterly Period Ended June 30, 2011

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

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

- our future compensation expenses;
- the increase of costs related to hedging activities under our foreign exchange risk management program;
- fluctuations in our effective tax rate;
- the sufficiency of our sources of funding;
- our payment terms to certain advertisers, which may increase our working capital requirements; and
- fluctuations in our capital expenditures;

as well as other statements regarding our future operations, financial condition and prospects, and business strategies. Forward-looking statements may appear throughout this report, including without limitation, the following sections: Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 1A Risk Factors. Forward-looking statements generally can be identified by words such as anticipates, believes, estimates, expects, intends, plans, predicts, projects, will be, will continue, and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q, and in particular, the risks discussed under the caption Risk Factors in Part II, Item 1A and those discussed in other documents we file with the Securities and Exchange Commission (SEC). We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

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

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

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Google Inc.

CONSOLIDATED BALANCE SHEETS

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

and par value per share amounts)

	As of December 31, 2010	As of June 30, 2011 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 13,630	$ 10,320
Marketable securities	21,345	28,798
Total cash, cash equivalents, and marketable securities (including securities loaned of $4,031 and $4,977)	34,975	39,118
Accounts receivable, net of allowance of $101 and $140	4,252	4,476
Receivable under reverse repurchase agreements	750	1,020
Deferred income taxes, net	259	153
Income taxes receivable, net	0	347
Prepaid revenue share, expenses and other assets	1,326	1,328
Total current assets	41,562	46,442
Prepaid revenue share, expenses and other assets, non-current	442	465
Deferred income taxes, net, non-current	265	0
Non-marketable equity securities	523	893
Property and equipment, net	7,759	9,003
Intangible assets, net	1,044	1,381
Goodwill	6,256	6,677
Total assets	$ 57,851	$ 64,861
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 483	$ 567
Short-term debt	3,465	1,217
Accrued compensation and benefits	1,410	1,180
Accrued expenses and other current liabilities	961	1,493
Accrued revenue share	885	916
Securities lending payable	2,361	1,936
Deferred revenue	394	489
Income taxes payable, net	37	0
Total current liabilities	9,996	7,798
Long-term debt	0	2,985

Deferred revenue, non-current		35		28
Income taxes payable, net, non-current		1,200		1,469
Deferred income taxes, net, non-current		0		129
Other long-term liabilities		379		461
Stockholders equity:				
Preferred stock, $0.001 par value per share, 100,000 shares authorized; no shares issued and outstanding		0		0
Class A and Class B common stock and additional paid-in capital, $0.001 par value per share: 9,000,000 shares authorized; 321,301 (Class A 250,413, Class B 70,888) and par value of $321 (Class A $250, Class B $71) and 322,668 (Class A 253,830, Class B 68,838) and par value of $323 (Class A $254, Class B $69) shares issued and outstanding		18,235		19,216
Accumulated other comprehensive income		138		603
Retained earnings		27,868		32,172
Total stockholders equity		46,241		51,991
Total liabilities and stockholders equity	$	57,851	$	64,861

See accompanying notes.

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Google Inc.

CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
		(unaudited)		
Revenues	$ 6,820	$ 9,026	$ 13,595	$ 17,602
Costs and expenses:				
Cost of revenues (including stock-based compensation expense of $8, $51, $14 and $100)	2,467	3,172	4,919	6,107
Research and development (including stock-based compensation expense of $202, $247, $393 and $484)	898	1,234	1,716	2,456
Sales and marketing (including stock-based compensation expense of $56, $74, $110 and $152)	629	1,091	1,236	2,117
General and administrative (including stock-based compensation expense of $43, $63, $83 and $130)	461	648	871	1,244
Charge related to potential resolution of Department of Justice investigation	0	0	0	500
Total costs and expenses	4,455	6,145	8,742	12,424
Income from operations	2,365	2,881	4,853	5,178
Interest and other income, net	69	204	87	300
Income before income taxes	2,434	3,085	4,940	5,478
Provision for income taxes	594	580	1,145	1,174
Net income	$ 1,840	$ 2,505	$ 3,795	$ 4,304
Net income per share of Class A and Class B common stock:				
Basic	$ 5.78	$ 7.77	$ 11.93	$ 13.37
Diluted	$ 5.71	$ 7.68	$ 11.77	$ 13.19

See accompanying notes.

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Google Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2011
	(unaudited)	
Operating activities		
Net income	$ 3,795	$ 4,304
Adjustments:		
Depreciation and amortization of property and equipment	530	648
Amortization of intangible and other assets	143	208
Stock-based compensation expense	600	866
Excess tax benefits from stock-based award activities	(31)	(33)
Deferred income taxes	(4)	464
Other	2	55
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(197)	(24)
Income taxes, net	(164)	(98)
Prepaid revenue share, expenses and other assets	(191)	(148)
Accounts payable	199	77
Accrued expenses and other liabilities	(75)	297
Accrued revenue share	34	6
Deferred revenue	28	69
Net cash provided by operating activities	4,669	6,691
Investing activities		
Purchases of property and equipment	(715)	(1,807)
Purchases of marketable securities	(25,421)	(20,955)
Maturities and sales of marketable securities	20,630	13,627
Investments in non-marketable equity securities	(230)	(343)
Cash collateral received (returned) from securities lending	2,870	(424)
Investments in reverse repurchase agreements	0	(270)
Acquisitions, net of cash acquired, and purchases of intangible and other assets	(419)	(863)
Net cash used in investing activities	(3,285)	(11,035)
Financing activities		
Net proceeds related to stock-based award activities	1	88
Excess tax benefits from stock-based award activities	31	33
Repurchase of common stock in connection with acquisitions	(801)	0
Proceeds from issuance of debt, net of costs	0	8,030
Repayment of debt	0	(7,304)
Net cash provided by (used in) financing activities	(769)	847
Effect of exchange rate changes on cash and cash equivalents	(100)	187
Net increase (decrease) in cash and cash equivalents	515	(3,310)
Cash and cash equivalents at beginning of year	10,198	13,630

Cash and cash equivalents at end of period	$ 10,713	$ 10,320
Supplemental disclosures of cash flow information		
Cash paid for income taxes	$ 1,309	$ 864
Non-cash financing activity:		
Fair value of common stock issued and vested options assumed in connection with acquisitions	$ 750	$ 0

See accompanying notes.

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Nature of Operations

We were incorporated in California in September 1998. We were re-incorporated in the State of Delaware in August 2003. We generate revenue primarily by delivering relevant, cost-effective online advertising.

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 June 30, 2011, the Consolidated Statements of Income for the three and six months ended June 30, 2010 and 2011, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2011 are unaudited. These unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). In our opinion, the unaudited interim consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of June 30, 2011, our results of operations for the three and six months ended June 30, 2010 and 2011, and our cash flows for the six months ended June 30, 2010 and 2011. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011.

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, 2010 filed with the SEC on February 11, 2011.

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, 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.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued a new accounting standard update, which amends the fair value measurement guidance and includes some enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard is effective for fiscal years beginning after December 15, 2011. We will adopt this standard in the first quarter of 2012 and are currently evaluating its impact on our financial statements and disclosures.

In June 2011, the FASB issued a new accounting standard, which eliminates the current option to report other comprehensive income and its components in the statement of stockholders equity. Instead, an entity will be required to present items of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. The standard is effective for fiscal years beginning after December 15, 2011. We will adopt this standard in the first quarter of 2012.

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

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

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2010		2011		2010		2011	
	(unaudited)							
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Basic net income per share:								
Numerator								
Allocation of undistributed earnings	$ 1,418	$ 422	$ 1,967	$ 538	$ 2,920	$ 875	$ 3,372	$ 932
Denominator								
Weighted-average common shares outstanding	245,411	72,939	253,080	69,148	244,777	73,346	252,150	69,728
Number of shares used in per share computation	245,411	72,939	253,080	69,148	244,777	73,346	252,150	69,728
Basic net income per share	$ 5.78	$ 5.78	$ 7.77	$ 7.77	$ 11.93	$ 11.93	$ 13.37	$ 13.37
Diluted net income per share:								
Numerator								
Allocation of undistributed earnings for basic computation	$ 1,418	$ 422	$ 1,967	$ 538	$ 2,920	$ 875	$ 3,372	$ 932
Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares	422	0	538	0	875	0	932	0
Reallocation of undistributed earnings to Class B shares	0	(5)	0	(6)	0	(11)	0	(11)
Allocation of undistributed earnings	$ 1,840	$ 417	$ 2,505	$ 532	$ 3,795	$ 864	$ 4,304	$ 921
Denominator								
Number of shares used in basic computation	245,411	72,939	253,080	69,148	244,777	73,346	252,150	69,728
Weighted-average effect of dilutive securities								
Add:								
Conversion of Class B to Class A common shares outstanding	72,939	0	69,148	0	73,346	0	69,728	0
Employee stock options, including warrants issued under Transferable Stock Option program	3,162	72	2,653	43	3,376	77	2,990	49
Restricted shares and restricted stock units	974	0	1,155	0	1,048	0	1,341	0
Number of shares used in per share computation	322,486	73,011	326,036	69,191	322,547	73,423	326,209	69,777
Diluted net income per share	$ 5.71	$ 5.71	$ 7.68	$ 7.68	$ 11.77	$ 11.77	$ 13.19	$ 13.19

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

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Note 3. Cash and Investments

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

	As of December 31, 2010	As of June 30, 2011 (unaudited)
Cash and cash equivalents:		
Cash	$ 4,652	$ 4,347
Cash equivalents:		
Time deposits	973	479
Money market and other funds[1]	7,547	5,491
U.S. government notes	300	3
Foreign government bonds	150	0
Corporate debt securities	8	0
Total cash and cash equivalents	13,630	10,320
Marketable securities:		
Time deposits	307	382
U.S. government agencies	1,857	2,772
U.S. government notes	3,930	7,273
Foreign government bonds	1,172	2,083
Municipal securities	2,503	2,905
Corporate debt securities	5,742	7,615
Agency residential mortgage-backed securities	5,673	5,594
Marketable equity security	161	174
Total marketable securities	21,345	28,798
Total cash, cash equivalents, and marketable securities	$ 34,975	$ 39,118

(1) The balances at December 31, 2010 and June 30, 2011 include $1.6 billion and $916 million of cash collateral received in connection with our securities lending program, which was invested in reverse repurchase agreements maturing within three months. See below for further discussion on this program.

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

	As of December 31, 2010			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Time deposits	$ 307	$ 0	$ 0	$ 307
U.S. government agencies	1,864	1	(8)	1,857
U.S. government notes	3,950	30	(50)	3,930
Foreign government bonds	1,154	23	(5)	1,172
Municipal securities	2,492	16	(5)	2,503
Corporate debt securities	5,600	167	(25)	5,742
Agency residential mortgage-backed securities	5,649	56	(32)	5,673

Marketable equity security	150	11	0	161
Total	$ 21,166	$ 304	$ (125)	$ 21,345

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	As of June 30, 2011			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(unaudited)		
Time deposits	$ 382	$ 0	$ 0	$ 382
U.S. government agencies	2,769	3	0	2,772
U.S. government notes	7,274	19	(20)	7,273
Foreign government bonds	2,049	39	(5)	2,083
Municipal securities	2,883	22	0	2,905
Corporate debt securities	7,495	167	(47)	7,615
Agency residential mortgage-backed securities	5,508	104	(18)	5,594
Marketable equity security	171	3	0	174
Total	$ 28,531	$ 357	$ (90)	$ 28,798

Gross unrealized gains and losses on cash equivalents were not material at December 31, 2010 and June 30, 2011.

We recognized gross realized gains of $53 million and $81 million for the three and six months ended June 30, 2010. We recognized gross realized gains of $94 million and $135 million for the three and six months ended June 30, 2011. Gross realized losses were not material for the three and six months ended June 30, 2010. We recognized gross realized losses of $19 million and $33 million for the three and six months ended June 30, 2011. We determine realized gains and losses on the sale of marketable securities on a specific identification method, and we reflect such gains and losses as a component of interest and other income, net, in the accompanying Consolidated Statements of Income.

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

	As of June 30, 2011 (unaudited)
Due in 1 year	$ 7,988
Due in 1 year through 5 years	6,442
Due in 5 years through 10 years	6,457
Due after 10 years	7,737
Total	$ 28,624

The following tables present fair values and gross unrealized losses for those investments that were in an unrealized loss position as of December 31, 2010 and June 30, 2011 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, 2010	
	Less than 12 Months	
Security Description	Fair Value	Unrealized Loss
U.S. government agencies	$ 831	$ (8)
U.S. government notes	2,225	(50)
Foreign government bonds	129	(5)
Municipal securities	962	(5)
Corporate debt securities	1,061	(25)
Agency mortgage-backed securities	1,675	(32)

Total	$ 6,883	$ (125)

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Security Description	As of June 30, 2011 Less than 12 Months Fair Value	Unrealized Loss
	(unaudited)	
U.S. government notes	2,556	(20)
Foreign government bonds	794	(5)
Corporate debt securities	2,626	(47)
Agency mortgage-backed securities	1,146	(18)
Total	$ 7,122	$ (90)

As of December 31, 2010, we did not have any investments in marketable securities that were in an unrealized loss position for a period of 12 months or greater. As of June 30, 2011, our investments in marketable securities that were in an unrealized loss position for a period of 12 months or greater was not material.

Securities Lending Program

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

Note 4. 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 the commercial paper program are used for general corporate purposes. As of June 30, 2011, we had $749 million of commercial paper outstanding recorded as short-term debt, with a weighted-average interest rate of 0.4% that matures at various dates through November 2011. The estimated fair value of the commercial paper approximates its carrying value. In conjunction with this program, we established a $3.0 billion revolving credit facility expiring on June 30, 2013. The interest rate for the credit facility is determined based on a formula using certain market rates. As of June 30, 2011, we were in compliance with the financial covenant in the credit facility. No amounts were outstanding under the credit facility as of June 30, 2011.

Additionally, as of June 30, 2011, we had $468 million outstanding under a secured promissory note with an interest rate of 1.0% that matures in December 2011. Proceeds of this note were used for the acquisition of an office building in New York City.

Long-Term Debt

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

	Outstanding Balance as of June 30, 2011
1.25% Notes due on May 19, 2014	$ 1,000
2.125% Notes due on May 19, 2016	1,000
3.625% Notes due on May 19, 2021	1,000

Unamortized discount for Notes above		(15)
Total	$	2,985

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Interest on the Notes is payable semi-annually in arrears on May 19 and November 19 of each year. We may redeem the Notes at any time in whole or from time to time in part at specified redemption prices. We are not subject to any financial covenants under the Notes. We used the net proceeds from the sale of the Notes to repay a portion of our outstanding commercial paper and for general corporate purposes. The total estimated fair value of our long-term debt was approximately $3 billion, which is based on quoted prices for our publicly-traded debt as of June 30, 2011.

Note 5. Derivative Financial Instruments

We enter into foreign currency contracts with financial institutions to reduce the risk that our cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. We use exchange-traded interest rate futures contracts to hedge interest rate exposures on certain fixed income securities. Our program is not designated for trading or speculative purposes.

We recognize derivative instruments as either assets or liabilities on the accompanying Consolidated Balance Sheets at fair value. We record changes in the fair value (i.e., gains or losses) of the derivatives in the accompanying Consolidated Statements of Income as interest and other income, net, as part of revenues, or to accumulated other comprehensive income (AOCI) on the accompanying Consolidated Balance Sheets.

Cash Flow Hedges

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

At June 30, 2011, the effective portion of our cash flow hedges before tax effect was $11 million, of which $8 million is expected to be reclassified from AOCI to revenues within the next 12 months.

We recognize any gain after a hedge is de-designated or related to an ineffective portion of a hedge in interest and other income, net, immediately. Further, we exclude the change in the time value of the options from our assessment of hedge effectiveness. We record the premium paid or time value of an option whose strike price is equal to or greater than the market price on the date of purchase as an asset. Thereafter, we recognize any change to this time value in interest and other income, net.

The notional principal of foreign exchange contracts to purchase U.S. dollars with Euros was 3.0 billion (or approximately $4.1 billion) and 2.9 billion (or approximately $3.9 billion) at December 31, 2010 and June 30, 2011; the notional principal of foreign exchange contracts to purchase U.S. dollars with British pounds was £1.5 billion (or approximately $2.3 billion) and £1.3 billion (or approximately $2.0 billion) at December 31, 2010 and June 30, 2011; and the notional principal of foreign exchange contracts to purchase U.S. dollars with Canadian dollars was C$407 million (or approximately $382 million) and C$324 million (or approximately $315 million) at December 31, 2010 and June 30, 2011. These foreign exchange options have maturities of 36 months or less. We have not designated any other foreign exchange contracts as cash flow hedges.

Fair Value Hedges

We use forward contracts designated as fair value hedges to hedge foreign currency risks for our investments denominated in currencies other than the U.S. dollar. Gains and losses on these contracts are recognized in interest and other income, net, along with the offsetting losses and gains of the related hedged items. We exclude changes in the time value for forward contracts from the assessment of hedge effectiveness and recognize them in interest and other income, net. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $787 million and $1.1 billion at December 31, 2010 and June 30, 2011.

Other Derivatives

Other derivatives not designated as hedging instruments consist primarily of forward contracts that we use to hedge intercompany balances and other monetary assets or liabilities denominated in currencies other than the local currency of a subsidiary. We recognize gains and losses on these contracts as well as the related costs in interest and other income, net, along with the gains and losses of the related hedged items. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $1.0 billion and $1.6 billion at December 31, 2010 and June 30, 2011.

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The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $84 million and $522 million at December 31, 2010 and June 30, 2011. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 991 million (or approximately $1.3 billion) and 750 million (or approximately $1.1 billion) at December 31, 2010 and June 30, 2011. The notional principal of foreign exchange contracts to sell Euros for other foreign currencies was 6 million (or approximately $8 million) at December 31, 2010 and no such contracts were outstanding at June 30, 2011.

We also use exchange-traded interest rate futures contracts which are not designated as hedging instruments to hedge interest rate risks on certain fixed income securities. 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. As of June 30, 2011, the total notional amounts of interest rate futures contracts outstanding were $200 million.

At December 31, 2010 and June 30, 2011, the fair values of our outstanding derivative instruments were (in millions):

		Fair Value of Derivative Instruments	
	Balance Sheet Location	As of December 31, 2010	As of June 30, 2011 (unaudited)
Derivative Assets			
Derivatives designated as hedging instruments:			
Foreign exchange option contracts	Prepaid revenue share, expenses and other assets, current and non-current	$ 330	$ 157
Foreign exchange forward contracts	Prepaid revenue share, expenses and other assets, current	12	7
Derivatives not designated as hedging instruments:			
Foreign exchange forward contracts	Prepaid revenue share, expenses and other assets, current	0	1
Interest rate futures contracts	Prepaid revenue share, expenses and other assets, current	0	1
Total		$ 342	$ 166
Derivative Liabilities			
Derivatives designated as hedging instruments:			
Foreign exchange forward contracts	Accrued expenses and other current liabilities	$ 5	$ 0
Derivatives not designated as hedging instruments:			
Foreign exchange forward contracts	Accrued expenses and other current liabilities	3	1
Total		$ 8	$ 1

The effect of derivative instruments in cash flow hedging relationship on income and other comprehensive income for the three and six months ended June 30, 2010 and 2011 is summarized below (in millions):

Derivatives in Cash Flow Hedging Relationship	Increase (Decrease) in Gains Recognized in AOCI on Derivatives Before Tax Effect (Effective Portion)	
	Three Months Ended June 30,	Six Months Ended June 30,

	2010	2011	2010	2011
		(unaudited)		
Foreign exchange option contracts	$ 250	$ (6)	$ 430	$ (115)

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Derivatives in Cash Flow Hedging Relationship	Location	Gains Reclassified from AOCI into Income (Effective Portion)			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2010	2011	2010	2011
		(unaudited)			
Foreign exchange option contracts	Revenues	$ 79	$ 4	$ 89	$ 18

Derivatives in Cash Flow Hedging Relationship	Location	Gains (Losses) Recognized in Income on Derivatives (Amount Excluded from Effectiveness Testing and Ineffective Portion)(1)			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2010	2011	2010	2011
		(unaudited)			
Foreign exchange option contracts	Interest and other income, net	$ (100)	$ (58)	$ (198)	$ (171)

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

The effect of derivative instruments in fair value hedging relationship on income for the three and six months ended June 30, 2010 and 2011 is summarized below (in millions):

Derivatives in Fair Value Hedging Relationship	Location	Gains (Losses) Recognized in Income on Derivatives(2)			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2010	2011	2010	2011
		(unaudited)			
Foreign exchange forward contracts	Interest and other income, net	$ 15	$ (21)	$ 21	$ (59)
Hedged item	Interest and other income, net	(15)	18	(21)	53
		$ 0	$ (3)	$ 0	$ (6)

(2) Losses related to the amount excluded from effectiveness testing of the hedges were none for the three and six months ended June 30, 2010, and $3 million and $6 million for the three and six months ended June 30, 2011.

The effect of derivative instruments not designated as hedging instruments on income for the three and six months ended June 30, 2010 and 2011 is summarized below (in millions):

Derivatives not Designated as Hedging Instruments	Location	Gains (Losses) Recognized in Income on Derivatives			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2010	2011	2010	2011
		(unaudited)			
Foreign exchange forward contracts	Interest and other income, net	$ 98	$ (7)	$ 196	$ 0
Interest rate futures contracts	Interest and other income, net	0	(9)	0	(9)
		$ 98	$ (16)	$ 196	$ (9)

Note 6. Fair Value Measurements

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

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

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

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

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

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

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

		Fair value measurement at reporting date using		
Description	**As of December 31, 2010**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets				
Cash equivalents:				
Time deposits	$ 973	$ 0	$ 973	$ 0
Money market and other funds	7,547	5,936	1,611[1]	0
U.S. government notes	300	300	0	0
Foreign government bonds	150	0	150	0
Corporate debt securities	8	0	8	0
Marketable securities:				
Time deposits	307	0	307	0
U.S. government agencies	1,857	0	1,857	0
U.S. government notes	3,930	3,930	0	0
Foreign government bonds	1,172	0	1,172	0
Municipal securities	2,503	0	2,503	0
Corporate debt securities	5,742	0	5,742	0
Agency residential mortgage-backed securities	5,673	0	5,673	0
Marketable equity security	161	161	0	0
Derivative contracts	342	0	342	0
Auction rate securities	153	0	0	153
Total	$ 30,818	$ 10,327	$ 20,338	$ 153
Liabilities				
Derivative contracts	$ 8	0	$ 8	0
Total	$ 8	$ 0	$ 8	$ 0

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Description	As of June 30, 2011	Fair value measurement at reporting date using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(unaudited)			
Assets				
Cash equivalents:				
Time deposits	$ 479	$ 0	$ 479	$ 0
Money market and other funds	5,491	4,575	916[(1)]	0
U.S. government notes	3	3	0	0
Marketable securities:				
Time deposit	382	0	382	0
U.S. government agencies	2,772	0	2,772	0
U.S. government notes	7,273	7,273	0	0
Foreign government bonds	2,083	0	2,083	0
Municipal securities	2,905	0	2,905	0
Corporate debt securities	7,615	0	7,615	0
Agency residential mortgage-backed securities	5,594	0	5,594	0
Marketable equity security	174	174	0	0
Derivative contracts	166	0	166	0
Auction rate securities	126	0	0	126
Total	$ 35,063	$ 12,025	$ 22,912	$ 126
Liabilities				
Derivative contracts	$ 1	$ 0	$ 1	$ 0
Total	$ 1	$ 0	$ 1	$ 0

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

At June 30, 2011, we held $126 million of ARS. Historically, these securities have provided liquidity through a Dutch auction process. However, these auctions began to fail in the first quarter of 2008. To estimate their fair values at June 30, 2011, we used a discounted cash flow model based on estimated interest rates, timing and amount of cash flows, the credit quality of the underlying securities, and illiquidity considerations. Specifically, we estimated the future cash flows of our ARS over the expected workout periods using a projected weighted-average interest rate of 2% per annum, which is based on the forward swap curve at the end of June 2011 plus any additional basis points currently paid by the issuers assuming these auctions continue to fail. A discount factor was applied over these estimated cash flows of our ARS, which is calculated based on the interpolated forward swap curve adjusted by up to 1,250 basis points to reflect the current market conditions for instruments with similar credit quality at the date of the valuation and further adjusted by up to 400 basis points to reflect a discount for the liquidity risk associated with these investments due to the lack of an active market.

At June 30, 2011, the estimated fair value of these ARS was $19 million less than their costs. As we have no intent to sell these ARS and it is more likely than not that we will not be required to sell these ARS prior to recovery of our entire cost basis, we concluded the decline in the fair value was temporary and recorded the unrealized loss to AOCI on the accompanying Consolidated Balance Sheet at June 30, 2011. To the extent we determine that any impairment is other-than-temporary, we would record a charge to earnings. In addition, we have concluded that the auctions for these securities may continue to fail for at least the next 12 months and as a result, we classified them as non-current assets on the accompanying Consolidated Balance Sheet at June 30, 2011.

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The following table presents a reconciliation for our ARS measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2010 and 2011 (in millions):

	Level 3 (unaudited)
Balance at March 31, 2010	$ 181
Change in unrealized loss included in other comprehensive income	(1)
Settlements	(12)
Balance at June 30, 2010	$ 168

	Level 3 (unaudited)
Balance at December 31, 2009	$ 182
Settlements	(14)
Balance at June 30, 2010	$ 168

	Level 3 (unaudited)
Balance at March 31, 2011	$ 137
Settlements	(11)
Balance at June 30, 2011	$ 126

	Level 3 (unaudited)
Balance at December 31, 2010	$ 153
Settlements	(27)
Balance at June 30, 2011	$ 126

Note 7. Property and Equipment

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

	As of December 31, 2010	As of June 30, 2011 (unaudited)
Information technology assets	$ 4,670	$ 5,577
Land and buildings	3,969	4,630
Construction in progress	2,329	2,433
Leasehold improvements	738	786
Furniture and fixtures	65	69
Total	11,771	13,495

Less accumulated depreciation and amortization	4,012	4,492
Property and equipment, net	$ 7,759	$ 9,003

Note 8. Acquisitions

On April 12, 2011, we completed the acquisition of ITA Software, Inc. (ITA), a privately-held flight information software company, for $676 million in cash.

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During the six months ended June 30, 2011, we completed 29 other acquisitions and purchases of intangible assets for a total cash consideration of approximately $260 million. These acquisitions were not material individually or in aggregate.

The following table summarizes the allocation of the purchase price for all the acquisitions completed during the six months ended June 30, 2011 (in millions):

	ITA	Other (unaudited)	Total
Goodwill	$ 320	$ 117	$ 437
Patents and developed technology	158	130	288
Customer relationships	220	4	224
Trade names and other	16	9	25
Net assets acquired	91	2	93
Deferred tax liabilities	(129)	(2)	(131)
Total	$ 676	$ 260	$ 936

For all acquisitions completed during the six months ended June 30, 2011, patents and developed technology have a weighted-average useful life of 6.9 years, customer relationships have a weighted-average useful life of 7.9 years and trade names and other have a weighted-average useful life of 3.2 years. The amount of goodwill expected to be deductible for tax purposes is $2 million.

Note 9. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended June 30, 2011 are as follows (in millions, unaudited):

Balance as of December 31, 2010	$ 6,256
Goodwill acquired	437
Goodwill adjustment	(16)
Balance as of June 30, 2011	$ 6,677

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

	As of December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Patents and developed technology	$ 915	$ 506	$ 409
Customer relationships	950	400	550
Trade names and other	283	198	85
Total	$ 2,148	$ 1,104	$ 1,044

	As of June 30, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
		(unaudited)	

Patents and developed technology	$ 1,203	$ 594	$ 609
Customer relationships	1,174	486	688
Trade names and other	309	225	84
Total	$ 2,686	$ 1,305	$ 1,381

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Amortization expense of acquisition-related intangible assets for the three and six months ended June 30, 2010 was $70 million and $133 million and for the three and six months ended June 30, 2011 was $106 million and $201 million. As of June 30, 2011, expected amortization expense for acquisition-related intangible assets for each of the next five years and thereafter is as follows (in millions, unaudited):

Remainder of 2011	$ 206
2012	368
2013	259
2014	200
2015	99
2016	68
Thereafter	181
	$ 1,381

Note 10. Interest and Other Income, Net

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Interest income	$ 136	$ 212	$ 232	$ 402
Realized gains on marketable securities, net	43	75	68	102
Foreign currency exchange losses, net	(106)	(72)	(211)	(200)
Other	(4)	(11)	(2)	(4)
Interest and other income, net	$ 69	$ 204	$ 87	$ 300

Note 11. Comprehensive Income

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Net income	$ 1,840	$ 2,505	$ 3,795	$ 4,304
Change in unrealized gains on marketable securities, net of taxes(1)	165	108	207	86
Change in cumulative translation adjustment	(84)	119	(168)	457
Change in unrealized gains on cash flow hedges, net of taxes(2)	102	(6)	202	(78)
Comprehensive income	$ 2,023	$ 2,726	$ 4,036	$ 4,769

(1) Change in unrealized gains on marketable securities is recorded net of taxes of $30 million and $19 million for the three months ended June 30, 2010 and 2011, and $32 million and $2 million for the six months ended June 30, 2010 and 2011.

(2)

Change in unrealized gains on cash flow hedges is recorded net of taxes of $70 million and $4 million for the three months ended June 30, 2010 and 2011, and $139 million and $55 million for the six months ended June 30, 2010 and 2011.

The components of AOCI are as follows (in millions):

	As of December 31, 2010	As of June 30, 2011 (unaudited)
Unrealized net gains on available-for-sale investments, net of taxes	$ 94	$ 180
Foreign currency translation adjustment	(41)	416
Unrealized gains on cash flow hedges, net of taxes	85	7
Accumulated other comprehensive income	$ 138	$ 603

Note 12. Contingencies

Legal Matters

We have had patent, copyright, and trademark infringement lawsuits filed against us claiming that certain of our products, services, and technologies, including Android, Google WebSearch, Google AdWords, Google AdSense, Google Books, Google News, Google Image Search, Google Chrome, Google Talk, Google Voice, 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, 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. Furthermore, such 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.

We are also regularly involved in other claims, suits, government investigations, and proceedings arising from the ordinary course of our business, including actions with respect to intellectual property claims, competition and antitrust matters (such as the pending investigations by the U.S. Federal Trade Commission and the European Commission), privacy matters, tax matters, labor and employment claims, commercial claims, as well as actions involving content generated by our users, and other matters.

We have recorded liabilities for certain of these outstanding legal matters. Certain of these matters assert claims for substantial or indeterminate damages. We record a provision for a liability when we believe that it is both probable that a liability 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 probability and the estimated amount. Such legal matters are inherently unpredictable and subject to significant uncertainties, some of which are beyond our control. In all of our outstanding legal matters in which we have not made an accrual, management is unable to estimate a range of reasonably possible loss due to various reasons, including, among others: (1) that the proceedings are in early stages, (2) that there is uncertainty as to the outcome of pending appeals, motions, or settlements, (3) that there are significant factual issues to be resolved, and (4) that there are novel legal issues presented.

While the results of such claims, suits, government investigations, and proceedings are not reasonably estimable at this time, based on our current knowledge, we believe that the final outcome of the matters discussed above, including liabilities in excess of the amounts accrued, if any, will not, individually or in the aggregate, have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows. However, in light of the uncertainties involved in such matters, the final outcome of a particular matter could have a material adverse effect on our results of operations or cash flows in a particular period.

EPA Investigation

In February 2009, we learned of a U.S. Environmental Protection Agency (EPA) investigation into an alleged release of refrigerant at one of our smaller data center facilities, which we acquired from DoubleClick, and the accuracy of related statements and records. We are cooperating with the EPA and have provided documents and other materials. The EPA investigation could result in fines, civil or criminal penalties, or other adverse consequences. Since there are significant factual issues to be resolved, we cannot estimate a reasonable range of possible loss at this time. We believe the final outcome of this matter, including any liability in excess of the amount accrued, if any, will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows.

Department of Justice Investigation (Advertising)

In May 2011, in connection with a potential resolution of an investigation by the United States Department of Justice into the use of Google advertising by certain advertisers, we accrued $500 million for the three-month period ended March 31, 2011. Although we cannot predict the final outcome of this matter, we believe that any liability in excess of the amount accrued will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows.

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Income Taxes

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

Note 13. Stockholders Equity

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Risk-free interest rate	2.6%	2.5%	2.6%	2.4%
Expected volatility	33%	33%	33%	33%
Expected life (in years)	3.0	6.2	3.3	5.8
Dividend yield	0	0	0	0
Weighted-average estimated fair value of options granted during the period	$ 436.11	$ 209.97	$ 408.28	$ 210.28

The following table summarizes the activities for our options for the six months ended June 30, 2011:

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions) [(1)]
	(unaudited)			
Balance at December 31, 2010	11,525,422	$ 330.24		
Granted	589,448	$ 582.51		
Exercised	(1,019,763)	$ 285.13		
Forfeited/canceled	(133,564)	$ 383.23		
Balance at June 30, 2011	10,961,543	$ 347.36	6.2	$ 1,812
Vested and exercisable as of June 30, 2011	6,023,457	$ 290.22	5.5	$ 1,306
Vested and exercisable as of June 30, 2011 and expected to vest thereafter [(2)]	10,447,805	$ 343.93	6.2	$ 1,759

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $506.38 of our Class A common stock on June 30, 2011.

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

The following table summarizes additional information regarding outstanding, exercisable, and vested and exercisable stock options and warrants at June 30, 2011:

Options Outstanding				Options Exercisable		Options Vested and Exercisable	
Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Life (in years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
			(unaudited)				
$0.30 $94.80	406,917	3.0	$ 27.93	403,387	$ 27.46	374,014	$ 23.96
$117.84 $198.41	546,258	3.1	$ 177.38	546,258	$ 177.38	546,258	$ 177.38
$205.96 $298.86	590,340	3.8	$ 274.55	584,194	$ 274.41	584,194	$ 274.41
$300.97 $399.00	6,265,028	5.7	$ 309.65	3,962,714	$ 309.71	3,962,714	$ 309.71
$401.78 $499.07	1,011,482	7.4	$ 439.19	452,333	$ 437.06	452,333	$ 437.06
$500.03 $594.97	1,911,044	9.0	$ 529.46	101,546	$ 545.95	101,546	$ 545.95
$605.49 $699.35	230,394	9.5	$ 612.34	2,328	$ 630.29	2,328	$ 630.29
$710.84	80	6.5	$ 710.84	70	$ 710.84	70	$ 710.84
$0.30 $710.84	10,961,543	6.2	$ 347.36	6,052,830	$ 289.16	6,023,457	$ 290.22

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The above tables include approximately 0.9 million warrants held by selected financial institutions that were options purchased from employees under our Transferable Stock Option (TSO) program, with a weighted-average exercise price of $318.54 and a weighted-average remaining life of 0.9 years.

The total grant date fair value of stock options vested during the three and six months ended June 30, 2010 was $91 million and $206 million. The total grant date fair value of stock options vested during the three and six months ended June 30, 2011 was $123 million and $250 million. The aggregate intrinsic value of all options and warrants exercised during the three and six months ended June 30, 2010 was $86 million and $133 million. The aggregate intrinsic value of all options and warrants exercised during the three and six months ended June 30, 2011 was $68 million and $313 million. These amounts do not include the aggregate sales price of options sold under our TSO program.

During the six months ended June 30, 2011, the number of shares underlying TSOs sold to selected financial institutions under the TSO program was 25,832 at a total value of $4 million, or an average price of $150.51 per share, including an average premium of $18.26 per share. The premium is calculated as the difference between (a) the sale price of the TSO and (b) the intrinsic value of the TSO, which we define as the excess, if any, of the price of our Class A common stock at the time of the sale over the exercise price of the TSO.

As of June 30, 2011, there was $777 million of unrecognized compensation cost related to outstanding employee stock options. This amount is expected to be recognized over a weighted-average period of 2.4 years. To the extent the actual forfeiture rate is different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

The following table summarizes the activities for our unvested restricted stock units (RSUs) and restricted shares for the six months ended June 30, 2011:

	Unvested Restricted Stock Units and Restricted Shares	
	Number of Shares	Weighted-Average Grant-Date Fair Value
	(unaudited)	
Unvested at December 31, 2010	6,671,971	$ 509.04
Granted	4,183,387	$ 522.22
Vested	(874,111)	$ 514.50
Forfeited/canceled	(168,250)	$ 515.27
Unvested at June 30, 2011	9,812,997	$ 514.01
Expected to vest after June 30, 2011 (1)	8,790,483	$ 514.01

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

As of June 30, 2011, there was $4,081 million of unrecognized compensation cost related to employee unvested RSUs and restricted shares. This amount is expected to be recognized over a weighted-average period of 3.2 years. To the extent the actual forfeiture rate is different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

Note 14. Income Taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Our total unrecognized tax benefits as of December 31, 2010 and June 30, 2011 were $1,140 million and $1,397 million. Our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were $951 million and $1,183 million as of December 31, 2010 and June 30, 2011. Our existing tax positions will continue to generate an increase in liabilities for unrecognized tax benefits.

Our effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected to the extent earnings are lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates. Our effective tax rate could also fluctuate due to the net gains and losses recognized by legal entities on certain hedges and related hedged intercompany and other transactions under our foreign

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exchange risk management program, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, or accounting principles, as well as certain discrete items. In addition, we are subject to the continuous examination of our income tax returns by the IRS and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Note 15. Information about Geographic Areas

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Revenues:				
United States	$ 3,288	$ 4,155	$ 6,484	$ 8,160
United Kingdom	770	976	1,612	1,946
Rest of the world	2,762	3,895	5,499	7,496
Total revenues	$ 6,820	$ 9,026	$ 13,595	$ 17,602

	As of December 31, 2010	As of June 30, 2011 (unaudited)
Long-lived assets:		
United States	$ 14,000	$ 15,221
International	2,289	3,198
Total long-lived assets	$ 16,289	$ 18,419

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

The following discussion and analysis of our financial condition and results of operations should be read together with our consolidated financial statements and related notes included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Overview

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

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

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

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

How We Generate Revenue

Advertising revenues made up 96% for the three and six months ended June 30, 2010 and 97% of our revenues for the three and six months ended June 30, 2011. We derive most of our additional revenues from offering display advertising management services to advertisers, ad agencies, and publishers, as well as licensing our enterprise products, search solutions, and web search technology.

Google AdWords is our auction-based advertising program that enables advertisers to place text-based and display ads on our websites and our Google Network Members websites. Display advertising comprises the videos, text, images, and other interactive ads that run across the web on computers and mobile devices, including smart phones and handheld computers such as netbooks and tablets. Most of our AdWords customers pay us on a cost-per-click basis, which means that an advertiser pays us only when a user clicks on one of its ads. We also offer AdWords on a cost-per-impression basis that enables advertisers to pay us based on the number of times their ads appear on our websites and our Google Network Members websites as specified by the advertiser. For advertisers using our AdWords cost-per-click pricing, we recognize as revenue the fees charged to advertisers each time a user clicks on one of the ads that appears next to the search results or content on our websites or our Google Network Members websites. For advertisers using our AdWords cost-per-impression pricing, we recognize as revenue the fees charged to advertisers each time their ads are displayed on our websites or our Google Network Members websites. Our AdWords agreements are generally terminable at any time by our advertisers.

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

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

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

For our online AdSense program, our advertisers pay us a fee each time a user clicks on one of our advertisers ads displayed on our Google Network Members websites or, for those advertisers who choose our cost-per-impression pricing, as their ads are displayed. To date, we have paid most of these advertiser fees to our Google Network Members, and we expect to continue doing so for the foreseeable future. We recognize these advertiser fees as revenue and the portion of the advertiser fee we pay to our Google Network Members as traffic acquisition costs under cost of revenues. Google Network Members do not pay any fees associated with the use of our AdSense program on their websites.

Our agreements with Google Network Members consist largely of uniform online click-wrap agreements that members enter into by interacting with our registration websites. The standard agreements have no stated term and are terminable at will. Agreements with our larger members are individually negotiated. Both the standard agreements and the negotiated agreements require us to share with the Google Network Member most of the advertiser fees generated by users clicking on ads on the Google Network Member s website or, for advertisers who choose our cost-per-impression pricing, as the ads are displayed on the Google Network Member s website. For example, under our standard agreements, we pay 51% and 68% of the fees collected from advertisers to our Google Network Members in AdSense for search and AdSense for content, respectively.

Google ads for televisions enable advertisers, operators, and programmers to buy, schedule, deliver, and measure ads on television. We recognize as revenue the fees charged to advertisers each time an ad is displayed on television in accordance with the related agreements.

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

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

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

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

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

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

- The number and prominence of ads displayed on our websites and our Google Network Members websites.

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

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- The advertisers return on investment from advertising campaigns on our websites or our Google Network Members websites compared to other forms of advertising.

- The total advertising spending budgets of each advertiser.

- The number of advertisers and the breadth of items advertised.

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

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

Trends in Our Business

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, challenges in maintaining our growth rate as our revenues increase to higher levels, and increasing maturity of the online advertising market and other markets in which we participate. In addition, we plan to continue to invest aggressively in our core areas of strategic focus.

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

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

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

We also continue to invest aggressively in our systems, data centers, corporate facilities, information technology infrastructure, and employees. We expect to increase our hiring in 2011 and provide competitive compensation programs for our employees. For instance, effective January 1, 2011, we increased base salaries for all of our non-executive employees by 10% and shifted a portion of the bonus into base salary. Our full-time employee headcount was 21,805 at June 30, 2010 and 28,768 at June 30, 2011. Acquisitions will also remain an important component of our strategy and use of capital, and we expect our current pace of acquisitions to continue. We expect our cost of revenues will increase in dollars and may increase as a percentage of revenues in future periods, primarily as a result of forecasted increases in traffic acquisition costs, data center costs, credit card and other transaction fees, content acquisition costs, and other costs. In particular, traffic acquisition costs as a percentage of advertising revenues may increase in the future if we are unable to continue to improve the monetization or generation of revenues from traffic on our websites and our Google Network Members websites.

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.

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Results of Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Consolidated Statements of Income Data:				
Revenues	100.0%	100.0%	100.0%	100.0%
Costs and expenses:				
Cost of revenues	36.2	35.1	36.2	34.7
Research and development	13.2	13.7	12.6	14.0
Sales and marketing	9.2	12.1	9.1	12.0
General and administrative	6.7	7.2	6.4	7.1
Charge related to potential resolution of Department of Justice investigation	0	0	0	2.8
Total costs and expenses	65.3	68.1	64.3	70.6
Income from operations	34.7	31.9	35.7	29.4
Interest and other income, net	1.0	2.3	0.6	1.7
Income before income taxes	35.7	34.2	36.3	31.1
Provision for income taxes	8.7	6.4	8.4	6.6
Net income	27.0%	27.8%	27.9%	24.5%

Revenues

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Advertising revenues:				
Google websites	$ 4,499	$ 6,232	$ 8,938	$ 12,111
Google Network Members websites	2,063	2,484	4,099	4,911
Total advertising revenues	6,562	8,716	13,037	17,022
Other revenues	258	310	558	580
Revenues	$ 6,820	$ 9,026	$ 13,595	$ 17,602

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Advertising revenues:				
Google websites	66%	69%	66%	69%
Google Network Members websites	30	28	30	28
Total advertising revenues	96	97	96	97
Google websites as % of advertising revenues	69	72	69	71
Google Network Members websites as % of advertising revenues	31	28	31	29
Other revenues	4%	3%	4%	3%

The increase in our revenues from the three and six months ended June 30, 2010 to the three and six months ended June 30, 2011 resulted primarily from an increase in advertising revenues generated by Google websites and Google Network Members websites. The increase in advertising revenue for Google websites and Google Network Members websites from the three and six months ended June 30, 2010 to the three and six months ended June 30, 2011 resulted primarily from an increase in the number of paid clicks through our advertising programs and, to a lesser extent, an increase in the average cost-per-click paid by our advertisers. The increase in the number of paid clicks generated through our advertising programs was due to an increase in aggregate traffic, certain monetization improvements including new ad formats, and the continued global expansion of our products, and our advertiser and user base, as well as an increase in the number of Google Network Members. The increase in the average cost-per-click paid by our advertisers was primarily driven by the increased spending from advertisers and a general weakening of the U.S dollar compared to foreign currencies (primarily the Euro and the British pound). In addition, the increase in advertising revenue for Google Network Members websites from the three and six months ended June 30, 2010 to the three and six months ended June 30, 2011 was partially offset by the loss of a search partnership, and to a lesser extent by a search quality improvement made during the first half of 2011.

Improvements in our ability to ultimately monetize increased traffic primarily relate to enhancing the end user experience, including providing end users with ads that are more relevant to their search queries or to the content on the Google Network Members websites they visit. For instance, these improvements include moving a portion of the first line of the ad to the heading to better promote the content of the ad, providing an option to preview the ad, and moving the ad s URL (uniform resource locator) to a separate line below the heading for greater page format consistency.

Aggregate paid clicks on Google websites and Google Network Members websites increased approximately 18% from the three and six months ended June 30, 2010 to the three and six months ended June 30, 2011. Average cost-per-click on Google websites and Google Network Members websites increased approximately 12% from the three months ended June 30, 2010 to the three months ended June 30, 2011 and 10% from the six months ended June 30, 2010 to the six months ended June 30, 2011. The rate of change in aggregate paid clicks and average cost-per-click, and their correlation with the rate of change in revenues, has fluctuated and may fluctuate in the future because of various factors, including the revenue growth rates on our websites compared to those of our Google Network Members, advertiser competition for keywords, changes in foreign currency exchange rates, seasonality, the fees advertisers are willing to pay based on how they manage their advertising costs, and general economic conditions. In addition, traffic growth in emerging markets compared to more mature markets and across various advertising verticals also contributes to these fluctuations. Changes in aggregate paid clicks and average cost-per-click may not be indicative of our performance or advertiser experiences in any specific geographic market, vertical, or industry.

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

Revenues by Geography

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
United States	48%	46%	48%	46%
United Kingdom	11%	11%	12%	11%
Rest of the world	41%	43%	40%	43%

The growth in international revenues (other than the United Kingdom) as a percentage of consolidated revenues from the three and six months ended June 30, 2010 to the three and six months ended June 30, 2011 resulted largely from increased acceptance of our advertising programs and our continued progress in developing localized versions of our products for these international markets and, to a lesser extent, a general weakening of the U.S dollar compared to foreign currencies (primarily the Euro and the Japanese yen).

The general weakening of the U.S. dollar relative to certain foreign currencies (primarily the Euro, British pound, and Japanese yen) from the three months ended June 30, 2010 to the three months ended June 30, 2011 had a favorable impact on our international revenues. Had foreign exchange rates remained constant in these periods, our revenues from the United Kingdom would have been $81 million, or 8%, lower and our revenues from the rest of the world would have been approximately $336 million, or 9%, lower in the three months ended June 30, 2011. This is before consideration of hedging gains of $19 million and $60 million recognized to revenues from the United Kingdom and the rest of the world in the three months ended June 30, 2010 and hedging gains of $4 million recognized to revenues from the rest of the world in the three months ended June 30, 2011.

The general weakening of the U.S. dollar relative to certain foreign currencies (primarily the Euro, British pound, and Japanese yen) from the six months ended June 30, 2010 to the six months ended June 30, 2011 had a favorable impact on our international revenues. Had foreign exchange rates remained constant in these periods, our revenues from the United Kingdom would have been $102 million, or 5%, lower and our revenues from the rest of the world would have been approximately $342 million, or 5%, lower and in the six months ended June 30, 2011. This is before consideration of hedging gains of $29 million and $60 million recognized to revenues from the United Kingdom and the rest of the world in the six months ended June 30, 2010 and hedging gains of $4 million and $14 million recognized to revenues from the United Kingdom and the rest of the world in the six months ended June 30, 2011.

The aforementioned foreign exchange impact on international revenues is calculated by translating current quarter revenues using prior quarter and prior year exchange rates, as well as excluding any hedging gains realized in the current periods. We consider this information useful as it facilitates a comparison to our historical revenue performance on a constant currency basis.

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 2011 or thereafter. See Note 15 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information about geographic areas.

Costs and Expenses

Cost of Revenues

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

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Certain distribution arrangements require us to pay our distribution partners based on a fee per access point delivered and not exclusively or at all based on revenue share. The fees are non-refundable. Further, these distribution 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 distribution arrangements over the estimated useful lives of the access points (approximately two years) to the extent we can reasonably estimate those lives and they are longer than one year, or based on any contractual revenue share, if greater. Otherwise, we expense the fees as incurred. The estimated useful life of the access points is based on the historical average period of time they generate traffic and revenues.

Cost of revenues also includes the expenses associated with the operation of our data centers, including depreciation, labor, energy and bandwidth costs, content acquisition costs, amortization of acquired intangible assets, and credit card and other transaction fees related to processing customer transactions. We have entered into arrangements with certain content providers under which we distribute or license their video and other content. In a number of these arrangements we display ads on the pages of our websites and our Google Network Members websites from which the content is viewed and share most of the fees these ads generate with the content providers and the Google Network Members.

The following table presents our cost of revenues and cost of revenues as a percentage of revenues, and our traffic acquisition costs and traffic acquisition costs as a percentage of advertising revenues, for the periods presented (dollars in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Cost of revenues	$ 2,467	$ 3,172	$ 4,919	$ 6,107
Cost of revenues as a percentage of revenues	36.2%	35.1%	36.2%	34.7%
Traffic acquisition costs related to AdSense arrangements	$ 1,463	$ 1,755	$ 2,906	$ 3,455
Traffic acquisition costs related to distribution arrangements	269	355	537	693
Traffic acquisition costs	$ 1,732	$ 2,110	$ 3,443	$ 4,148
Traffic acquisition costs as a percentage of advertising revenues	26.4%	24.2%	26.4%	24.4%

Cost of revenues increased $705 million from the three months ended June 30, 2010 to the three months ended June 30, 2011. The increase was primarily related to an increase in traffic acquisition costs of $292 million resulting from more advertiser fees generated through our AdSense program. The increase was also related to an increase in traffic acquisition costs of $86 million from our distribution arrangements as a result of more traffic directed to our websites, as well as more distribution fees paid. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to an increase in the proportion of advertising revenues from our websites compared to our Google Network Members websites, and more revenues realized from Google Network Members to whom we pay less revenue share. In addition, there was an increase in data center costs of $204 million primarily resulting from the depreciation of additional information technology assets and data center buildings and an increase in labor, energy, and bandwidth costs, and an increase in content acquisition costs of $59 million primarily related to content displayed on YouTube.

Cost of revenues increased $1,188 million from the six months ended June 30, 2010 to the six months ended June 30, 2011. The increase was primarily related to an increase in traffic acquisition costs of $549 million resulting from more advertiser fees generated through our AdSense program. The increase was also related to an increase in traffic acquisition costs of $156 million from our distribution arrangements as a result of more traffic directed to our websites, as well as more distribution fees paid. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to an increase in the proportion of advertising revenues from our websites compared to our Google Network Members websites, more revenues realized from Google Network Members to whom we pay less revenue share, and, to a lesser extent, expiration of an AdSense arrangement under which we paid guaranteed minimum revenue share. In addition, there was an increase in data center costs of $283 million primarily resulting from the depreciation of additional information technology assets and data center buildings and an increase in labor, energy, and bandwidth costs, and an increase in content acquisition costs of $123 million primarily related to content displayed on YouTube, partially offset by a decrease in mobile phone costs.

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We expect cost of revenues will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2011 and in future periods, primarily as a result of forecasted increases in traffic acquisition costs, data center costs, credit card and other transaction fees, content acquisition costs, and other costs. Traffic acquisition costs as a percentage of advertising revenues may fluctuate in the future based on a number of factors, including the following:

- The relative growth rates of revenues from our websites and from our Google Network Members websites.

- Whether we are able to enter into more AdSense arrangements that provide for lower revenue share obligations or whether increased competition for arrangements with existing and potential Google Network Members results in less favorable revenue share arrangements.

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

- The relative growth rates of expenses associated with distribution arrangements and the related revenues generated, including whether we share with certain existing and new distribution partners proportionately more of the aggregate advertising fees that we earn from paid clicks derived from search queries these partners direct to our websites.

Research and Development

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	**2011**	**2010**	**2011**
	(unaudited)			
Research and development expenses	$ 898	$ 1,234	$ 1,716	$ 2,456
Research and development expenses as a percentage of revenues	13.2%	13.7%	12.6%	14.0%

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

Research and development expenses increased $336 million from the three months ended June 30, 2010 to the three months ended June 30, 2011. This increase was primarily due to an increase in labor and facilities related costs of $209 million primarily as a result of a 30% increase in research and development headcount, including headcount from acquisitions, as well as a 10% increase in base salaries of non-executive employees effective January 1, 2011. In addition, there was an increase in stock-based compensation expense of $45 million.

Research and development expenses increased $740 million from the six months ended June 30, 2010 to the six months ended June 30, 2011. This increase was primarily due to an increase in labor and facilities related costs of $499 million primarily as a result of a 30% increase in research and development headcount, including headcount from acquisitions, as well as a 10% increase in base salaries of non-executive employees effective January 1, 2011. In addition, there was an increase in stock-based compensation expense of $91 million.

We expect that research and development expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2011 and future periods because we expect to continue to invest in building the necessary employee and systems infrastructures required to support the development of new, and improve existing, products and services.

Sales and Marketing

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Sales and marketing expenses	$ 629	$ 1,091	$ 1,236	$ 2,117
Sales and marketing expenses as a percentage of revenues	9.2%	12.1%	9.1%	12.0%

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

Sales and marketing expenses increased $462 million from the three months ended June 30, 2010 to the three months ended June 30, 2011. This increase was primarily due to an increase in labor and facilities related costs of $201 million primarily due to a 30% increase in sales and marketing headcount, as well as a 10% increase in base salaries of non-executive employees effective January 1, 2011. In addition, there was an increase in advertising and promotional expenses of $185 million.

Sales and marketing expenses increased $881 million from the six months ended June 30, 2010 to the six months ended June 30, 2011. The increase was primarily related to an increase in labor and facilities related costs of $380 million primarily due to a 30% increase in sales and marketing headcount, as well as a 10% increase in base salaries of non-executive employees effective January 1, 2011. In addition, there was an increase in advertising and promotional expenses of $368 million.

We expect that sales and marketing expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2011 and future periods, as we expand our business globally, increase advertising and promotional expenditures in connection with new and existing products, and increase the level of service we provide to our advertisers, Google Network Members, and other partners.

General and Administrative

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
General and administrative expenses	$ 461	$ 648	$ 871	$ 1,244
General and administrative expenses as a percentage of revenues	6.7%	7.2%	6.4%	7.1%

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 increased $187 million from the three months ended June 30, 2010 to the three months ended June 30, 2011. This increase was primarily due to an increase in labor and facilities related costs of $119 million primarily as a result of a 33% increase in general and administrative headcount and a 10% increase in base salaries of non-executive employees effective January 1, 2011, as well as an increase in professional services of $17 million, the majority of which related to legal costs and consulting services. In addition, there was an increase in stock-based compensation expense of $20 million.

General and administrative expenses increased $373 million from the six months ended June 30, 2010 to the six months ended June 30, 2011. This increase was primarily due to an increase in labor and facilities related costs of $191 million primarily as a result of a 33% increase in general and administrative headcount and a 10% increase in base salaries of non-executive employees effective January 1, 2011, as well as an increase in professional services of $74 million, the majority of which related to legal costs and consulting services. In addition, there was an increase in stock-based compensation expense of $47 million.

As we expand our business and incur additional expenses, we expect general and administrative expenses will increase in dollar amount and may increase as a percentage of revenues in the remainder of 2011 and future periods.

Charge Related to Potential Resolution of Department of Justice Investigation

In May 2011, in connection with a potential resolution of an investigation by the United States Department of Justice into the use of Google advertising by certain advertisers, we accrued $500 million for the three month period ended March 31, 2011. Although we cannot predict the final outcome of this matter, we believe that any liability in excess of the amount accrued will not have a material adverse effect on our business, consolidated financial position, results of operations, or cash flows.

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Stock-Based Compensation

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Stock-based compensation	$ 309	$ 435	$ 600	$ 866
Stock-based compensation as a percentage of revenues	4.5%	4.8%	4.4%	4.9%

Stock-based compensation increased $126 million and $266 million from the three and six months ended June 30, 2010 to the three and six months ended June 30, 2011. These increases were primarily due to additional stock awards issued to existing and new employees.

We estimate stock-based compensation to be approximately $1.9 billion in 2011 and $3.8 billion thereafter. This estimate does not include expenses to be recognized related to employee stock awards that are granted after June 30, 2011 or non-employee stock awards that have been or may be granted. In addition, to the extent forfeiture rates are different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

Interest and Other Income, Net

Interest and other income, net increased $135 million from the three months ended June 30, 2010 to the three months ended June 30, 2011. This increase was primarily driven by an increase in interest income of $76 million due to an increase in our cash and investment balances and higher yields, a decrease in net foreign exchange related costs of $34 million, and an increase in realized gains on sale of marketable securities of $32 million.

Interest and other income, net increased $213 million from the six months ended June 30, 2010 to the six months ended June 30, 2011. This increase was primarily driven by an increase in interest income of $170 million due to an increase in our cash and investment balances and higher yields, an increase in realized gains on sale of marketable securities of $34 million and a decrease in net foreign exchange related costs of $11 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, and the movement of the foreign exchange rates relative to the strike prices of the contracts, as well as the volatility of the foreign exchange rates.

As we expand our international business, we believe costs related to hedging activities under our foreign exchange risk management program may increase in dollar amount in the remainder of 2011 and future periods.

Provision for Income Taxes

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2011	2010	2011
	(unaudited)			
Provision for income taxes	$ 594	$ 580	$ 1,145	$ 1,174
Effective tax rate	24.4%	18.8%	23.2%	21.4%

Our provision for income taxes decreased from the three months ended June 30, 2010 to the three months ended June 30, 2011, primarily as a result of proportionately more earnings expected to be realized in countries where we have lower statutory tax rates, partially offset by an increase in federal income taxes, driven by higher taxable income year over year. Our effective tax rate decreased from the three months ended June 30, 2010 to the three months ended June 30, 2011, primarily as a result of proportionately more earnings expected to be realized in countries where we have lower statutory tax rates. The decrease is also attributable to a decrease in state income taxes and higher research and development credit recognized in the three months ended June 30, 2011.

Our provision for income taxes increased from the six months ended June 30, 2010 to the six months ended June 30, 2011, primarily as a result of an increase in federal income taxes, driven by higher taxable income year over year, partially offset by proportionately more earnings expected to be realized in countries where we have lower statutory tax rates. Our effective tax rate decreased from the six months ended June 30, 2010 to the six months ended June 30, 2011, primarily as a result of proportionately more earnings expected to be realized in countries where we have lower statutory tax rates and a decrease in state income taxes and higher research and development credit recognized in the six months ended June 30, 2011, partially offset by a recognition of charge related to a potential resolution of an investigation by the Department of Justice which is not deductible for tax purposes.

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

Liquidity and Capital Resources

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

	Six Months Ended June 30,	
	2010	**2011**
	(unaudited)	
Net cash provided by operating activities	$ 4,669	$ 6,691
Net cash used in investing activities	(3,285)	(11,035)
Net cash provided by (used in) financing activities	(769)	847

At June 30, 2011, we had $39.1 billion of cash, cash equivalents, and marketable securities. Cash equivalents and marketable securities are comprised of highly liquid debt instruments of the U.S. government and its agencies, municipalities in the U.S., debt instruments issued by foreign governments, time deposits, money market and other funds, including cash collateral received related to our securities lending program, mortgage-backed securities, and corporate securities.

As of June 30, 2011, $18.8 billion of the $39.1 billion of cash, cash equivalents, and marketable securities was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Our principal sources of liquidity are our cash, cash equivalents, and marketable securities, as well as the cash flow that we generate from our operations. At December 31, 2010 and June 30, 2011, we had unused letters of credit for approximately $65 million and $48 million. We believe that our sources of funding will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months. Our liquidity could be negatively affected by a decrease in demand for our products and services. In addition, we may make acquisitions or license products and technologies complementary to our business and may need to raise additional capital through future debt or equity financing to provide for greater flexibility to fund any such acquisitions and licensing activities. Additional financing may not be available at all or on terms favorable to us.

We have established a debt financing program of up to $3.0 billion through the issuance of commercial paper. Net proceeds from the commercial paper program are used for general corporate purposes. As of June 30, 2011, we had $749 million of commercial paper outstanding recorded as short-term debt, with a weighted-average interest rate of 0.4% that matures at various dates through November 2011. Average commercial paper borrowings during the quarter were $1.8 billion, and the maximum amount of commercial paper borrowings outstanding during the quarter was $2.7 billion. In conjunction with this program, we established a $3.0 billion revolving credit facility expiring on June 30, 2013. The interest rate for the credit facility is determined based on a formula using certain market rates. As of June 30, 2011, we were in compliance with the financial covenant in the credit facility. No amounts were outstanding under the credit facility as of June 30, 2011.

Additionally, as of June 30, 2011, we had $468 million outstanding under a secured promissory note with an interest rate of 1.0% that matures in December 2011. Proceeds of this note were used for the acquisition of an office building in New York City.

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

Cash provided by operating activities in the six months ended June 30, 2011 was $6,691 million and consisted of net income of $4,304 million, adjustments for non-cash items of $2,208 million, and cash provided by working capital and other activities of $179 million. Adjustments for non-cash items primarily consisted of $866 million of stock-based compensation expense, $648 million of depreciation and amortization expense on property and equipment, $464 million of deferred income taxes, and $208 million of amortization of intangible and other assets. In addition, the increase in cash from changes in working capital activities primarily consisted of an increase in accrued expenses and other liabilities of $297 million primarily due to a charge recorded related to a potential resolution of an investigation by the Department of Justice, an increase in accounts payable of $77 million primarily a result of the growth of our business, and an increase in deferred revenue of $69 million. These increases were partially offset by an increase in prepaid revenue share, expenses and other assets of $148 million and a net decrease in income taxes payable and deferred income taxes of $98 million. The decrease in income taxes payable and deferred income taxes reflected primarily increased estimated income taxes paid during the second quarter of 2011 with respect to the year ending December 31 2011, partially offset by additional tax obligations accrued.

Cash provided by operating activities in the six months ended June 30, 2010 was $4,669 million and consisted of net income of $3,795 million, adjustments for non-cash items of $1,240 million and cash used in working capital and other activities of $366 million. Adjustments for non-cash items primarily consisted of $600 million of stock-based compensation expense, $530 million of depreciation and amortization expense on property and equipment, and $143 million of amortization of intangible and other assets, partially offset by $31 million of excess tax benefits from stock-based award activities. In addition, the decrease in cash from changes in working capital activities primarily consisted of an increase of $197 million in accounts receivable due to the growth in fees billed to our advertisers, an increase of $191 million in prepaid revenue share, expenses and other assets, a net decrease of $164 million of income taxes payable and deferred income taxes (which includes the same $31 million of excess tax benefits from stock-based awards included under adjustments for non-cash items), partially offset by an increase in accounts payable of $199 million. The decrease in income taxes payable and deferred income taxes reflected primarily increased estimated income taxes paid during the second quarter of 2010 with respect to the year ended December 31 2010, partially offset by additional tax obligations accrued. The increase in accounts payable was primarily a result of the growth of our business.

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

Cash used in investing activities in the six months ended June 30, 2011 of $11,035 million was primarily attributable to net purchases of marketable securities of $7,328 million, capital expenditures of $1,807 million related principally to our facilities, data centers and related equipment, and cash consideration used in acquisitions and other investments of $1,206 million, including $676 million paid in connection with the acquisition of ITA. Also, in connection with our securities lending program, we returned $424 million of cash collateral and invested $270 million in certain reverse repurchase agreements.

Cash used in investing activities in the six months ended June 30, 2010 of $3,285 million was primarily attributable to net purchases of marketable securities of $4,791 million, capital expenditures of $715 million, and cash consideration used in acquisitions and other investments of $649 million. This was partially offset by $2,870 million of cash collateral that we received in connection with our securities lending program.

In order to manage expected increases in internet traffic, advertising transactions, and new products and services, and to support our overall global business expansion, we expect to make significant investments in our systems, data centers, corporate facilities, information technology infrastructure, and employees in 2011 and thereafter. However, the amount of our capital expenditures has fluctuated and may continue to fluctuate on a quarterly basis.

In addition, we expect to spend a significant amount of cash on acquisitions and other investments from time to time. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other functional areas, our technologies, and our product offerings.

Cash provided by financing activities in the six months ended June 30, 2011 of $847 million was primarily driven by net proceeds of $726 million of debt issued and stock-based award activities of $88 million.

Cash used in financing activities in the six months ended June 30, 2010 of $769 million was primarily related to $801 million in stock repurchases pursuant to Rule 10b5-1 trading plans in connection with our acquisitions of AdMob, Inc. and On2 Technologies, Inc., partially offset by excess tax benefits of $31 million from stock-based award activities during the period which represented a portion of the $115 million reduction to income taxes payable that we recorded in the first half of 2010 related to the total direct tax benefit realized from the exercise, sale, or vesting of these awards.

Contractual Obligations

We recorded long-term taxes payable of $270 million in the six months ended June 30, 2011 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.

Our effective tax rates have differed from the statutory rate primarily due to the tax impact of foreign operations, state taxes, certain benefits realized related to stock option activities, and research and experimentation tax credits. The effective tax rates were 24.4% and 18.8% for the three months ended June 30, 2010 and 2011 and 23.2% and 21.4% for the six months ended June 30, 2010 and 2011. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, the net gains and losses recognized by legal entities on certain hedges and related hedged intercompany and other transactions under our foreign exchange risk management program, changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws, regulations, or accounting principles, as well as certain discrete items. In addition, we are subject to the continuous examination of our income tax returns by the IRS and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Loss Contingencies

We are regularly involved in claims, suits, government investigations, and proceedings arising from the ordinary course of our business. We record a provision for a liability when we believe that it is both probable that a liability 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 probability and the estimated amount. Such legal proceedings are inherently unpredictable and subject to significant uncertainties, some of which are beyond our control. Should any of these estimates and assumptions change or prove to have been incorrect, it could have a material impact on our business, consolidated financial position, results of operations, or cash flows. See Note 12 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this

Quarterly Report on Form 10-Q for additional information regarding legal contingencies.

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Stock-Based Compensation

Our stock-based compensation expense is estimated at the grant date based on the award s fair value as calculated by the Black-Scholes-Merton (BSM) option pricing model and is recognized as expense over the requisite service period. The BSM model requires various highly judgmental assumptions including expected volatility and expected term. If any of the assumptions used in the BSM model changes significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. We estimate the forfeiture rate based on historical experience and our expectations regarding future pre-vesting termination behavior of employees. To the extent our actual forfeiture rate is different from our estimate, stock-based compensation expense is adjusted accordingly.

Impairment of Marketable and Non-Marketable Securities

We periodically review our marketable securities and our non-marketable equity securities for impairment. If we conclude that any of these investments are impaired, we determine whether such impairment is other-than-temporary. Factors we consider to make such determination include the duration and severity of the impairment, the reason for the decline in value, the potential recovery period, and our intent to sell, or whether it is more likely than not that we will be required to sell, the investment before recovery. If any impairment is considered other-than-temporary, we will write down the asset to its fair value and take a corresponding charge to our Consolidated Statements of Income.

Recent Accounting Pronouncements

In May 2011, the FASB issued a new accounting standard update, which amends the fair value measurement guidance and includes some enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard is effective for fiscal years beginning after December 15, 2011. We will adopt this standard in the first quarter of 2012 and are currently evaluating its impact on our financial statements and disclosures.

In June 2011, the FASB issued a new accounting standard, which eliminates the current option to report other comprehensive income and its components in the statement of stockholders equity. Instead, an entity will be required to present items of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements. The standard is effective for fiscal years beginning after December 15, 2011. We will adopt this standard in the first quarter of 2012.

Available Information

Our website is located at www.google.com, and our investor relations website is located at http://investor.google.com. The following filings are available through our investor relations website after we file them with the SEC: Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and our Proxy Statements for our annual meetings of stockholders, for the last three years. These filings are also available for download free of charge on our investor relations website. We also provide a link to the section of the SEC s website at www.sec.gov that has all of our public filings, including Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports, our Proxy Statements, and other ownership related filings. Further, a copy of this Quarterly Report on Form 10-Q is located at the SEC s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

We webcast our earnings calls and certain events we participate in or host with members of the investment community on our investor relations website. Additionally, we provide notifications of news or announcements regarding our financial performance, including SEC filings, investor events, press and earnings releases, and blogs as part of our investor relations website. Investors and others can receive notifications of new information posted on our investor relations website in real time by signing up for email alerts and RSS feeds. Further corporate governance information, including our certificate of incorporation, bylaws, governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website under the heading Corporate Governance. The contents of our websites are not intended to be incorporated by reference into this Quarterly Report on Form 10-Q or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Foreign Currency Exchange Risk

Economic Exposure

We transact business in various foreign currencies and have significant international revenues, as well as costs denominated in foreign currencies. This exposes us to the risk of fluctuations in foreign currency exchange rates. We purchase foreign exchange option contracts to reduce the volatility of cash flows related to forecasted revenues denominated in certain foreign currencies. The objective of the foreign exchange contracts is to better ensure that the U.S. dollar-equivalent cash flows are not adversely affected by changes in the U.S. dollar/foreign currency exchange rates. These contracts are designated as cash flow hedges. The gain on the effective portion of a cash flow hedge is initially reported as a component of AOCI and subsequently reclassified into revenues when the hedged revenues are recorded or as interest and other income, net, if the hedged transaction becomes probable of not occurring. Any gain after a hedge is de-designated or related to an ineffective portion of a hedge is recognized as interest and other income, net, immediately.

At December 31, 2010, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 3.0 billion (or approximately $4.1 billion) and $227 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £1.5 billion (or approximately $2.3 billion) and $97 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$407 million (or approximately $382 million) and $6 million. At June 30, 2011, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Euros were 2.9 billion (or approximately $3.9 billion) and $100 million; the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with British pounds were £1.3 billion (or approximately $2.0 billion) and $52 million; and the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were C$324 million (or approximately $315 million) and $5 million. These foreign exchange options have maturities of 36 months or less. There are no other foreign exchange contracts designated as cash flow hedges. However, we may enter into similar contracts in other foreign currencies in the future.

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

If the U.S. dollar weakened by 20%, the amount recorded in AOCI before tax effect would have been approximately $11 million lower at June 30, 2011, and the total amount of expense recorded as interest and other income, net, would have been approximately $123 million higher in the three months ended June 30, 2011. If the U.S. dollar strengthened by 20%, the amount recorded in AOCI before tax effect would have been approximately $1.0 billion higher at June 30, 2011, and the total amount of expense recorded as interest and other income, net, would have been approximately $111 million higher in the three months ended June 30, 2011.

Transaction Exposure

Our exposure to foreign currency transaction gains and losses is the result of certain net receivables due from our foreign subsidiaries and customers being denominated in currencies other than the functional currency of the subsidiary, primarily the Euro and the British pound. Our foreign subsidiaries conduct their businesses in local currency. We have entered into foreign exchange contracts to offset the foreign exchange risk on certain monetary assets and liabilities denominated in currencies other than the local currency of the subsidiary.

The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $1.0 billion and $1.6 billion at December 31, 2010 and June 30, 2011. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $84 million and $522 million at December 31, 2010 and June 30, 2011. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 991 million (or approximately $1.3 billion) and 750 million (or approximately $1.1 billion) at December 31, 2010 and June 30, 2011. The notional principal of foreign exchange contracts to sell Euros for other foreign currencies was 6 million (or approximately $8 million) at December 31, 2010 and no such contracts were outstanding at June 30, 2011.

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 $20 million and $11 million at December 31, 2010 and June 30, 2011. The adverse impact at December 31, 2010 and June 30, 2011 is after consideration of the offsetting effect of approximately $467 million and $473 million from forward exchange contracts in place for the months of December 2010 and June 2011. These reasonably possible adverse changes in exchange rates of 20% were applied to total monetary assets and liabilities denominated in currencies other than the local currencies at the balance sheet dates to compute the adverse impact these changes would have had on our income before income taxes in the near term.

Interest Rate Risk

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

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

We considered the historical volatility of short-term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term. A hypothetical 1.00% (100 basis points) increase in interest rates would have resulted in a decrease in the fair values of our marketable securities of approximately $895 million and $958 million at December 31, 2010 and June 30, 2011, after taking into consideration of the offsetting effect from interest rate futures contracts outstanding as of June 30, 2011.

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 June 30, 2011, 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 June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business and Industry

We face intense competition.

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

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

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

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

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

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

We generated 96% of our revenues in 2010 and 97% of our revenues in the six months ended June 30, 2011 from our advertisers. Our advertisers can generally terminate their contracts with us at any time. Advertisers will not continue to do business with us if their investment in advertising with us does not generate sales leads, and ultimately customers, or if we do not deliver their advertisements in an appropriate and effective manner. If we are unable to remain competitive and provide value to our advertisers, they may stop placing ads with us, which would negatively affect our revenues and business.

In addition, expenditures by advertisers tend to be cyclical, reflecting overall economic conditions and budgeting and buying patterns. Adverse economic conditions could negatively impact spending on advertising, which in turn could negatively impact our revenues and business.

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

Our revenue growth rate could decline over time as a result of a number of factors, including increasing competition, the challenges in maintaining our growth rate as our revenues increase to higher levels, and the increasing maturity of the online advertising market and the other markets in which we participate. We believe our operating margin will experience downward pressure as a result of increasing competition and increased expenditures for many aspects of our business. Our operating margin will also experience downward pressure if a greater percentage of our revenues comes from ads placed on our Google Network Members websites compared to revenues generated through ads placed on our own websites or if we spend a proportionately larger amount to promote the distribution of certain products, including Google Chrome. The margin on revenues we generate from our Google Network Members is significantly less than the margin on revenues we generate from advertising on our websites. Additionally, the margin we earn on revenues generated from our Google Network Members could decrease in the future if we pay an even larger percentage of advertising fees to our Google Network Members.

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

The growth of our company and our expansion into a variety of new fields implicate a variety of new regulatory issues, and we have experienced increased regulatory scrutiny as we have grown. In particular, we are cooperating with the U.S. Federal Trade Commission (FTC) and the European Commission 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 involved in legal proceedings that may result in adverse outcomes.

We are regularly involved in claims, suits, government investigations, and proceedings arising from the ordinary course of our business, including actions with respect to intellectual property claims, competition and antitrust matters (such as the pending investigations by the FTC and the European Commission), privacy matters, tax matters, labor and employment claims, commercial claims, as well as actions involving content generated by our users, and other matters. 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 criminal sanctions, consent decrees, or orders preventing us from offering certain features, functionalities, products, or services, requiring a change in our business practices, or requiring development of non-infringing products or technologies, which could also adversely affect our business and results of operations.

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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 privacy 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 products and services, which we may not do successfully.

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

Acquisitions are an important element of our overall corporate strategy and use of capital, and we expect our current pace of acquisitions to continue. These transactions could be material to our financial condition and results of operations. We also expect to continue to evaluate and enter into discussions regarding a wide array of potential strategic transactions. The process of integrating an acquired company, business, or technology has created, and will continue to create, unforeseen operating difficulties and expenditures. The areas where we face risks include:

- Diversion of management time and focus from operating our business to acquisition integration challenges.

- Implementation or remediation of controls, procedures, and policies at the acquired company.

- Integration of the acquired company s accounting, human resource, and other administrative systems, and coordination of product, engineering, and sales and marketing functions.

- Transition of operations, users, and customers onto our existing platforms.

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

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

- Failure to successfully further develop the acquired technology.

- Cultural challenges associated with integrating employees from the acquired company into our organization, and retention of employees from the businesses we acquire.

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

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

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

Future acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, or amortization expenses, or write-offs of goodwill, any of which could harm our financial condition. Also, the anticipated benefit of many of our acquisitions may not materialize.

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

We are subject to a variety of laws in the U.S. and abroad that are costly to comply with, can result in negative publicity and diversion of management time and effort, and can subject us to claims or other remedies. Many of these laws were adopted prior to the advent of the internet and related technologies and, as a result, do not contemplate or address the unique issues of the internet and related technologies. The laws that do reference the internet are being interpreted by the courts, but their applicability and scope remain uncertain. For example, the laws relating to the liability of providers of online services are currently unsettled both within the U.S. and abroad. Claims have 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, U.S. patent law is likely to be amended in 2012 in a manner that may affect our ability to protect our innovations and, furthermore, defend against claims of patent infringement.

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

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

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

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

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

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

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

We are, and may in the future be, subject to intellectual property or other claims, which are costly to defend, could result in significant damage awards, and could limit our ability to use certain technologies in the future.

Internet, technology, and media companies own large numbers of patents, copyrights, trademarks, and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. In addition, patent holding companies may continue to seek to monetize patents they have purchased or otherwise obtained. As we have grown, the intellectual property rights claims against us have increased and may continue to increase as we develop new products, services, and technologies.

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We have had patent, copyright, and trademark infringement lawsuits filed against us claiming that certain of our products, services, and technologies, including Android, Google WebSearch, Google AdWords, Google AdSense, Google Books, Google News, Google Image Search, Google Chrome, Google Talk, Google Voice, 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, 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. Furthermore, such 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.

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

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

Our patents, trademarks, trade secrets, copyrights, and other intellectual property rights are important assets for us. Various events outside of our control pose a threat to our intellectual property rights, as well as to our products, services and technologies. For example, effective intellectual property protection may not be available in every country in which our products and services are distributed or made available through the internet. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective.

Although we seek to obtain patent protection for our innovations, it is possible we may not be able to protect some of these innovations. Moreover, because of our long-term interests in open source, we may not have adequate patent protection for certain innovations that later turn out to be important. Furthermore, there is always the possibility, despite our efforts, that the scope of the protection gained will be insufficient or that an issued patent may be deemed invalid or unenforceable.

We also seek to maintain certain intellectual property as trade secrets. The secrecy could be compromised by outside parties, or by our employees, which would 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.

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

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

- Our ability to continue to attract users to our websites and satisfy existing users on our websites.

- Our ability to monetize (or generate revenues from) traffic on our websites and our Google Network Members websites.

Our ability to attract advertisers to our AdWords program, 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.

The amount of revenues and expenses generated and incurred in currencies other than U.S. dollars, and our ability to manage the resulting risk through our foreign exchange risk management program.

The amount and timing of operating costs and expenses and capital expenditures related to the maintenance and expansion of our businesses, operations, and infrastructure.

Our focus on long-term goals over short-term results.

The results of our investments in risky projects, including new business strategies and new products, services, and technologies.

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

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

Because our business is changing and evolving, our historical operating results may not be useful to you in predicting our future operating results. In addition, advertising spending has historically been cyclical in nature, reflecting overall economic conditions, as well as budgeting and buying patterns. Also, user traffic tends to be seasonal. Our rapid growth has tended to mask the cyclicality and seasonality of our business. As our growth rate has slowed, the cyclicality and seasonality in our business has become more pronounced and caused our operating results to fluctuate.

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

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

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 have also improved our ability to detect hacked websites, a major source of web spam in 2010. We face new 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. In 2010, we launched two 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.

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

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

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

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

Our international operations expose us to additional risks which 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 52% of our total revenues in 2010 and 54% of our total revenues in the six months ended June 30, 2011, 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. In addition to risks described elsewhere in this section, our international operations expose us to additional 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 that may prevent us from offering products or providing services to a particular market and may increase our operating costs.
- Currency exchange rate fluctuations and our ability to manage these fluctuations through our foreign exchange risk management program.
- Longer payment cycles in some countries, increased credit risk, and higher levels of payment fraud.

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.

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In addition, compliance with complex foreign and U.S. laws and regulations that apply to our international operations increases our cost of doing business. These numerous and sometimes conflicting laws and regulations include internal control and disclosure rules, data privacy and filtering requirements, anti-corruption laws, such as the Foreign Corrupt Practices Act, and other local laws prohibiting corrupt payments to governmental officials, and antitrust and competition regulations, among others. Violations of these laws and regulations could result in fines and penalties, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business and on our ability to offer our products and services in one or more countries, and could also materially affect our brand, our international expansion efforts, our ability to attract and retain employees, our business, and our operating results. Although we have implemented policies and procedures designed to ensure compliance with these laws and regulations, there can be no assurance that our employees, contractors, or agents will not violate our policies.

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

If we were to lose the services of Larry, Sergey, Eric, or other key personnel, we may not be able to execute our business strategy.

Our future success depends in a large part upon the continued service of key members of our senior management team. In particular, Larry Page and Sergey Brin are critical to the overall management of Google and the development of our technology. Along with our Executive Chairman Eric E. Schmidt, they also play a key role in maintaining our culture and setting our strategic direction. All of our executive officers and key employees are at-will employees, and we do not maintain any key-person life insurance policies. The loss of key personnel could seriously harm our business.

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

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

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

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

Our products and services depend on the ability of our users to access the internet, and certain of our products require significant bandwidth to work effectively. Currently, this access is provided by companies that have significant market power in the broadband and internet access marketplace, including incumbent telephone companies, cable companies, mobile communications companies, and government-owned service providers. Some of these providers have taken, or have stated that they may take, measures that could degrade, disrupt, or increase the cost of user access to certain of our products by restricting or prohibiting the use of their infrastructure to support or facilitate our offerings, or by charging increased fees to us or our users to provide our offerings. Such interference could result in a loss of existing users and advertisers, and increased costs, and could impair our ability to attract new users and advertisers, thereby harming our revenues and growth.

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

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

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

Although we have not recognized any significant losses to date on our cash, cash equivalents, and marketable securities, any significant future declines in the market values of our marketable securities could materially adversely affect our financial condition and operating results. 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, 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 where we have lower statutory tax rates and higher than anticipated in jurisdictions where we have higher statutory tax rates, by changes in the valuation of our deferred tax assets and liabilities, as a result of gains on our foreign exchange risk management program, or changes in tax laws, regulations, 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 Common Stock

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

The trading price of our Class A common stock has at times experienced substantial price volatility and may continue to be volatile. For example, in 2010, the price of our Class A common stock ranged from $433.63 per share to $630.85 per share. The trading price of our Class A common stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include:

- Quarterly variations in our results of operations or those of our competitors.
- Announcements by us or our competitors of acquisitions, new products, significant contracts, commercial relationships, or capital commitments.
- Recommendations by securities analysts or changes in earnings estimates.
- Announcements about our earnings that are not in line with analyst expectations, the risk of which is enhanced because it is our policy not to give guidance on earnings.
- Announcements by our competitors of their earnings that are not in line with analyst expectations.
- 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 stock by us or by our stockholders (including sales by our directors, executive officers, and other employees).

Short sales, hedging, and other derivative transactions on shares of our Class A common stock (including derivative transactions under our TSO program).

In addition, the stock market in general, and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may harm the market price of our Class A common 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 June 30, 2011, Larry, Sergey, and Eric beneficially owned approximately 92% of our outstanding Class B common stock, representing approximately 67% 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. This concentrated control limits our stockholders ability to influence corporate matters and, as a result, we may take actions that our stockholders do not view as beneficial. As a result, the market price of our Class A common stock could be adversely affected.

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

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

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

- 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.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
Results of Google s Transferable Stock Option Program

Under our TSO program, which we launched in April 2007, eligible employees are able to sell vested stock options to participating financial institutions in an online auction as an alternative to exercising options using the traditional method and then selling the underlying shares. The following table provides information with respect to sales by our employees of TSOs during the three months ended June 30, 2011:

	Aggregate Amounts			Weighted-Average Per Share Amounts		
Period[1]	Number of Shares Underlying TSOs Sold	Sale Price of TSOs Sold	TSO Premium[2]	Exercise Price of TSOs Sold	Sale Price of TSOs Sold	TSO Premium[2]
	(in thousands)					
April 1-30	2,293	$ $262	$ 53	$ 437.62	$ 114.20	$ 23.09
May 1-31	6,365	$ 696	$ 165	$ 445.97	$ 109.44	$ 25.86
June 1-30	0	$ 0	$ 0	$ 0	$ 0	$ 0
Total (except weighted-average per share amounts)	**8,658**	**$ 958**	**$ 218**	**$ 443.76**	**$ 110.70**	**$ 25.13**

(1) The TSO program is generally active during regular trading hours for the Nasdaq Stock Market when Google s trading window is open. However, we have the right to suspend the TSO program at any time for any reason, including for maintenance and other 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) in our TSO program. There were no sales of TSOs by our executive officers during the three months ended June 30, 2011.

ITEM 6. EXHIBITS

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

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SIGNATURE

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

	GOOGLE INC
Date: July 27, 2011	By: /s/ PATRICK PICHETTE **Patrick Pichette** **Senior Vice President and Chief Financial Officer** **(Principal financial officer and duly authorized signatory)**

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EXHIBIT INDEX

Exhibit Number		Description	Incorporated by reference herein Form	Date
1.01		Amendment Agreement, dated as of July 12, 2011, among Google Inc., Morgan Stanley & Co. LLC, Citigroup Global Markets Inc., Credit Suisse Management LLC, Credit Suisse Securities (USA) LLC, UBS AG, London Branch, and UBS Securities LLC	Current Report on Form 8-K (File No. 000-50726)	July 12, 2011
4.01		Indenture, dated as of May 19, 2011 between Google Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee	Current Report on Form 8-K (File No. 000-50726)	May 19, 2011
4.02		Form of 1.250% Note due 2014	Current Report on Form 8-K (File No. 000-50726)	May 19, 2011
4.03		Form of 2.125% Note due 2016	Current Report on Form 8-K (File No. 000-50726)	May 19, 2011
4.04		Form of 3.625% Note due 2021	Current Report on Form 8-K (File No. 000-50726)	May 19, 2011
4.05	©	Deferred Compensation Plan	Registration Statement on Form S-8 (File No. 333-175180)	June 28, 2011
10.01	©	2004 Stock Plan, as amended	Current Report on Form 8-K (File No. 000-50726)	June 7, 2011
31.01	*	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		
31.02	*	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		
32.01		Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		
101.INS	**	XBRL Instance Document		
101.SCH	**	XBRL Taxonomy Extension Schema Document		
101.CAL	**	XBRL Taxonomy Extension Calculation Linkbase Document		
101.DEF	**	XBRL Taxonomy Extension Definition Linkbase Document		
101.LAB	**			

	XBRL Taxonomy Extension Label Linkbase Document
101.PRE **	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith.

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Furnished herewith.

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

© Indicates management compensatory plan, contract, or arrangement.