Google Inc.
Form 10-Q
August 09, 2006
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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, 2006

OR

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

For the transition period from ______ to ______

Commission file number: 000-50726

Google Inc.

(Exact name of registrant as specified in its charter)

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

1600 Amphitheatre Parkway

Mountain View, CA 94043

(Address of principal executive offices)

(Zip Code)

(650) 253-4000

(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

At July 31, 2006, the number of shares outstanding of Google s Class A common stock was 219,193,569 shares and the number of shares outstanding of Google s Class B common stock was 85,167,040 shares.

GOOGLE INC.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GOOGLE INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value)

	As of December 31, 2005	As of June 30, 2006 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 3,877,174	$ 4,015,922
Marketable securities	4,157,073	5,805,710
Accounts receivable, net of allowance of $14,852 and $13,891	687,976	885,088
Deferred income taxes, net	49,341	55,513
Prepaid revenue share, expenses and other assets	229,507	295,874
Total current assets	9,001,071	11,058,107
Deferred income taxes, net, non-current		34,768
Prepaid revenue share, expenses and other assets, non-current	16,941	19,576
Non-marketable equity securities	14,369	1,018,591
Property and equipment, net	961,749	1,799,766
Intangible assets, net	82,783	146,601
Goodwill	194,900	318,597
Total assets	$ 10,271,813	$ 14,396,006
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 115,575	$ 179,441
Accrued compensation and benefits	198,788	150,526
Accrued expenses and other current liabilities	114,377	183,163
Accrued revenue share	215,771	272,731
Deferred revenue	73,099	83,286
Income taxes payable	27,774	108,283
Total current liabilities	745,384	977,430
Deferred revenue, long-term	10,468	15,904
Deferred income taxes, net	35,419	
Other long-term liabilities	61,585	45,664
Stockholders equity:		
Common stock, $0.001 par value: 9,000,000 shares authorized and 293,027 and 302,588 shares issued and outstanding, excluding 3,303 and 1,522 shares subject to repurchase at December 31, 2005 and June 30, 2006	293	303
Additional paid-in capital	7,477,792	10,014,393
Deferred stock-based compensation	(119,015)	
Accumulated other comprehensive income (loss)	4,019	(26,924)
Retained earnings	2,055,868	3,369,236

Total stockholders equity	9,418,957	13,357,008
Total liabilities and stockholders equity	$ 10,271,813	$ 14,396,006

See accompanying notes.

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GOOGLE INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
	(unaudited)			
Revenues	$ 1,384,495	$ 2,455,991	$ 2,641,011	$ 4,709,746
Costs and expenses:				
Cost of revenues (including stock-based compensation expense of $1,024, $2,322, $2,597 and $4,606)(1)	598,119	989,032	1,144,900	1,893,151
Research and development (including stock-based compensation expense of $27,362, $70,564, $56,661 and $143,650) (1)	123,134	282,552	231,845	529,151
Sales and marketing (including stock-based compensation expense of $7,522, $14,285, $14,058 and $30,214) (1)	104,546	196,397	194,034	387,340
General and administrative (including stock-based compensation expense of $11,430, $21,978, $22,930 and $45,343) (1)	82,998	172,638	151,764	342,033
Total costs and expenses	908,797	1,640,619	1,722,543	3,151,675
Income from operations	475,698	815,372	918,468	1,558,071
Interest income and other, net	19,722	160,805	33,408	228,724
Income before income taxes	495,420	976,177	951,876	1,786,795
Provision for income taxes	152,606	255,100	239,869	473,427
Net income	$ 342,814	$ 721,077	$ 712,007	$ 1,313,368
Net income per share:				
Basic	$ 1.27	$ 2.39	$ 2.65	$ 4.41
Diluted	$ 1.19	$ 2.33	$ 2.48	$ 4.28
Number of shares used in per share calculations:				
Basic	270,729	301,410	268,418	297,653
Diluted	287,238	310,038	286,926	307,080

(1) Stock-based compensation recognized in the three and six months ended June 30, 2005, accounted for under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, has been reclassified to these expense lines to conform with the presentation in the three and six months ended June 30, 2006. As discussed in Note 1 of the accompanying notes, stock-based compensation for the three and six months ended June 30, 2006, is presented in conformity with Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*.

See accompanying notes.

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GOOGLE INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30, 2005	2006
	(unaudited)	
Operating activities		
Net income	$ 712,007	$ 1,313,368
Adjustments:		
Depreciation of property and equipment	103,445	206,079
Amortization of intangibles and warrants	19,677	31,300
In-process research and development		4,000
Stock-based compensation	96,246	223,813
Excess tax benefits from stock-based award activity	196,163	(258,087)
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(104,587)	(193,211)
Income taxes, net	37,270	265,384
Prepaid revenue share, expenses and other assets	(22,942)	(67,974)
Accounts payable	72,779	63,879
Accrued expenses and other liabilities	(829)	14,782
Accrued revenue share	31,064	56,984
Deferred revenue	13,948	5,073
Net cash provided by operating activities	1,154,241	1,665,390
Investing activities		
Purchases of property and equipment	(299,854)	(1,043,938)
Purchases of marketable securities	(1,853,666)	(17,576,067)
Maturities and sales of marketable securities	1,361,895	15,856,478
Investments in non-marketable equity securities	(10,000)	(1,004,222)
Acquisitions, net of cash acquired, and purchases of intangible and other assets	(19,202)	(188,506)
Net cash used in investing activities	(820,827)	(3,956,255)
Financing activities		
Proceeds from exercise of stock options, net	13,072	97,088
Net proceeds from a public stock offering		2,063,777
Excess tax benefits from stock-based award activity		258,087
Payments of principal on capital leases and equipment loans	(1,611)	
Net cash provided by financing activities	11,461	2,418,952
Effect of exchange rate changes on cash and cash equivalents	(18,276)	10,661
Net increase in cash and cash equivalents	326,599	138,748
Cash and cash equivalents at beginning of year	426,873	3,877,174
Cash and cash equivalents at end of period	$ 753,472	$ 4,015,922

Supplemental disclosures of cash flow information				
Cash paid for interest	$	94	$	185
Cash paid for income taxes	$	2,360	$	208,380
Acquisition related activities:				
Issuance of equity in connection with acquisitions, net of deferred stock-based compensation	$	15,237	$	

See accompanying notes.

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Google Inc. and Summary of Accounting Policies

Nature of Operations

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

Basis of Consolidation

The condensed consolidated financial statements include the accounts of Google and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Unaudited Interim Financial Information

The accompanying condensed consolidated balance sheet as of June 30, 2006, the condensed consolidated statements of income for the three and six months ended June 30, 2005 and 2006, and the condensed consolidated statements of cash flows for the six months ended June 30, 2005 and 2006 are unaudited. These unaudited interim condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. In our opinion, the unaudited interim condensed consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of June 30, 2006, our results of operations for the three and six months ended June 30, 2005 and 2006, and our cash flows for the six months ended June 30, 2005 and 2006. The results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results to be expected for the year ending December 31, 2006.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our 2005 Annual Report on Form 10-K filed on March 16, 2006.

Use of Estimates

The preparation of interim condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States 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 marketable and non-marketable securities, fair values of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of options to purchase our common stock, and income taxes, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Revenue Recognition

The following table presents our revenues (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2006**	**2005**	**2006**
		(unaudited)		
Advertising revenues:				
Google web sites	$ 737,172	$ 1,432,461	$ 1,394,169	$ 2,729,778

Google Network web sites	630,242	996,567	1,214,357	1,924,942
Total advertising revenues	1,367,414	2,429,028	2,608,526	4,654,720
Licensing and other revenues	17,081	26,963	32,485	55,026
Revenues	$ 1,384,495	$ 2,455,991	$ 2,641,011	$ 4,709,746

In the first quarter of 2000, we introduced our first advertising program through which we offered advertisers the ability to place text-based ads on Google web sites targeted to users search queries. Advertisers paid us based on the number of times their ads were displayed on users search results pages and we recognized revenue at the time these ads appeared. In

GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

the fourth quarter of 2000, we launched Google AdWords, an online self-service program that enables advertisers to place text-based ads on Google web sites. AdWords is also available through our direct sales force. AdWords advertisers originally paid us based on the number of times their ads appeared on users search results pages. In the first quarter of 2002, we began offering AdWords exclusively on a cost-per-click basis, so that an advertiser pays us only when a user clicks on one of its ads. We recognize as revenue the fees charged advertisers each time a user clicks on one of the text-based ads that are displayed next to the search results on Google web sites. From January 1, 2004 until the end of the first quarter of 2005, the AdWords cost-per-click pricing structure was the only structure available to our advertisers. However, during the second quarter of 2005, we launched an AdWords program that enables advertisers to pay us based on the number of times their ads appear on Google Network member sites specified by the advertiser. We recognize as revenue the fees charged advertisers each time their ads are displayed on our web sites or our Google Network members web sites because the services have been provided, and the other criteria set forth under Staff Accounting Bulletin Topic 13: *Revenue Recognition* have been met, namely, the fees we charge are fixed or determinable, we and our advertisers understand the specific nature and terms of the agreed-upon transactions and collectibility is reasonably assured.

In the third quarter of 2005, we launched the Google Publication Ads Program through which we distribute our advertisers ads for publication in magazines. We recognize as revenue the fees charged advertisers when ads are published in magazines. Also in the first quarter of 2006, we acquired dMarc Broadcasting, Inc. (dMarc), a digital solutions provider for the radio broadcast industry. dMarc, now one of our wholly-owned subsidiaries, distributes our advertisers ads for broadcast by radio stations. We recognize as revenue the fees charged advertisers each time an ad is broadcasted or a listener responds to that ad. We consider the magazines and radio stations that participate in these programs to be members of our Google Network.

Google AdSense is the program through which we distribute our advertisers ads for display on the web sites of our Google Network members. In accordance with Emerging Issues Task Force (EITF) Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent* (EITF 99-19), we recognize as revenues the fees charged advertisers each time a user clicks on one of the text-based ads that are displayed next to the search results or on the content pages of our Google Network members web sites and, for those advertisers who use our cost-per impression pricing, the fees charged advertisers each time an ad is displayed on our members sites. Finally, we recognize as revenues the fees charged advertisers for ads published in the magazines or broadcasted by the radio stations of our Google Network members. These revenues are reported on a gross basis primarily because we are the primary obligor to our advertisers.

We generate fees from search services through a variety of contractual arrangements, which include per-query search fees and search service hosting fees. Revenues from set-up and support fees and search service hosting fees are recognized on a straight-line basis over the term of the contract, which is the expected period during which these services will be provided. Our policy is to recognize revenues from per-query search fees in the period queries are made and results are delivered.

We provide search services pursuant to certain AdSense agreements. We believe that search services and revenue share arrangements represent separate units of accounting pursuant to EITF Issue No. 00-21 *Revenue Arrangements with Multiple Deliverables*. These separate services are provided simultaneously to the Google Network member and are recognized as revenues in the periods provided.

In the first quarter of 2006, we launched Google Video through which we make video owned by others available for download and purchase by end users. We recognize as revenue the fees we receive from end users to the extent we are the primary obligor to them; however, to the extent we are not, we recognize as revenues the fees we receive from end users net of the amounts we pay to our video content providers in accordance with EITF 99-19. In the second quarter of 2006, we launched Google Checkout, an on-line shopping payment processing system for both consumers and merchants. We recognize as revenues the fees charged merchants on transactions processed through Google Checkout.

We also generate fees from the sale and license of our Search Appliance, which includes hardware, software and 12 to 24 months of post-contract support. We recognize revenue in accordance with Statement of Position 97-2, *Software Revenue Recognition*, as amended. As the elements are not sold separately, sufficient vendor-specific objective evidence does not exist for the allocation of revenue. As a result, the entire fee is recognized ratably over the term of the post-contract support arrangement. Deferred revenue is recorded when payments are received in advance of our performance in the underlying agreement on the accompanying condensed consolidated balance sheets.

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cost of Revenues

Cost of revenues consists primarily of traffic acquisition costs. Traffic acquisition costs consist of amounts ultimately paid to Google Network members and to certain partners who distribute our toolbar and other products or otherwise direct search queries to our web site. These amounts are primarily based on our revenue share arrangements (including toolbar and other product distribution deals which are revenue sharing in nature) with our Google Network members and other partners. In addition, certain AdSense agreements obligate us to make guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. We amortize guaranteed minimum revenue share prepayments (or accrete an amount payable to a Google Network member if the payment is due in arrears) based on the number of search queries or advertisements displayed on the Google Network member s web site or the actual revenue share amounts, whichever is greater. In addition, concurrent with the commencement of a small number of AdSense and other agreements, we have purchased certain items from, or provided other consideration to, our Google Network members and partners. We have determined that certain of these amounts are prepaid traffic acquisition costs and are amortized on a straight-line basis over the terms of the related agreements. Traffic acquisition costs were $494.3 million and $785.2 million in the three months ended June 30, 2005 and 2006, and $956.1million and $1,507.9 million in the six months ended June 30, 2005 and 2006.

In addition, cost of revenues includes the expenses associated with the operation of our data centers, including depreciation, labor, energy and bandwidth costs, as well as credit card and other transaction fees related to processing customer transactions including Google Checkout transactions.

Stock-based Compensation

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R) that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and generally requires instead that such transactions be accounted for using a fair-value-based method. We adopted SFAS 123R beginning January 1, 2006.

SFAS 123R requires the use of a valuation model to calculate the fair value of stock-based awards. We have elected to use the Black-Scholes-Merton (BSM) option-pricing model to determine the fair value of stock-based awards on the dates of grant, consistent with that used for pro forma disclosures under SFAS No. 123, *Accounting for Stock-Based Compensation*. Restricted Stock Units (RSUs) are measured based on the fair market values of the underlying stock on the dates of grant. Shares are issued on the dates of vest net of the statutory withholding requirements to be paid by us on behalf of our employees. As a result, the actual number of shares issued will be less than the actual number of RSUs outstanding. Furthermore, in accordance with SFAS 123R, the liability for withholding amounts to be paid by us will be recorded as a reduction to additional paid-in capital when paid.

We have elected the modified prospective transition method as permitted by SFAS 123R, and accordingly, prior periods have not been restated to reflect the impact of SFAS 123R. Under this method, we are required to recognize stock-based compensation for all new and unvested stock-based awards that are ultimately expected to vest as the requisite service is rendered beginning January 1, 2006. Stock-based compensation is measured based on the fair values of all stock-based awards on the dates of grant.

We recognize stock-based compensation using the straight-line method for all stock awards issued after January 1, 2006. For stock awards issued prior to January 1, 2006, we continue to recognize stock-based compensation using the accelerated method, other than RSUs issued to new employees that vest based on the employee s performance for which we use the straight-line method in accordance with FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*.

SFAS 123R requires that the deferred stock-based compensation on our balance sheet on the date of adoption be netted against additional paid-in capital. At December 31, 2005, we had $119.0 million of deferred stock-based compensation which was netted against additional paid-in capital on January 1, 2006, as reflected in the accompanying Condensed Consolidated Balance Sheet at June 30, 2006.

Also, in accordance with SFAS 123R, beginning in the first quarter of 2006 we have presented the benefits of tax deductions in excess of recognized compensation expense as a cash flow from financing activities in the accompanying

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Condensed Consolidated Statement of Cash Flows, rather than as a cash flow from operating activities, as was prescribed under accounting rules applicable through December 31, 2005. This requirement reduces and increases the amounts we record as net cash provided by operating activities and net cash provided by financing activities, respectively. Total cash flow remains unchanged from what would have been reported under prior accounting rules. During the six months ended June 30, 2006, the tax benefit realized for the tax deduction from option exercises and other awards totaled $275 million.

In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB No. 107). In accordance with this Bulletin, beginning in the first quarter of 2006, we no longer presented stock-based compensation separately on our Condensed Consolidated Statements of Income. Instead we present stock-based compensation in the same lines as cash compensation paid to the same individuals. Stock-based compensation in the three and six months ended June 30, 2005 has been reclassified to conform to the presentation in the three and six months ended June 30, 2006.

We account for stock awards issued to non-employees in accordance with the provisions of SFAS 123R and EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18). Under SFAS 123R and EITF 96-18, we use the BSM method to measure the value of options granted to non-employees at each vesting date to determine the appropriate charge to stock-based compensation.

Prior to the adoption of SFAS 123R, we accounted for our employee stock-based compensation using the intrinsic value method prescribed by APB 25. We applied below the disclosure provisions of SFAS 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* as if the fair value method had been applied. If this method had been used, our net income and net income per share for the three and six months ended June 30, 2005 would have been adjusted to the pro forma amounts below (in thousands except per share data):

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
	(unaudited)	
Net income, as reported	$ 342,814	$ 712,007
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	30,509	59,831
Deduct: Total stock-based employee compensation expense under the fair value based method for all awards, net of related tax effects	(54,301)	(100,581)
Net income, pro forma	$ 319,022	$ 671,257
Net income per share:		
As reported for prior period basic	$ 1.27	$ 2.65
Pro forma basic	$ 1.18	$ 2.50
As reported for prior period diluted	$ 1.19	$ 2.48
Pro forma diluted	$ 1.11	$ 2.34

In the three and six months ended June 30, 2006, we recognized stock-based compensation and related tax benefits of $109.1 million ($25.8 million tax benefits) and $223.8 million ($53.3 million tax benefits) respectively.

As a result of adopting SFAS 123R, our income before income taxes and net income for the three months ended June 30, 2006, were $48.0 million and $36.7 million less than if we had continued to account for stock-based compensation under APB 25; and our income before income taxes and net income for the six months ended June 30, 2006, were $109.5 million and $83.6 million less than if we had continued to account for stock-based compensation under APB 25. Furthermore, basic and diluted earnings per share for the three months ended June 30, 2006 would both have been $0.12 less than if we had continued to account for share-based compensation under APB 25; and basic and diluted earnings per share for the six months ended June 30, 2006 would have been $0.28 and $0.27 less than if we had continued to account for share-based compensation under APB 25.

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Net Income per Share

We compute net income per share in accordance with SFAS No. 128, *Earnings per Share* (SFAS 128). Under the provisions of SFAS 128, basic net income per share is computed using the weighted average number of common shares outstanding during the period except that it does not include unvested common shares subject to repurchase or cancellation. Diluted net income per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options, restricted shares, restricted stock units and unvested common shares subject to repurchase or cancellation. The dilutive effect of outstanding stock options, restricted shares and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method.

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

	Three Months Ended June 30, 2005	Three Months Ended June 30, 2006	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
	(unaudited)			
Basic and diluted net income per share:				
Numerator:				
Net income	$ 342,814	$ 721,077	$ 712,007	$ 1,313,368
Denominator:				
Weighted average common shares outstanding	278,253	303,445	277,035	300,201
Less: Weighted average unvested common shares subject to repurchase or cancellation	(7,524)	(2,035)	(8,617)	(2,548)
Denominator for basic calculation	270,729	301,410	268,418	297,653
Effect of dilutive securities:				
Add:				
Weighted average stock options, restricted shares, restricted stock units and unvested common shares subject to repurchase or cancellation	16,509	8,628	18,508	9,428
Denominator for diluted calculation	287,238	310,038	286,926	307,080
Net income per share, basic	$ 1.27	$ 2.39	$ 2.65	$ 4.41
Net income per share, diluted	$ 1.19	$ 2.33	$ 2.48	$ 4.28

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally two to five years. Buildings are depreciated over periods up to 25 years. Equipment under capital leases and leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the assets. Construction in process is primarily related to the building of production equipment servers, unoccupied buildings and leasehold improvements. Depreciation for these assets commences once they are placed in service.

Software Development Costs

We account for software development costs, including costs to develop software products or the software component of products to be marketed to external users, as well as software programs to be used solely to meet our internal needs in accordance with SFAS No. 86, *Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed* and SOP 98-1, *Accounting for Costs of Computer Software Developed or Obtained for Internal Use*. We have determined that technological feasibility for our products to be marketed to external users was reached shortly before the release of those products. As a result, the development costs incurred after the establishment of technological feasibility and before the release of those products were not material, and accordingly, were expensed as incurred. In addition, costs incurred during the application development stage for software programs to be used solely to meet our internal needs were not material.

Cash, Cash Equivalents and Marketable Securities

We invest our excess cash in money market funds and in highly liquid debt instruments of U.S. municipalities, corporations and the U.S. government and its agencies. All highly liquid investments with stated maturities of three months or less from date of purchase are classified as cash equivalents; all highly liquid investments with stated maturities of greater than three months are classified as marketable securities.

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We determine the appropriate classification of our investments in marketable debt and equity securities at the time of purchase and reevaluate such designation at each balance sheet date. Our marketable debt and equity securities have been classified and accounted for as available for sale. We may or may not hold securities with stated maturities greater than twelve months until maturity. In response to changes in the availability of and the yield on alternative investments as well as liquidity requirements, we occasionally sell these securities prior to their stated maturities. As these debt and equity securities are viewed by us as available to support current operations, based on the provisions of Accounting Research Bulletin No. 43, Chapter 3A, Working Capital-Current Assets and Liabilities, equity securities, as well as debt securities with maturities beyond 12 months (such as our auction rate securities) are classified as current assets under the caption marketable securities in the accompanying Condensed Consolidated Balance Sheets. These securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a component of stockholders equity, except for unrealized losses determined to be other than temporary which are recorded as interest income and other, net, in accordance with our policy and FASB Staff Position (FSP) Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*. Any realized gains or losses on the sale of marketable securities are determined on a specific identification method, and such gains and losses are reflected as a component of interest income and other, net.

Derivative Financial Instruments

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

In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, we recognize derivative instruments as either assets or liabilities on the balance sheet at fair value. These forward exchange contracts are not accounted for as hedges and, therefore, changes in the fair value of these instruments are recorded as interest income and other, net. Neither the cost nor the fair value of these forward foreign exchange contracts was material at June 30, 2006. The notional principal of forward foreign exchange contracts to purchase U.S. dollars with foreign currencies was $477.0 million and $602.0 million at December 31, 2005 and June 30, 2006, respectively. The notional principal of forward foreign exchange contracts to purchase Euros with British Pounds was 115.6 million (or approximately $144.7 million) at June 30, 2006. There were no other forward foreign exchange contracts outstanding at December 31, 2005 or June 30, 2006.

Legal Costs

Legal costs are expensed as incurred.

Effect of a Recent Accounting Pronouncement

In July, 2006 the FASB issued Financial Interpretation Number 48, *Accounting for Uncertainty in Income Taxes,* (FIN 48) as an interpretation of FASB Statement No. 109, *Accounting for Income Taxes* (SFAS 109). This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS 109 and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination. Measurement of the tax uncertainty occurs if the recognition threshold has been met. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 will be effective for us beginning January 1, 2007. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are still evaluating what impact, if any, the adoption of this interpretation will have on our financial position or results of operations.

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 2. Cash, Cash Equivalents and Marketable Securities

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

	As of December 31, 2005	As of June 30, 2006 (unaudited)
Cash and cash equivalents:		
Cash	$ 1,588,515	$ 3,399,689
Cash equivalents:		
U.S. government notes and agencies	2,281,858	598,752
Money market mutual funds	6,801	17,481
Total cash and cash equivalents	3,877,174	4,015,922
Marketable securities:		
Municipal securities	1,203,209	702,015
U.S. government notes and agencies	2,906,698	5,103,695
Equity security	47,166	
Total marketable securities	4,157,073	5,805,710
Total cash, cash equivalents and marketable securities	$ 8,034,247	$ 9,821,632

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

	As of December 31, 2005			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal securities	$ 1,219,078	$ 28	$ (15,897)	$ 1,203,209
U.S. government notes and agencies	2,911,410	418	(5,130)	2,906,698
Equity security	5,000	42,166		47,166
Total marketable securities	$ 4,135,488	$ 42,612	$ (21,027)	$ 4,157,073

	As of June 30, 2006 (unaudited)			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value

Municipal securities	$ 713,680	$ 14	$ (11,679)	$ 702,015
U.S. government notes and agencies	5,141,411	52	(37,768)	5,103,695
Total marketable securities	$ 5,855,091	$ 66	$ (49,447)	$ 5,805,710

Gross unrealized gains and losses on cash equivalents were not material at December 31, 2005 and June 30, 2006. There were no other-than-temporary impairments to our marketable securities in the three and six months ended June 30, 2006 and June 30, 2005. We recognized a net realized gain of $54.4 million and $46.8 million on the sale of marketable securities during the three and six months ended June 30, 2006 that included the realized gain on the sale of a marketable equity security of $54.9 million in the three months ended June 30, 2006. Net realized gains and losses on the sale of marketable securities were not material during the three and six months ended June 30, 2005.

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

	As of December 31, 2005	**As of June 30, 2006 (unaudited)**
Due within 1 year	$ 970,073	$ 2,755,264
Due after 1 year through 5 years	2,967,148	2,912,451
Due after 5 years through 10 years	59,122	21,269
Due after 10 years	160,730	116,726
Total marketable securities	$ 4,157,073	$ 5,805,710

GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In accordance with EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, the following table shows gross unrealized losses and fair value for those investments that were in an unrealized loss position as of December 31, 2005 and June 30, 2006, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in thousands):

	As of December 31, 2005					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government notes and agencies	$ 2,099,408	$ (5,130)	$	$	$ 2,099,408	$ (5,130)
Municipal securities	607,990	(7,705)	513,425	(8,192)	1,121,415	(15,897)
Total	$ 2,707,398	$ (12,835)	$ 513,425	$ (8,192)	$ 3,220,823	$ (21,027)

	As of June 30, 2006 (unaudited)					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government notes and agencies	$ 4,901,721	$ (37,768)	$	$	$ 4,901,721	$ (37,768)
Municipal securities	226,359	(3,852)	408,104	(7,827)	634,463	(11,679)
Total	$ 5,128,080	$ (41,620)	$ 408,104	$ (7,827)	$ 5,536,184	$ (49,447)

Note 3. Investment in America Online, Inc. (AOL)

In April 2006, we completed our $1.0 billion cash purchase of a five percent equity interest in a wholly-owned subsidiary of Time Warner, Inc. that owns all of the outstanding interests of AOL. Our investment in this non-marketable equity security is accounted for at historical cost. Previously, in March 2006, we entered into certain commercial arrangements with AOL. We believe that the terms of the investment and commercial agreements are at fair value, and as a result, they are accounted for in accordance with their contractual terms. Further we are obligated over a five year term to make up to $100 million of co-marketing payments (but not to exceed $20 million per year plus any amounts not spent in prior years) and issue up to $300 million of AdWords credits (but not to exceed $60 million per year plus any credits not redeemed in prior years). Co-marketing costs are expensed as incurred and AdWords credits are accounted for as a reduction to revenues in the periods they are redeemed.

Note 4. Property and Equipment

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

	As of December 31, 2005	As of June 30, 2006

		(unaudited)
Information technology assets	$ 949,758	$ 1,263,154
Construction in process	211,088	729,546
Land and buildings	124,752	286,286
Leasehold improvements	115,108	149,173
Furniture and fixtures	16,719	23,896
Total	1,417,425	2,452,055
Less accumulated depreciation and amortization	455,676	652,289
Property and equipment, net	$ 961,749	$ 1,799,766

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5. Acquisitions

In February 2006, we acquired all of the voting interests of dMarc Broadcasting, Inc. (dMarc), a digital solutions provider for the radio broadcast industry. This transaction was accounted for as a business combination. The total purchase price was $97.6 million which primarily consisted of cash payments of $97.1 million. In addition, we are obligated to make additional cash payments of up to $1.136 billion if certain product integration, net revenue and advertising inventory targets are met through December 2008. Since these contingent payments are based on the achievement of performance targets, actual payments may be substantially lower. Substantially all of these contingent payments will be accounted for as goodwill, and the remaining amounts will be expensed, when earned. No contingent payments were earned through June 30, 2006.

During the six months ended June 30, 2006, we also acquired all of the voting interests of five other companies. One of these transactions was accounted for as a business combination. Because the remaining four transactions were with companies considered to be development stage enterprises, they were accounted for as asset purchases in accordance with EITF Issue No. 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*. The total purchase price of this business combination and these asset purchases was $80.2 million, which primarily consisted of cash payments of $76.5 million. In addition, we are obligated to make additional cash payments of up to $17.9 million if certain performance targets are met through March 2010. Since these contingent payments are based on the achievement of performance targets, actual payments may be substantially lower. Substantially all of these contingent payments will be accounted for as goodwill, and the remaining amounts will be expensed, when earned.

In addition, during the six months ended June 30, 2006, we acquired certain other intangible assets for total cash payments of $16.7 million.

The following table summarizes the allocation of the purchase price for all of the above acquisitions (in thousands):

Goodwill	$ 123,697
Patents and developed technology	41,613
Customer contracts and other	53,789
Net liabilities assumed	(6,059)
Deferred tax liabilities	(22,527)
Purchased in-process research and development	4,000
Total	$ 194,513

Goodwill is not deductible for tax purposes. The developed technology, customer contracts and other intangible assets have a weighted-average useful life of 3.6 years from the date of acquisition. The amortization of these intangibles is not deductible for tax purposes.

Purchased in-process research and development of $4.0 million in the six months ended June 30, 2006 was expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed. This amount is included in research and development expenses on the accompanying Condensed Consolidated Statements of Income and is not deductible for tax purposes.

Note 6. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended June 30, 2006, are as follows (in thousands):

Balance as of December 31, 2005	$ 194,900
Goodwill acquired	123,697
Balance as of June 30, 2006	$ 318,597

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

	As of December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Patents and developed technology	$ 120,413	$ 46,272	$ 74,141
Customer contracts and other	26,145	17,503	8,642
Total	$ 146,558	$ 63,775	$ 82,783

	As of June 30, 2006 (unaudited)		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Patents and developed technology	$ 156,553	$ 69,089	$ 87,464
Customer contracts and other	85,406	26,269	59,137
Total	$ 241,959	$ 95,358	$ 146,601

Patents and developed technology and customer contracts and other have weighted-average useful lives from the date of purchase of 3.3 years.

Amortization expense of acquisition-related intangible assets for the three and six months ended June 30, 2006 were $15.9 million and $31.3 million, respectively.

Estimated amortization expense for acquisition-related intangible assets on our June 30, 2006 Condensed Consolidated Balance Sheet for each of the next five years is as follows (in thousands):

2006	$ 30,145
2007	55,889
2008	38,122
2009	10,791
2010	9,212
Thereafter	2,442
	$ 146,601

Note 7. Interest Income and Other, Net

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
	(unaudited)			
Interest income	$ 15,655	$ 103,187	$ 27,383	$ 182,111
Interest expense	(26)	(177)	(149)	(185)
Other	4,093	57,795	6,174	46,798
Interest income and other, net	$ 19,722	$ 160,805	$ 33,408	$ 228,724

Note 8. Contingencies

Legal Matters

Certain companies have filed trademark infringement and related claims against us over the display of ads in response to user queries that include trademark terms. The outcomes of these lawsuits have differed from jurisdiction to jurisdiction. Courts in France have held us liable for allowing advertisers to select certain trademarked terms as keywords. We are appealing those decisions. We were also subject to two lawsuits in Germany on similar matters where the courts held that we

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

are not liable for the actions of our advertisers prior to notification of trademark rights. We are litigating or recently have litigated similar issues in other cases in the U.S., France, Germany, Italy, Israel and Austria. Adverse results in these lawsuits may result in, or even compel, a change in this practice which could result in a loss of revenue for us, which could harm our business.

Certain entities have also filed intellectual property claims against us, alleging that features of certain of our products, including Google Web Search, Google News, Google Image Search, and Google Book Search, infringe their rights. Adverse results in these lawsuits may include awards of damages and may also result in, or even compel, a change in our business practices, which could result in a loss of revenue for us or otherwise harm our business.

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

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

Income Taxes

We have reserved for potential adjustments that may result from examinations by, or any negotiated agreements with, the Internal Revenue Service or other tax authorities, and we believe that the final outcome of these examinations or agreements will not have a material affect on our results of operations. If events occur which indicate payment of these amounts are 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 9. Stockholders Equity

In April 2006, we issued 5,300,000 shares of our Class A common stock upon the closing of a follow-on public stock offering for net proceeds of approximately $2.064 billion.

Stock Plans

We maintain the 1998 Stock Plan, the 2000 Stock Plan, the 2003 Stock Plan, the 2003 Stock Plan (No. 2), the 2003 Stock Plan (No. 3), the 2004 Stock Plan and plans assumed through acquisitions which are collectively referred to as the Stock Plans. Under our Stock Plans, incentive and nonqualified stock options or rights to purchase common stock may be granted to eligible participants. Options must generally be priced to be at least 85% of our common stock s fair market value at the date of grant (100% in the case of incentive stock options). Options are generally granted for a term of ten years. Options granted under the Stock Plans generally vest 25% after the first year of service and ratably each month over the remaining 36 month period contingent upon employment with us on the date of vest. Options granted under plans other than the 2004 Stock Plan may be exercised prior to vesting. We have also issued RSUs and restricted shares under our Stock Plans. An RSU award is an agreement to issue shares of our stock at the time of vest. RSUs issued to new employees vest over four years with a yearly cliff contingent upon employment with us on the dates of vest. These RSUs vest from zero to 37.5 percent of the grant amount at the end of each of the four years from date of hire based on the employee s performance. RSUs under the Founders Award programs are issued to individuals on teams that have made extraordinary contributions to Google. These awards vest quarterly over four years contingent upon employment with us on the dates of vest.

We estimated the fair value of each option award on the date of grant using the BSM valuation model. Our assumptions about stock-price volatility have been based exclusively on the implied volatilities of publicly traded options to buy our stock with contractual terms closest to the expected life of options granted to our employees applying the guidance provided by SAB 107. In addition, our assumptions about the expected term have been based primarily on that of companies that have option vesting and contractual terms, expected stock volatility and employee demographics and physical locations that are similar to ours. We have used this comparable data because we have limited relevant historical information to support the expected exercise behavior of our employees who have been granted options recently. This relevant historical information is limited because our stock has been publicly traded only since August 2004, and the fair market value of our stock has increased substantially during this time. Accordingly, the exercise behavior of employees who have been granted options

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(Unaudited)

recently may be different than that of employees who have exercised their significantly in-the-money options after the initial public offering. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Forfeitures were estimated based on historical experience.

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GOOGLE INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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, 2005	Three Months Ended June 30, 2006	Six Months Ended June 30, 2005	Six Months Ended June 30, 2006
	(unaudited)			
Risk-free interest rate	3.74%	5.00%	3.69%	4.75%
Expected volatility	36%	38%	38%	39%
Expected life (in years)	3.1	3.2	3.1	3.1
Dividend yield				
Weighted-average estimated fair value of options granted during the period	$ 69.43	$ 129.08	$ 64.57	$ 128.56

The following table summarizes the activity for outstanding stock options for the six months ended June 30, 2006:

	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, 2005	18,589,646	$ 113.51		
Granted	611,411	$ 393.79		
Exercised	(4,250,743)	$ 43.43		
Canceled/forfeited/expired	(221,350)	$ 60.88		
Balance at June 30, 2006	14,728,964	$ 140.51	8.0	$ 3,681.2
Vested and exercisable as of June 30, 2006	2,953,258	$ 54.23	7.1	$ 1,078.2
Vested and expected to vest as of June 30, 2006	14,140,179	$ 140.51	8.0	$ 3,497.2

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $419.33 of our common stock on June 30, 2006.

The number of options outstanding at June 30, 2006 includes 1,522,448 options granted and exercised subsequent to March 21, 2002 that are unvested at June 30, 2006, in accordance with EITF Issue No. 00-23, *Issues Related to Accounting for Stock Compensation Under APB Opinion No. 25 and FASB Interpretation No. 44* (EITF 00-23). However, the computations of the weighted-average exercise prices, weighted average remaining contractual term and aggregate intrinsic value for all stock options outstanding, those expected to vest and those exercisable do not consider these unvested shares. The aggregate intrinsic value of all options exercised during the three and six months ended June 30, 2006 was $473.9 million and $862.1 million. The total grant date fair value of stock options vested during the three and six months ended June 30, 2006 was $86.7 million and $163.8 million.

As of June 30, 2006, there was $328.5 million of unrecognized compensation cost related to outstanding stock options, net of forecasted forfeitures. This amount is expected to be recognized over a weighted average period of 3.0 years. To the extent forfeiture rate is different than we have anticipated, stock-based compensation related to these awards will be different from our expectations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the activity for our unvested restricted stock units for the six months ended June 30, 2006:

	Unvested Restricted Stock Units	
	Number of Shares	Weighted-Average Grant-Date Fair Value
	(unaudited)	
Unvested at December 31, 2005	920,057	$ 324.38
Granted	412,100	$ 383.85
Vested	(84,365)	$ 254.76
Forfeited	(14,774)	$ 333.06
Unvested at June 30, 2006	1,233,018	$ 323.77
Expected to vest at June 30, 2006	1,171,367	$ 323.77

As of June 30, 2006, there was $314.6 million of unrecognized compensation cost related to unvested restricted stock units, net of forecasted forfeitures. This amount is expected to be recognized over a weighted average period of 3.4 years. To the extent actual forfeiture rate is different than we have anticipated, the numbers of restricted stock units expected to vest would be different from our expectations.

The following table summarizes additional information regarding outstanding and exercisable stock options at June 30, 2006 (unaudited):

		Options Outstanding					Options Exercisable	
Range of Exercise Prices		Total Number of Shares	Unvested Options Granted and Exercised Subsequent to March 21, 2002	Number of Shares	Weighted-Average Remaining Life (Years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 0.08	$ 85.00	8,093,745	1,522,448	6,571,297	7.0	$ 15.93	6,386,079	$ 15.62
$117.84	$198.41	2,359,924		2,359,924	8.5	$ 175.84	436,209	$ 174.99
$205.96	$298.91	1,818,124		1,818,124	9.0	$ 274.08	231,556	265.07
$300.97	$398.15	2,007,490		2,007,490	9.3	$ 322.47	2,371	$ 330.37
$401.78	$471.63	449,681		449,681	9.6	$ 422.35		
$ 0.08	$471.63	14,728,964	1,522,448	13,206,516	8.0	$ 140.48	7,056,215	$ 33.76

The number of options outstanding at June 30, 2006 includes 1,522,448 of options granted and exercised subsequent to March 21, 2002 that are unvested at June 30, 2006, in accordance with EITF 00-23. However, the computations of the weighted-average exercise prices and the weighted average remaining life in the table above do not consider these unvested shares. Also, the number of options exercisable at June 30, 2006 includes unvested options that can be early exercised.

Note 10. Information about Geographic Areas

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

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(Unaudited)

Revenues by geography are based on the billing addresses of the advertisers. No single foreign country, other than the United Kingdom, accounted for more than ten percent of total revenues in the three and six months ended June 30, 2005 or 2006. The following table sets forth revenues and long-lived assets by geographic area (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2006	2005	2006
		(unaudited)		
Revenues:				
United States	$ 843,258	$ 1,421,026	$ 1,615,070	$ 2,738,548
United Kingdom	199,164	369,949	385,379	712,820
Rest of the world	342,073	665,016	640,562	1,258,378
Total revenues	$ 1,384,495	$ 2,455,991	$ 2,641,011	$ 4,709,746

	As of December 31, 2005	As of June 30, 2006 (unaudited)
Long-lived assets:		
United States	$ 1,080,236	$ 3,088,622
International	190,506	249,278
Total long-lived assets	$ 1,270,742	$ 3,337,900

Note 11. Subsequent Event

In July 2006, we received final approval for settlement of the Lane s Gift class action lawsuit in Arkansas which will require us to pay plaintiffs attorneys fees of $30 million and issue total AdWords credits of no more than $60 million. The AdWords credits will be accounted for as a reduction to revenues in the periods they are redeemed. These plaintiffs attorneys fees were expensed in the three months ended March 31, 2006.

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

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

regarding the growth of our operations, business and revenues and the growth rate of our costs and expenses.

that seasonal fluctuations in Internet usage and traditional advertising seasonality are likely to affect our business.

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

that our operating margin may decrease as we invest in our infrastructure.

that we will continue to employ a significant number of temporary employees.

regarding our future stock-based compensation charges.

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

that our cost of revenues will increase in 2006 primarily as a result of anticipated increases in traffic acquisition and data center costs, although traffic acquisition costs may fluctuate as a percentage of advertising revenues.

that research and development, sales and marketing and general and administrative expenses will increase in the future.

regarding our expansion and investments in international markets.

that the annual rate of growth in 2006 of our spending on property and equipment will be substantially greater than the annual rate of growth of our revenues.

regarding our income tax rates, tax liabilities and the expected higher proportion of our earnings we expect our Irish subsidiary to recognize.

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

that our cash-based compensation per employee will likely increase.

regarding our expected further contributions to, and investments in, philanthropic endeavors.

as well as other statements regarding our future operations, financial condition and prospects and business strategies. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report, and in particular, the risks discussed under the heading Risk Factors in Part II, Item 1A of this report and those discussed in other documents we file with the Securities and Exchange Commission. The following discussion should be read in conjunction with our Annual Report on Form 10-K filed March 16, 2006, and the consolidated financial statements and notes thereto. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

The following discussion and analysis of our financial condition and results of operations should be read together with our condensed consolidated financial statements and related notes included elsewhere in this report.

Overview

Google is a global technology leader focused on improving the ways people connect with information. Our innovations in web search and advertising have made our web site a top Internet destination 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 several ways to deliver relevant targeted advertising including our Google AdWords program, an auction-based advertising program that enables advertisers to deliver relevant ads targeted to search results or web content, our Google Publication Ads Program, which allows our advertisers to deliver targeted ads for publication in magazines and our dMarc radio advertising program, which distributes our advertisers ads for broadcast by radio stations. Our advertising programs provide advertisers with a cost-effective way to deliver ads to customers across Google sites and through the Google Network, which is the network of on-line and off-line third parties that use our advertising programs to deliver relevant ads on their web sites, print pages or radio broadcasts.

Web sites. We provide the on-line members of our Google Network with our Google AdSense program, which is the program through which we distribute our advertisers AdWords ads for display on the web sites of our Google Network members. We share most of the fees these ads generate with our Google Network members creating an important revenue stream for them.

How We Generate Revenue

We derive most of our revenues from fees we receive from our advertisers through our AdWords and AdSense programs.

Our original business model consisted of licensing our search engine services to other web sites. In the first quarter of 2000, we introduced our first advertising program. Through our direct sales force we offered advertisers the ability to place text-based ads on our web sites targeted to our users search queries under a program called Premium Sponsorships. Advertisers paid us based on the number of times their ads were displayed on users search results pages, and we recognized revenue at the time these ads appeared. In the fourth quarter of 2000, we launched Google AdWords, an online self-service program that enables advertisers to place targeted text-based ads on our web sites. AdWords customers originally paid us based on the number of times their ads appeared on users search results pages. In the first quarter of 2002, we began offering AdWords exclusively on a cost-per-click basis, which means that an advertiser pays us only when a user clicks on one of its ads. AdWords is also available through our direct sales force.

Effective beginning the first quarter of 2004 until the end of the first quarter of 2005, the AdWords cost-per-click pricing structure was the only pricing structure available to our advertisers. However, during the second quarter of 2005, we launched an AdWords cost-per-impression program that enables advertisers to pay us based on the number of times their ads appear on Google Network members sites specified by the advertiser. For advertisers using our AdWords cost-per-click pricing, we recognize as revenue the fees charged advertisers each time a user clicks on one of the text-based ads that appears next to the search results on our web sites, or next to the search results or content on Google Network members sites. For advertisers using our AdWords cost-per-impression pricing, we recognize as revenue the fees charged advertisers each time their ads are displayed on the Google Network members sites. Our AdWords agreements are generally terminable at any time by our advertisers.

Google AdSense is the program through which we distribute our advertisers AdWords ads for display on the web sites of our Google Network members. Our AdSense program includes AdSense for search and AdSense for content. AdSense for search, launched in the first quarter of 2002, is our service for distributing relevant ads from our advertisers for display with search results on our Google Network members sites. To use AdSense for search, most of our AdSense for search partners add Google search functionality to their web pages in the form of customizable Google search boxes. When visitors of these web sites search either the web site or the Internet using these customizable search boxes, we display relevant ads on the search results pages, targeted to match user search queries. Ads shown through AdSense for search are generally text ads.

AdSense for content, launched in the first quarter of 2003, is our service for distributing ads from our advertisers that are relevant to content on our Google Network members sites. Under this program, we use automated technology to analyze the meaning of the content on the web site and serve relevant ads based on the meaning of such content. For example, a web page on an automotive blog that contains an entry about vintage cars might display ads for vintage car parts or vintage car shows. These ads are displayed in spaces that our AdSense for content partners have set aside on their web sites for our AdWords content. AdSense for content allows a variety of ad types to be shown, including text ads, image ads, video ads, link units (which are sets of clickable links to topic pages related to page content) and themed units (which are regular text ad units with graphic treatments that change seasonally and by geography).

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

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

In the third quarter of 2005, we launched the Google Publication Ads Program through which we distribute our advertisers ads for publication in magazines. We recognize as revenue the fees charged advertisers when their ads are published in magazines. Also, in the first quarter of 2006, we acquired dMarc Broadcasting, Inc. (dMarc), a digital solutions provider for the radio broadcast industry. dMarc, now one of our wholly owned subsidiaries, distributes our advertisers ads

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for broadcast by radio stations. We recognize as revenue the fees charged advertisers each time an ad is broadcasted or a listener responds to that ad. We consider the magazines and radio stations that participate in these programs to be members of our Google Network.

We believe the factors that influence the success of our advertising programs inc