

Google Inc.  
Form 10-Q  
July 25, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended June 30, 2014

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: 001-36380

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

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|  |   |
|--|---|
| Delaware   | 77-0493581                              |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 1600 Amphitheatre Parkway                                      |   |
| Mountain View, CA 94043  |   |
| (Address of principal executive offices, including zip code)   |   |
| (650) 253-0000   |   |
| (Registrant's telephone number, including area code)           |   |

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

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

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

Large accelerated filer ☒ Accelerated filer ☐

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

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

At July 17, 2014, there were 283,356,281 shares of Google's Class A common stock outstanding, 54,825,710 shares of

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Google's Class B common stock outstanding and 338,209,995 Class C capital stock outstanding.

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Google Inc.

Form 10-Q

For the Quarterly Period Ended June 30, 2014

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### NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

- the growth of our business and revenues and our expectations about the factors that influence our success and trends in our business;
- our plans to continue to invest in new businesses, products and technologies, systems, facilities, and infrastructure, to continue to hire aggressively and provide competitive compensation programs, as well as to continue to invest in acquisitions;
- seasonal fluctuations in internet usage and advertiser expenditures, traditional retail seasonality and macroeconomic conditions, which are likely to cause fluctuations in our quarterly results;
- the potential for declines in our revenue growth rate;
- our expectation that growth in advertising revenues from our websites will continue to exceed that from our Google Network Members' websites, which will have a positive impact on our operating margins;
- our expectation that we will continue to pay most of the fees we receive from advertisers on our Google Network Members' websites to our Google Network Members;
- our expectation that we will continue to take steps to improve the relevance of the ads we deliver and to reduce the number of accidental clicks;
- fluctuations in aggregate paid clicks and average cost-per-click;
- our belief that our foreign exchange risk management program will not fully offset our net exposure to fluctuations in foreign currency exchange rates;
- the expected increase of costs related to hedging activities under our foreign exchange risk management program;
- our expectation that our cost of revenues, research and development expenses, sales and marketing expenses, and general and administrative expenses will increase in dollars and may increase as a percentage of revenues;
- our potential exposure in connection with pending investigations, proceedings, and other contingencies;
- our expectation that our traffic acquisition costs will fluctuate in the future;
- our continued investments in international markets;
- estimates of our future compensation expenses;
- fluctuations in our effective tax rate;
- the sufficiency of our sources of funding;
- our payment terms to certain advertisers, which may increase our working capital requirements;
- fluctuations in our capital expenditures;
- our expectations regarding the trading price of our Class A common stock and Class C capital stock; and
- our expectations about the disposition of the Motorola Mobile business;

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



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

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

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

Google Inc.

## CONSOLIDATED BALANCE SHEETS

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

|  | As of<br>December 31,<br>2013 | As of<br>June 30,<br>2014<br>(unaudited) |
|--|-------------------------------|--|
| Assets   |                               |  |
| Current assets:  |                               |  |
| Cash and cash equivalents  | \$ 18,898                     | \$ 19,620                                |
| Marketable securities  | 39,819                        | 41,584                                   |
| Total cash, cash equivalents, and marketable securities (including securities loaned of \$5,059 and \$5,697) | 58,717                        | 61,204                                   |
| Accounts receivable, net of allowance of \$631 and \$269   | 8,882                         | 8,321                                    |
| Inventories  | 426                           | 293                                      |
| Receivable under reverse repurchase agreements   | 100                           | 100                                      |
| Deferred income taxes, net   | 1,526                         | 1,158                                    |
| Income taxes receivable, net   | 408                           | 1,118                                    |
| Prepaid revenue share, expenses and other assets   | 2,827                         | 2,043                                    |
| Assets held for sale   | 0                             | 3,668                                    |
| Total current assets   | 72,886                        | 77,905                                   |
| Prepaid revenue share, expenses and other assets, non-current  | 1,976                         | 1,982                                    |
| Non-marketable equity investments  | 1,976                         | 2,415                                    |
| Property and equipment, net  | 16,524                        | 19,486                                   |
| Intangible assets, net   | 6,066                         | 5,234                                    |
| Goodwill   | 11,492                        | 14,586                                   |
| Total assets   | \$ 110,920                    | \$ 121,608                               |
| Liabilities and Stockholders' Equity   |                               |  |
| Current liabilities:   |                               |  |
| Accounts payable   | \$ 2,453                      | \$ 1,345                                 |
| Short-term debt  | 3,009                         | 2,009                                    |
| Accrued compensation and benefits  | 2,502                         | 2,102                                    |
| Accrued expenses and other current liabilities   | 3,755                         | 3,683                                    |
| Accrued revenue share  | 1,729                         | 1,686                                    |
| Securities lending payable   | 1,374                         | 3,086                                    |
| Deferred revenue   | 1,062                         | 882                                      |
| Income taxes payable, net  | 24                            | 0  |
| Liabilities held for sale  | 0                             | 2,304                                    |
| Total current liabilities  | 15,908                        | 17,097                                   |
| Long-term debt   | 2,236                         | 3,232                                    |
| Deferred revenue, non-current  | 139                           | 93                                       |
| Income taxes payable, non-current  | 2,638                         | 3,002                                    |
| Deferred income taxes, net, non-current  | 1,947                         | 1,625                                    |
| Other long-term liabilities  | 743                           | 810                                      |
| Stockholders' equity:  |                               |  |

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|  |           |           |
|--|-----------|-----------|
| Convertible preferred stock, \$0.001 par value per share, 100,000 shares authorized; no shares issued and outstanding  | 0         | 0         |
| Class A and Class B common stock, and Class C capital stock and additional paid-in capital, \$0.001 par value per share: 15,000,000 shares authorized (Class A 9,000,000, Class B 3,000,000, Class C 3,000,000); 671,664 (Class A 279,325, Class B 56,507, Class C 335,832) and par value of \$672 (Class A \$279, Class B \$57, Class C \$336) and 675,905 (Class A 283,014, Class B 54,925, Class C 337,966) and par value of \$676 (Class A \$283, Class B \$55, Class C \$338) shares issued and outstanding | 25,922    | 27,111    |
| Accumulated other comprehensive income   | 125       | 502       |
| Retained earnings  | 61,262    | 68,136    |
| Total stockholders' equity   | 87,309    | 95,749    |
| Total liabilities and stockholders' equity   | \$110,920 | \$121,608 |
| See accompanying notes.  |           |           |



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Google Inc.

## CONSOLIDATED STATEMENTS OF INCOME

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

|   | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---|--------------------------------|-----------|------------------------------|-----------|
|   | 2013                           | 2014      | 2013                         | 2014      |
|   | (unaudited)                    |           |                              |           |
| Revenues  | \$ 13,107                      | \$ 15,955 | \$ 26,058                    | \$ 31,375 |
| Costs and expenses:   |                                |           |                              |           |
| Cost of revenues <sup>(1)</sup>                               | 5,195                          | 6,114     | 10,331                       | 12,075    |
| Research and development <sup>(1)</sup>                       | 1,766                          | 2,238     | 3,383                        | 4,364     |
| Sales and marketing <sup>(1)</sup>                            | 1,583                          | 1,941     | 3,018                        | 3,670     |
| General and administrative <sup>(1)</sup>                     | 1,098                          | 1,404     | 2,113                        | 2,893     |
| Total costs and expenses                                      | 9,642                          | 11,697    | 18,845                       | 23,002    |
| Income from operations  | 3,465                          | 4,258     | 7,213                        | 8,373     |
| Interest and other income, net                                | 236                            | 145       | 370                          | 502       |
| Income from continuing operations before income taxes         | 3,701                          | 4,403     | 7,583                        | 8,875     |
| Provision for income taxes                                    | 927                            | 913       | 1,281                        | 1,735     |
| Net income from continuing operations                         | 2,774                          | 3,490     | 6,302                        | 7,140     |
| Net income (loss) from discontinued operations <sup>(1)</sup> | 454                            | (68)      | 272                          | (266)     |
| Net income  | \$ 3,228                       | \$ 3,422  | \$ 6,574                     | \$ 6,874  |
| Net income (loss) per share -- basic:                         |                                |           |                              |           |
| Continuing operations   | \$ 4.17                        | \$ 5.17   | \$ 9.51                      | \$ 10.59  |
| Discontinued operations                                       | 0.68                           | (0.10)    | 0.41                         | (0.39)    |
| Net income per share - basic                                  | \$ 4.85                        | \$ 5.07   | \$ 9.92                      | \$ 10.20  |
| Net income (loss) per share - diluted:                        |                                |           |                              |           |
| Continuing operations   | \$ 4.10                        | \$ 5.09   | \$ 9.34                      | \$ 10.41  |
| Discontinued operations                                       | 0.67                           | (0.10)    | 0.40                         | (0.39)    |
| Net income per share - diluted                                | \$ 4.77                        | \$ 4.99   | \$ 9.74                      | \$ 10.02  |
| Shares used in per share calculation - basic                  | 664,960                        | 675,115   | 662,934                      | 673,851   |
| Shares used in per share calculation - diluted                | 676,674                        | 686,363   | 675,000                      | 685,788   |

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

|  |        |        |          |          |
|--|--------|--------|----------|----------|
| Cost of revenues                       | \$ 110 | \$ 100 | \$ 209   | \$ 195   |
| Research and development               | 401    | 447    | 739      | 903      |
| Sales and marketing                    | 125    | 158    | 243      | 305      |
| General and administrative             | 107    | 175    | 207      | 316      |
| Discontinued operations                | 104    | 35     | 157      | 83       |
| Total stock-based compensation expense | \$ 847 | \$ 915 | \$ 1,555 | \$ 1,802 |

See accompanying notes.

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Google Inc.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

|  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2013                           | 2014    | 2013                         | 2014    |
|  | (unaudited)                    |         |                              |         |
| Net income   | \$3,228                        | \$3,422 | \$6,574                      | \$6,874 |
| Other comprehensive income (loss):                                     |                                |         |                              |         |
| Change in foreign currency translation adjustment                      | (36                            | ) (11   | ) (204                       | ) 54    |
| Available-for-sale investments:  |                                |         |                              |         |
| Change in net unrealized gains (losses)                                | (604                           | ) 228   | (659                         | ) 445   |
| Less: reclassification adjustment for net gains included in net income | (108                           | ) (40   | ) (154                       | ) (107  |
| Net change (net of tax effect of \$202, \$62, \$239 and \$104)         | (712                           | ) 188   | (813                         | ) 338   |
| Cash flow hedges:  |                                |         |                              |         |
| Change in net unrealized gains   | 16                             | (16     | ) 125                        | (6      |
| Less: reclassification adjustment for net gains included in net income | (22                            | ) (4    | ) (44                        | ) (9    |
| Net change (net of tax effect of \$4, \$21, \$47 and \$9)              | (6                             | ) (20   | ) 81                         | (15     |
| Other comprehensive income (loss)                                      | (754                           | ) 157   | (936                         | ) 377   |
| Comprehensive income   | \$2,474                        | \$3,579 | \$5,638                      | \$7,251 |
| See accompanying notes.  |                                |         |                              |         |

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Google Inc.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

|   | Six Months Ended<br>June 30, |          |
|---|------------------------------|----------|
|   | 2013                         | 2014     |
|   | (unaudited)                  |          |
| Operating activities  |                              |          |
| Net income  | \$6,574                      | \$6,874  |
| Adjustments:  |                              |          |
| Depreciation expense and loss on disposal of property and equipment               | 1,331                        | 1,629    |
| Amortization of intangible and other assets                                       | 598                          | 536      |
| Stock-based compensation expense  | 1,555                        | 1,802    |
| Excess tax benefits from stock-based award activities                             | (198)                        | (292)    |
| Deferred income taxes   | 265                          | (138)    |
| Gain on divestiture of businesses   | (690)                        | 0        |
| Gain on equity interest   | 0                            | (126)    |
| Gain on sale of non-marketable equity investments                                 | 0                            | (138)    |
| Other   | (54)                         | (10)     |
| Changes in assets and liabilities, net of effects of acquisitions:                |                              |          |
| Accounts receivable   | 62                           | (454)    |
| Income taxes, net   | (156)                        | (62)     |
| Inventories   | (158)                        | 20       |
| Prepaid revenue share, expenses and other assets                                  | (348)                        | 499      |
| Accounts payable  | (72)                         | 14       |
| Accrued expenses and other liabilities  | (363)                        | (68)     |
| Accrued revenue share   | 8                            | (68)     |
| Deferred revenue  | (16)                         | 0        |
| Net cash provided by operating activities   | 8,338                        | 10,018   |
| Investing activities  |                              |          |
| Purchases of property and equipment   | (2,814)                      | (4,991)  |
| Purchases of marketable securities  | (22,782)                     | (24,857) |
| Maturities and sales of marketable securities                                     | 17,006                       | 23,605   |
| Investments in non-marketable equity investments                                  | (172)                        | (467)    |
| Cash collateral related to securities lending                                     | 1,538                        | 1,713    |
| Investments in reverse repurchase agreements                                      | (70)                         | 0        |
| Proceeds from divestiture of businesses   | 2,351                        | 0        |
| Acquisitions, net of cash acquired, and purchases of intangibles and other assets | (1,301)                      | (3,490)  |
| Net cash used in investing activities   | (6,244)                      | (8,487)  |
| Financing activities  |                              |          |
| Net payments related to stock-based award activities                              | (268)                        | (921)    |
| Excess tax benefits from stock-based award activities                             | 198                          | 292      |
| Proceeds from issuance of debt, net of costs                                      | 5,651                        | 6,293    |
| Repayments of debt  | (6,203)                      | (6,304)  |
| Net cash used in financing activities   | (622)                        | (640)    |
| Effect of exchange rate changes on cash and cash equivalents                      | (86)                         | (9)      |
| Net increase in cash and cash equivalents   | 1,386                        | 882      |
| Cash and cash equivalents at beginning of period                                  | 14,778                       | 18,898   |
| Reclassification to assets held for sale  | 0                            | (160)    |

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|   |          |          |
|---|----------|----------|
| Cash and cash equivalents at end of period                              | \$16,164 | \$19,620 |
| Supplemental disclosures of cash flow information                       |          |          |
| Cash paid for taxes   | \$796    | \$1,666  |
| Cash paid for interest  | \$35     | \$38     |
| Non-cash investing activity:  |          |          |
| Receipt of Arris shares in connection with divestiture of Motorola Home | \$175    | \$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

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

On January 29, 2014, we entered into an agreement with Lenovo Group Limited (Lenovo) providing for the disposition of the Motorola Mobile business. As such, the financial results of Motorola Mobile are presented as "Net income (loss) from discontinued operations" on the Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2014; and assets and liabilities of Motorola Mobile to be disposed of are presented as "Assets held for sale" and "Liabilities held for sale" on the Consolidated Balance Sheet as of June 30, 2014, respectively.

On April 2, 2014, we completed a two-for-one stock split effected in the form of a stock dividend (the Stock Split). All references made to share or per share amounts in the accompanying consolidated financial statements and applicable disclosures have been retroactively adjusted to reflect the Stock Split. See Notes 10 and 11 for additional information about the Stock Split.

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, 2014, the Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2014, the Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2014, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2014 are unaudited. These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP). In our opinion, the unaudited interim consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of June 30, 2014, our results of operations for the three and six months ended June 30, 2013 and 2014, and our cash flows for the six months ended June 30, 2013 and 2014. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the year ending December 31, 2014.

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, 2013, filed with the SEC on February 12, 2014.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates. On an ongoing basis, we evaluate our estimates, including those related to the accounts receivable and sales allowances, fair values of financial instruments, intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of stock-based awards, inventory valuations, income taxes, and contingent liabilities, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Recent Accounting Pronouncement

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-08 (ASU 2014-08) "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." ASU 2014-08 raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the definition of a discontinued operation. It is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals



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that have not been reported in financial statements previously issued. We do not expect the impact of the adoption of ASU 2014-08 to be material to our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 (ASU 2014-09) "Revenue from Contracts with Customers." ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)", and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. We are currently in the process of evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial statements.

### Prior Period Reclassifications

Reclassifications of prior period amounts related to discontinued operations as a result of the expected Motorola Mobile disposition, and share and per share amounts due to the Stock Split have been made to conform to the current period presentation.

## Note 2. Financial Instruments

### Fair Value Measurements

We measure our cash equivalents, marketable securities, and foreign currency and interest rate derivative contracts at fair value on a recurring basis. Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. Assets and liabilities recorded at fair value are measured and classified in accordance with a three-tier fair value hierarchy based on the observability of the inputs available in the market used to measure fair value:

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

Level 2 - Inputs that are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant inputs are observable in the market or can be derived from observable market data. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, foreign exchange rates, and credit ratings.

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

The fair value hierarchy 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 because we use quoted market prices or alternative pricing sources and models utilizing market observable inputs to determine their fair value. We classify our foreign currency and interest rate derivative contracts primarily within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments.

### Cash, Cash Equivalents and Marketable Securities

The following tables summarize our cash, cash equivalents and marketable securities by significant investment categories as of December 31, 2013 and June 30, 2014 (in millions):

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| As of December 31, 2013                          |                                     |                              |                               |               |                                 |                          |
|--|-------------------------------------|------------------------------|-------------------------------|---------------|---------------------------------|--------------------------|
|  | Adjusted<br>Cost                    | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value | Cash and<br>Cash<br>Equivalents | Marketable<br>Securities |
| Cash   | \$9,909                             | \$0                          | \$0                           | \$9,909       | \$9,909                         | \$0                      |
| Level 1:   |                                     |                              |                               |               |                                 |                          |
| Money market and other funds                     | 4,428                               | 0                            | 0                             | 4,428         | 4,428                           | 0                        |
| U.S. government notes                            | 18,276                              | 23                           | (37)                          | ) 18,262      | 2,501                           | 15,761                   |
| Marketable equity securities                     | 197                                 | 167                          | 0                             | 364           | 0                               | 364                      |
|  | 22,901                              | 190                          | (37)                          | ) 23,054      | 6,929                           | 16,125                   |
| Level 2:   |                                     |                              |                               |               |                                 |                          |
| Time deposits <sup>(1)</sup>                     | 1,207                               | 0                            | 0                             | 1,207         | 790                             | 417                      |
| Money market and other<br>funds <sup>(2)</sup>   | 1,270                               | 0                            | 0                             | 1,270         | 1,270                           | 0                        |
| U.S. government agencies                         | 4,575                               | 3                            | (3)                           | ) 4,575       | 0                               | 4,575                    |
| Foreign government bonds                         | 1,502                               | 5                            | (26)                          | ) 1,481       | 0                               | 1,481                    |
| Municipal securities                             | 2,904                               | 9                            | (36)                          | ) 2,877       | 0                               | 2,877                    |
| Corporate debt securities                        | 7,300                               | 162                          | (67)                          | ) 7,395       | 0                               | 7,395                    |
| Agency residential<br>mortgage-backed securities | 5,969                               | 27                           | (187)                         | ) 5,809       | 0                               | 5,809                    |
| Asset-backed securities                          | 1,142                               | 0                            | (2)                           | ) 1,140       | 0                               | 1,140                    |
|  | 25,869                              | 206                          | (321)                         | ) 25,754      | 2,060                           | 23,694                   |
| Total  | \$58,679                            | \$396                        | \$(358)                       | ) \$58,717    | \$18,898                        | \$39,819                 |
| As of June 30, 2014                              |                                     |                              |                               |               |                                 |                          |
|  | Adjusted<br>Cost<br><br>(unaudited) | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value | Cash and<br>Cash<br>Equivalents | Marketable<br>Securities |
| Cash   | \$10,087                            | \$0                          | \$0                           | \$10,087      | \$10,087                        | \$0                      |
| Level 1:   |                                     |                              |                               |               |                                 |                          |
| Money market and other funds                     | 3,024                               | 0                            | 0                             | 3,024         | 3,024                           | 0                        |
| U.S. government notes                            | 13,668                              | 38                           | (9)                           | ) 13,697      | 252                             | 13,445                   |
| Marketable equity securities                     | 186                                 | 210                          | 0                             | 396           | 0                               | 396                      |
|  | 16,878                              | 248                          | (9)                           | ) 17,117      | 3,276                           | 13,841                   |
| Level 2:   |                                     |                              |                               |               |                                 |                          |
| Time deposits <sup>(1)</sup>                     | 4,168                               | 0                            | 0                             | 4,168         | 3,218                           | 950                      |
| Money market and other<br>funds <sup>(2)</sup>   | 2,889                               | 0                            | 0                             | 2,889         | 2,889                           | 0                        |
| Fixed-income bond funds <sup>(3)</sup>           | 150                                 | 1                            | 0                             | 151           | 0                               | 151                      |
| U.S. government agencies                         | 5,560                               | 4                            | (1)                           | ) 5,563       | 150                             | 5,413                    |
| Foreign government bonds                         | 1,681                               | 16                           | (8)                           | ) 1,689       | 0                               | 1,689                    |
| Municipal securities                             | 3,057                               | 26                           | (7)                           | ) 3,076       | 0                               | 3,076                    |
| Corporate debt securities                        | 7,783                               | 219                          | (13)                          | ) 7,989       | 0                               | 7,989                    |
| Agency residential<br>mortgage-backed securities | 6,733                               | 82                           | (76)                          | ) 6,739       | 0                               | 6,739                    |
| Asset-backed securities                          | 1,736                               | 1                            | (1)                           | ) 1,736       | 0                               | 1,736                    |
|  | 33,757                              | 349                          | (106)                         | ) 34,000      | 6,257                           | 27,743                   |
| Total  | \$60,722                            | \$597                        | \$(115)                       | ) \$61,204    | \$19,620                        | \$41,584                 |



(1) The majority of our time deposits are foreign deposits.

The balances at December 31, 2013 and June 30, 2014 were related to cash collateral received in connection with  
(2) our securities lending program, which was invested in reverse repurchase agreements maturing within three months. See below for further discussion of this program.

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(3) Fixed-income bond funds consist of mutual funds that primarily invest in corporate and government bonds. Cash, cash equivalents and marketable securities to be disposed of as a result of the Motorola Mobile disposition were included in "Assets held for sale" on the Consolidated Balance Sheet as of June 30, 2014, and accordingly, are not included in this table.

During the second quarter of 2013, we received approximately \$175 million in Arris Group, Inc. (Arris) common stock (10.6 million shares) in connection with the sale of the Motorola Home business (see details in Note 7). These shares are accounted for as available-for-sale marketable equity securities.

We determine realized gains or losses on the sale of marketable securities on a specific identification method. We recognized gross realized gains of \$142 million and \$217 million for the three and six months ended June 30, 2013 and \$58 million and \$156 million for the three and six months ended June 30, 2014. We recognized gross realized losses of \$41 million and \$56 million for the three and six months ended June 30, 2013 and \$10 million and \$34 million for the three and six months ended June 30, 2014. We reflect these gains and losses as a component of "Interest and other income, net", in the accompanying Consolidated Statements of Income.

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

|                                 | As of June 30,<br>2014<br>(unaudited) |
|---------------------------------|---------------------------------------|
| Due in 1 year                   | \$11,039                              |
| Due in 1 year through 5 years   | 17,029                                |
| Due in 5 years through 10 years | 6,044                                 |
| Due after 10 years              | 6,925                                 |
| Total                           | \$41,037                              |

The following tables present gross unrealized losses and fair values for those investments that were in an unrealized loss position as of December 31, 2013 and June 30, 2014, 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, 2013 |                 |                      |                 |            |                 |
|---|-------------------------|-----------------|----------------------|-----------------|------------|-----------------|
|   | Less than 12 Months     |                 | 12 Months or Greater |                 | Total      |                 |
|   | Fair Value              | Unrealized Loss | Fair Value           | Unrealized Loss | Fair Value | Unrealized Loss |
| U.S. government notes                         | \$4,404                 | \$(37)          | \$0                  | \$0             | \$4,404    | \$(37)          |
| U.S. government agencies                      | 496                     | (3)             | 0                    | 0               | 496        | (3)             |
| Foreign government bonds                      | 899                     | (23)            | 83                   | (3)             | 982        | (26)            |
| Municipal securities                          | 1,210                   | (32)            | 99                   | (4)             | 1,309      | (36)            |
| Corporate debt securities                     | 2,583                   | (62)            | 69                   | (5)             | 2,652      | (67)            |
| Agency residential mortgage-backed securities | 4,065                   | (167)           | 468                  | (20)            | 4,533      | (187)           |
| Asset-backed securities                       | 643                     | (2)             | 0                    | 0               | 643        | (2)             |
| Total   | \$14,300                | \$(326)         | \$719                | \$(32)          | \$15,019   | \$(358)         |

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|   | As of June 30, 2014 |            |                      |            |            |            |
|---|---------------------|------------|----------------------|------------|------------|------------|
|   | Less than 12 Months | Unrealized | 12 Months or Greater | Unrealized | Total      | Unrealized |
|   | Fair Value          | Loss       | Fair Value           | Loss       | Fair Value | Loss       |
|   |                     |            | (unaudited)          |            |            |            |
| U.S. government notes                         | \$0                 | \$0        | \$438                | \$(9       | ) \$438    | \$(9       |
| U.S. government agencies                      | 474                 | (1         | ) 0                  | 0          | 474        | (1         |
| Foreign government bonds                      | 369                 | (4         | ) 162                | (4         | ) 531      | (8         |
| Municipal securities                          | 0                   | 0          | 352                  | (7         | ) 352      | (7         |
| Corporate debt securities                     | 675                 | (5         | ) 352                | (8         | ) 1,027    | (13        |
| Agency residential mortgage-backed securities | 0                   | 0          | 2,730                | (76        | ) 2,730    | (76        |
| Asset-backed securities                       | 0                   | 0          | 196                  | (1         | ) 196      | (1         |
| Total   | \$1,518             | \$(10      | ) \$4,230            | \$(105     | ) \$5,748  | \$(115     |

We periodically review our marketable debt and equity securities for other-than-temporary impairment. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and our intent to sell. For marketable debt securities, we also consider whether (i) it is more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis, and (ii) the amortized cost basis cannot be recovered as a result of credit losses. During the three and six months ended June 30, 2013 and 2014, we did not recognize any other-than-temporary impairment loss.

**Securities Lending Program**

From time to time, we enter into securities lending agreements with financial institutions to enhance investment income. We loan selected securities which are collateralized in the form of cash or securities. Cash collateral is invested in reverse repurchase agreements which are collateralized in the form of securities.

We classify loaned securities as cash equivalents or marketable securities and record the cash collateral as an asset with a corresponding liability in the accompanying Consolidated Balance Sheets. We classify reverse repurchase agreements maturing within three months as cash equivalents and those longer than three months as receivable under reverse repurchase agreements in the accompanying Consolidated Balance Sheets. For security collateral received, we do not record an asset or liability except in the event of counterparty default.

**Derivative Financial Instruments**

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

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

We enter into master netting arrangements, which reduce credit risk by permitting net settlement of transactions with the same counterparty. To further reduce credit risk, we enter into collateral security arrangements under which the counterparty is required to provide collateral when the net fair value of certain financial instruments fluctuates from contractually established thresholds. We can take possession of the collateral in the event of counterparty default. As of December 31, 2013 and June 30, 2014, we received cash collateral related to the derivative instruments under our collateral security arrangements of \$35 million and \$1 million.

**Cash Flow Hedges**

We use options designated as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar. The notional principal of these contracts was approximately \$10.0 billion and



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\$9.4 billion as of December 31, 2013 and June 30, 2014. These foreign exchange contracts have maturities of 36 months or less.

In 2012, we entered into forward-starting interest rate swaps, with a total notional amount of \$1.0 billion and terms calling for us to receive interest at a variable rate and to pay interest at a fixed rate, that effectively locked in an interest rate on our anticipated debt issuance of \$1.0 billion in 2014. We issued \$1.0 billion of unsecured senior notes in February 2014 (See details in Note 3). As a result, we terminated the forward-starting interest rate swaps upon the debt issuance. The gain associated with the termination is reported within operating activities in the Consolidated Statement of Cash Flows for the six months ended June 30, 2014, consistent with the impact of the hedged item. We reflect gains or losses on the effective portion of a cash flow hedge as a component of AOCI and subsequently reclassify cumulative gains and losses to revenues or interest expense when the hedged transactions are recorded. If the hedged transactions become probable of not occurring, the corresponding amounts in AOCI would be immediately reclassified to "Interest and other income, net". Further, we exclude the change in the time value of the options from our assessment of hedge effectiveness. We record the premium paid or time value of an option on the date of purchase as an asset. Thereafter, we recognize changes to this time value in "Interest and other income, net".

As of June 30, 2014, the effective portion of our cash flow hedges before tax effect was \$70 million, of which \$8 million is expected to be reclassified from AOCI into earnings within the next 12 months.

### Fair Value Hedges

We use forward contracts designated as fair value hedges to hedge foreign currency risks for our investments denominated in currencies other than the U.S. dollar. Gains and losses on these contracts are recognized in "Interest and other income, net", along with the offsetting losses and gains of the related hedged items. We exclude changes in the time value for forward contracts from the assessment of hedge effectiveness. The notional principal of these contracts was \$1.2 billion and \$1.4 billion as of December 31, 2013 and June 30, 2014.

### Other Derivatives

Other derivatives not designated as hedging instruments consist of forward contracts that we use to hedge intercompany transactions and other monetary assets or liabilities denominated in currencies other than the local currency of a subsidiary. We recognize gains and losses on these contracts, as well as the related costs in "Interest and other income, net", along with the foreign currency gains and losses on monetary assets and liabilities. The notional principal of foreign exchange contracts outstanding was \$9.4 billion and \$6.3 billion at December 31, 2013 and June 30, 2014.

We also use exchange-traded interest rate futures contracts and "To Be Announced" (TBA) forward purchase commitments of mortgage-backed assets to hedge interest rate risks on certain fixed income securities. The TBA contracts meet the definition of derivative instruments in cases where physical delivery of the assets is not taken at the earliest available delivery date. Our interest rate futures and TBA contracts (together interest rate contracts) are not designated as hedging instruments. We recognize gains and losses on these contracts, as well as the related costs, in "Interest and other income, net". The gains and losses are generally economically offset by unrealized gains and losses in the underlying available-for-sale securities, which are recorded as a component of AOCI until the securities are sold or other-than-temporarily impaired, at which time the amounts are moved from AOCI into "Interest and other income, net". The total notional amounts of interest rate contracts outstanding were \$13 million at December 31, 2013 and \$200 million at June 30, 2014.

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

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|   |  | As of December 31, 2013  |  |                     |
|---|--|--|--|---------------------|
|   | Balance Sheet Location   | Fair Value of<br>Derivatives<br>Designated as<br>Hedging Instruments | Fair Value of<br>Derivatives Not<br>Designated as<br>Hedging Instruments | Total Fair<br>Value |
| Derivative Assets:  |  |  |  |                     |
| Level 2:  |  |  |  |                     |
| Foreign exchange contracts  | Prepaid revenue share,<br>expenses and other<br>assets, current and<br>non-current                             | \$ 133   | \$ 12  | \$ 145              |
| Interest rate contracts   | Prepaid revenue share,<br>expenses and other<br>assets, current and<br>non-current                             | 87   | 0  | 87                  |
| Total   |  | \$ 220   | \$ 12  | \$ 232              |
| Derivative Liabilities:   |  |  |  |                     |
| Level 2:  |  |  |  |                     |
| Foreign exchange contracts  | Accrued expenses and<br>other current liabilities  | \$ 0   | \$ 4   | \$ 4                |
|   |  | \$ 0   | \$ 4   | \$ 4                |
|   |  |  |  |                     |
|   |  | As of June 30, 2014  |  |                     |
|   | Balance Sheet Location   | Fair Value of<br>Derivatives<br>Designated as<br>Hedging Instruments | Fair Value of<br>Derivatives Not<br>Designated as<br>Hedging Instruments | Total Fair<br>Value |
| Derivative Assets:  |  |  |  |                     |
| Level 2:  |  |  |  |                     |
| Foreign exchange contracts  | Prepaid revenue share,<br>expenses and other<br>assets, current and<br>non-current and assets<br>held for sale | \$ 91  | \$ 0   | \$ 91               |
| Total   |  | \$ 91  | \$ 0   | \$ 91               |
| Derivative Liabilities:   |  |  |  |                     |
| Level 2:  |  |  |  |                     |
| Foreign exchange contracts  | Accrued expenses, and<br>other current liabilities<br>and liabilities held for<br>sale                         | \$ 10  | \$ 1   | \$ 11               |
| Total   |  | \$ 10  | \$ 1   | \$ 11               |
| The effect of derivative instruments in cash flow hedging relationships on income and other comprehensive income (OCI) is summarized below (in millions): |  |  |  |                     |

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|   | Gains (Losses) Recognized in OCI on Derivatives Before Tax Effect (Effective Portion) |       |                           |        |
|---|---|-------|---------------------------|--------|
|   | Three Months Ended June 30,   |       | Six Months Ended June 30, |        |
|   | 2013  | 2014  | 2013                      | 2014   |
| Derivatives in Cash Flow Hedging Relationship | (unaudited)   |       |                           |        |
| Foreign exchange contracts                    | \$(33   | ) \$9 | \$130                     | \$22   |
| Interest rate contracts                       | 58  | 0     | 68                        | (31 )  |
| Total   | \$25  | \$9   | \$198                     | \$(9 ) |

|   |                                | Gains Reclassified from AOCI into Income (Effective Portion) |      |                           |      |
|---|--------------------------------|--|------|---------------------------|------|
|   |                                | Three Months Ended June 30,                                  |      | Six Months Ended June 30, |      |
| Derivatives in Cash Flow Hedging Relationship | Income Statement Location      | 2013   | 2014 | 2013                      | 2014 |
|   |                                | (unaudited)  |      |                           |      |
| Foreign exchange contracts                    | Revenues                       | \$35   | \$6  | \$70                      | \$14 |
| Interest rate contracts                       | Interest and other income, net | 0  | 1    | 0                         | 1    |
| Total   |                                | \$35   | \$7  | \$70                      | \$15 |

|   |                                | Gains (Losses) Recognized in Income on Derivatives (Amount Excluded from Effectiveness Testing and Ineffective Portion) <sup>(1)</sup> |         |                           |          |
|---|--------------------------------|--|---------|---------------------------|----------|
|   |                                | Three Months Ended June 30,  |         | Six Months Ended June 30, |          |
| Derivatives in Cash Flow Hedging Relationship | Income Statement Location      | 2013   | 2014    | 2013                      | 2014     |
|   |                                | (unaudited)  |         |                           |          |
| Foreign exchange contracts                    | Interest and other income, net | \$(38 )  | \$(67 ) | \$(89 )                   | \$(134 ) |
| Interest rate contracts                       | Interest and other income, net | 0  | 0       | 0                         | 4        |
| Total   |                                | \$(38 )  | \$(67 ) | \$(89 )                   | \$(130 ) |

<sup>(1)</sup> Gains (losses) related to the ineffective portion of the hedges were not material in all periods presented. The effect of derivative instruments in fair value hedging relationships on income is summarized below (in millions):

|  |                                | Gains (Losses) Recognized in Income on Derivatives <sup>(2)</sup> |         |                           |         |
|--|--------------------------------|---|---------|---------------------------|---------|
|  |                                | Three Months Ended June 30,                                       |         | Six Months Ended June 30, |         |
| Derivatives in Fair Value Hedging Relationship | Income Statement Location      | 2013  | 2014    | 2013                      | 2014    |
|  |                                | (unaudited)   |         |                           |         |
| Foreign exchange contracts                     | Interest and other income, net | \$25  | \$(19 ) | \$62                      | \$(21 ) |
| Hedged item                                    | Interest and other income, net | (27 )   | 17      | (65 )                     | 17      |
| Total  |                                | \$(2 )  | \$(2 )  | \$(3 )                    | \$(4 )  |

Losses related to the amount excluded from effectiveness testing of the hedges were \$2 million and \$3 million for  
(2) the three and six months ended June 30, 2013 and \$2 million and \$4 million for the three and six months ended  
June 30, 2014.

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

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| Derivatives Not Designated As Hedging Instruments | Income Statement Location  | Gains (Losses) Recognized in Income on Derivatives |        |                           |         |
|---|--|--|--------|---------------------------|---------|
|   |  | Three Months Ended June 30,                        |        | Six Months Ended June 30, |         |
|   |  | 2013   | 2014   | 2013                      | 2014    |
|   |  | (unaudited)  |        |                           |         |
| Foreign exchange contracts                        | Interest and other income, net, and net income (loss) from discontinued operations | \$ 70  | \$(76) | ) \$ 157                  | \$(113) |
| Interest rate contracts                           | Interest and other income, net   | 0  | (1)    | ) 0                       | 0       |
| Total   |  | \$ 70  | \$(77) | ) \$ 157                  | \$(113) |

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

We present our derivatives, securities lending and reverse repurchase agreements at gross fair values in the Consolidated Balance Sheets. However, our master netting and other similar arrangements allow net settlements under certain conditions. As of December 31, 2013 and June 30, 2014, information related to these offsetting arrangements was as follows (in millions):

## Offsetting of Assets

As of December 31, 2013

| Description                   | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset |                          |                              |                    |
|-------------------------------|------------------------------------|---|--|--|--------------------------|------------------------------|--------------------|
|                               |                                    |   |  | Financial Instruments  | Cash Collateral Received | Non-Cash Collateral Received | Net Assets Exposed |
| Derivatives                   | \$ 232                             | \$ 0  | \$ 232   | \$(2 ) <sup>(1)</sup>  | \$(35 )                  | \$(52 )                      | \$ 143             |
| Reverse repurchase agreements | 1,370                              | 0   | 1,370  | 0 <sup>(2)</sup>   | 0                        | (1,370 )                     | 0                  |
| Total                         | \$ 1,602                           | \$ 0  | \$ 1,602   | \$(2 )   | \$(35 )                  | \$(1,422 )                   | \$ 143             |

As of June 30, 2014

| Description | Gross Amounts of Recognized Assets | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset |                          |                              |                    |
|-------------|------------------------------------|---|--|--|--------------------------|------------------------------|--------------------|
|             |                                    |   |  | Financial Instruments  | Cash Collateral Received | Non-Cash Collateral Received | Net Assets Exposed |

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|                                  | Assets<br>(unaudited) | Balance<br>Sheets | Balance<br>Sheets |                |                       |        |            |      |  |
|----------------------------------|-----------------------|-------------------|-------------------|----------------|-----------------------|--------|------------|------|--|
| Derivatives                      | \$91                  | \$ 0              | \$ 91             |                | \$(1 ) <sup>(1)</sup> | \$(1 ) | \$(16 )    | \$73 |  |
| Reverse repurchase<br>agreements | 2,989                 | 0                 | 2,989             | <sup>(2)</sup> | 0                     | 0      | (2,989 )   | 0    |  |
| Total                            | \$3,080               | \$ 0              | \$ 3,080          |                | \$(1 )                | \$(1 ) | \$(3,005 ) | \$73 |  |

<sup>(1)</sup> The balances at December 31, 2013 and June 30, 2014 were related to derivative liabilities which are allowed to be net settled against derivative assets in accordance with our master netting agreements.

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(2) The balances at December 31, 2013 and June 30, 2014 included \$1,270 million and \$2,889 million recorded in cash and cash equivalents, respectively, and \$100 million and \$100 million recorded in receivable under reverse repurchase agreements, respectively.

## Offsetting of Liabilities

As of December 31, 2013

Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset

| Description                   | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Financial Instruments | Cash Collateral Pledged | Non-Cash Collateral Pledged | Net Liabilities |
|-------------------------------|---|---|--|-----------------------|-------------------------|-----------------------------|-----------------|
| Derivatives                   | \$4                                     | \$ 0  | \$ 4   | \$(2 ) <sup>(3)</sup> | \$0                     | \$0                         | \$2             |
| Securities lending agreements | 1,374                                   | 0   | 1,374  | 0                     | 0                       | (1,357 )                    | 17              |
| Total                         | \$1,378                                 | \$ 0  | \$ 1,378   | \$(2 )                | \$0                     | \$(1,357 )                  | \$19            |

As of June 30, 2014

Gross Amounts Not Offset in the Consolidated Balance Sheets, but Have Legal Rights to Offset

| Description                   | Gross Amounts of Recognized Liabilities | Gross Amounts Offset in the Consolidated Balance Sheets | Net Presented in the Consolidated Balance Sheets | Financial Instruments | Cash Collateral Pledged | Non-Cash Collateral Pledged | Net Liabilities |
|-------------------------------|---|---|--|-----------------------|-------------------------|-----------------------------|-----------------|
|                               | (unaudited)                             |   |  |                       |                         |                             |                 |
| Derivatives                   | \$11                                    | \$ 0  | \$ 11  | \$(1 ) <sup>(3)</sup> | \$0                     | \$0                         | \$10            |
| Securities lending agreements | 3,086                                   | 0   | 3,086  | 0                     | 0                       | (3,040 )                    | 46              |
| Total                         | \$3,097                                 | \$ 0  | \$ 3,097   | \$(1 )                | \$0                     | \$(3,040 )                  | \$56            |

(3) The balances at December 31, 2013 and June 30, 2014 were related to derivative assets which are allowed to be net settled against derivative liabilities in accordance with our master netting agreements.

## Note 3. Debt

## Short-Term Debt

We have a debt financing program of up to \$3.0 billion through the issuance of commercial paper. Net proceeds from this program are used for general corporate purposes. At December 31, 2013 and June 30, 2014, we had \$2.0 billion of outstanding commercial paper recorded as short-term debt with weighted-average interest rates of 0.1%. In conjunction with this program, we have a \$3.0 billion revolving credit facility expiring in July 2016. The interest rate for the credit facility is determined based on a formula using certain market rates. At December 31, 2013 and June 30, 2014, we were in compliance with the financial covenant in the credit facility, and no amounts were outstanding under the credit facility at December 31, 2013 and June 30, 2014. The estimated fair value of the commercial paper

approximated its carrying value at December 31, 2013 and June 30, 2014.

**Long-Term Debt**

We issued \$1.0 billion of unsecured senior notes (the "2014 Notes") in February 2014 and \$3.0 billion of unsecured senior notes in three tranches (collectively, the "2011 Notes") in May 2011. On May 19, 2014, we repaid \$1.0 billion on the first tranche of our 2011 Notes upon their maturity. Additionally, we entered into a capital lease obligation in August 2013. The details of these financing arrangements are described in the table below (in millions):

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|  | As of<br>December 31,<br>2013 | As of<br>June 30,<br>2014<br>(unaudited) |
|--|-------------------------------|--|
| Short-Term Portion of Long-Term Debt     |                               |  |
| 1.25% Notes due on May 19, 2014          | \$1,000                       | \$0                                      |
| Capital Lease Obligation                 | 9                             | 9  |
| Total                                    | \$1,009                       | \$9                                      |
| Long-Term Debt                           |                               |  |
| 2.125% Notes due on May 19, 2016         | \$1,000                       | \$1,000                                  |
| 3.625% Notes due on May 19, 2021         | 1,000                         | 1,000                                    |
| 3.375% Notes due on February 25, 2024    | 0                             | 1,000                                    |
| Unamortized discount for the Notes above | (10                           | ) (9                                     |
| Subtotal                                 | 1,990                         | 2,991                                    |
| Capital Lease Obligation                 | 246                           | 241                                      |
| Total                                    | \$2,236                       | \$3,232                                  |

The effective interest yields of the Notes due in 2016, 2021, and 2024 were 2.241%, 3.734% and 3.377%, respectively. Interest on the 2011 and 2014 Notes is payable semi-annually. The 2011 and 2014 Notes rank equally with each other and with all of our other senior unsecured and unsubordinated indebtedness from time to time outstanding. We may redeem the 2011 and 2014 Notes at any time in whole or in part at specified redemption prices. We are not subject to any financial covenants under the 2011 Notes or the 2014 Notes. We used the net proceeds from the issuance of the 2011 Notes to repay a portion of our outstanding commercial paper and for general corporate purposes. We used the net proceeds from the issuance of the 2014 Notes for the repayment of the portion of the principal amount of our 2011 Notes which matured on May 19, 2014 and for general corporate purposes. The total estimated fair value of the 2011 and 2014 Notes was approximately \$3.1 billion at both December 31, 2013 and June 30, 2014. The fair value of the outstanding 2011 and 2014 Notes was determined based on observable market prices of identical instruments in less active markets and is categorized accordingly as Level 2 in the fair value hierarchy. In August 2013, we entered into a capital lease obligation on certain property expiring in 2028 with an option to purchase the property in 2016. The effective rate of the capital lease obligation approximates the market rate. The estimated fair value of the capital lease obligation approximated its carrying value at December 31, 2013 and June 30, 2014.

## Note 4. Balance Sheet Components

## Inventories

Inventories consisted of the following (in millions):

|                                   | As of<br>December 31,<br>2013 | As of<br>June 30,<br>2014<br>(unaudited) |
|-----------------------------------|-------------------------------|--|
| Raw materials and work in process | \$115                         | \$1                                      |
| Finished goods                    | 311                           | 292                                      |
| Inventories                       | \$426                         | \$293                                    |

Inventories to be disposed of as a result of the Motorola Mobile disposition were included in "Assets held for sale" on the Consolidated Balance Sheet as of June 30, 2014, and accordingly, are not included in this table.

## Property and Equipment

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



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|  | As of<br>December 31,<br>2013 | As of<br>June 30,<br>2014<br>(unaudited) |
|--|-------------------------------|--|
| Information technology assets  | \$9,094                       | \$9,701                                  |
| Land and buildings   | 7,488                         | 10,274                                   |
| Construction in progress   | 5,602                         | 5,890                                    |
| Leasehold improvements   | 1,576                         | 1,629                                    |
| Furniture and fixtures   | 77                            | 80                                       |
| Total  | 23,837                        | 27,574                                   |
| Less: accumulated depreciation and amortization  | 7,313                         | 8,088                                    |
| Property and equipment, net  | \$16,524                      | \$19,486                                 |
| Property under capital lease with a cost basis of \$258 million was included in land and buildings and construction in progress as of June 30, 2014. Additionally, property and equipment to be disposed of as a result of the Motorola Mobile disposition were included in "Assets held for sale" on the Consolidated Balance Sheet as of June 30, 2014, and accordingly, are not included in this table. |                               |  |

## Accumulated Other Comprehensive Income (Loss)

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

|  | Foreign Currency<br>Translation<br>Adjustments | Unrealized Gains<br>(Losses) on<br>Available-for-Sale<br>Investments | Unrealized<br>Gains on Cash<br>Flow Hedges | Total  |
|--|--|--|--|--------|
| Balance as of December 31, 2013                            | \$16   | \$50   | \$59                                       | \$125  |
| Other comprehensive income (loss) before reclassifications | 54   | 445  | (6   | ) 493  |
| Amounts reclassified from AOCI                             | 0  | (107   | ) (9                                       | ) (116 |
| Other comprehensive income (loss)                          | 54   | 338  | (15  | ) 377  |
| Balance as of June 30, 2014                                | \$70   | \$388  | \$44                                       | \$502  |

The effects on net income of amounts reclassified from AOCI were as follows (in millions, unaudited):

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| AOCI Components                                    | Location                                       | Gains (Losses) Reclassified from AOCI to the Consolidated Statement of Income |      |                              |       |
|--|--|---|------|------------------------------|-------|
|  |  | Three Months Ended<br>June 30,  |      | Six Months Ended<br>June 30, |       |
|  |  | 2013  | 2014 | 2013                         | 2014  |
| Unrealized gains on available-for-sale investments | Interest and other income, net                 | \$101   | \$48 | \$161                        | \$122 |
|  | Net Income (loss) from discontinued operations | 43  | 0    | 43                           | 0     |
|  | Provision for income taxes                     | (36)  | (8)  | (50)                         | (15)  |
|  | Net of tax                                     | \$108   | \$40 | \$154                        | \$107 |
| Unrealized gains on cash flow hedges               |  |   |      |                              |       |
| Foreign exchange contracts                         | Revenue  | \$35  | \$6  | \$70                         | \$14  |
| Interest rate contracts                            | Interest and other income, net                 | 0   | 1    | 0                            | 1     |
|  | Provision for income taxes                     | (13)  | (3)  | (26)                         | (6)   |
|  | Net of tax                                     | \$22  | \$4  | \$44                         | \$9   |
| Total amount reclassified, net of tax              |  | \$130   | \$44 | \$198                        | \$116 |

## Note 5. Acquisitions

In February 2014, we completed the acquisition of Nest Labs, Inc. (Nest), a company whose mission is to reinvent devices in the home such as thermostats and smoke alarms. Prior to this transaction, we had an approximately 12% ownership interest in Nest. The acquisition is expected to enhance Google's suite of products and services and allow Nest to continue to innovate upon devices in the home, making them more useful, intuitive, and thoughtful, and to reach more users in more countries.

Of the total \$2.5 billion purchase price and the fair value of our previously held equity interest of \$152 million, \$51 million was cash acquired, \$430 million was attributed to intangible assets, \$2.32 billion was attributed to goodwill, and \$129 million was attributed to net liabilities assumed. The goodwill of \$2.32 billion is primarily attributable to the synergies expected to arise after the acquisition. Goodwill is not expected to be deductible for tax purposes.

This transaction is considered a "step acquisition" under GAAP whereby our ownership interest in Nest held before the acquisition is required to be remeasured to fair value at the date of the acquisition. Such fair value was estimated by using discounted cash flow valuation methodologies. Inputs used in the methodologies primarily included projected future cash flows, discounted at a rate commensurate with the risk involved. The gain of \$103 million as a result of remeasurement is included in "Interest and other income, net" on our Consolidated Statement of Income for the six months ended June 30, 2014.

During the six months ended June 30, 2014, we completed other acquisitions and purchases of intangible assets for total cash consideration of approximately \$1,003 million. Of the total \$1,003 million purchase price and the fair value of our previously held equity interest of \$33 million, \$62 million was cash acquired, \$216 million was attributed to intangible assets, \$833 million was attributed to goodwill, and \$75 million was attributed to net liabilities assumed. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other functional areas, our technologies, and our product offerings. The amount of goodwill expected to be deductible for tax purposes is approximately \$20 million.



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

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For all acquisitions completed during the six months ended June 30, 2014, patents and developed technology have a weighted-average useful life of 4.8 years, customer relationships have a weighted-average useful life of 4.8 years, and trade names and other have a weighted-average useful life of 7.6 years.

In June 2014, Nest entered into an agreement to acquire Dropcam, Inc. (Dropcam), a company that enables consumers and businesses to monitor their homes and offices via video, for approximately \$555 million in cash, subject to adjustments. With Dropcam on board, Nest expects to continue to reinvent products that will help shape the future of the connected home. The transaction closed on July 17, 2014. Valuation of the assets acquired and liabilities assumed in the transaction is currently in process and required disclosures will be provided upon the completion of the valuation in the third quarter of 2014.

In June 2014, we entered into an agreement to acquire Skybox Imaging, Inc., a satellite imaging company, for approximately \$500 million in cash, subject to adjustments. We expect the acquisition to keep Google Maps accurate with up-to-date imagery and, over time, improve Internet access and disaster relief. The transaction is subject to customary closing conditions, including the receipt of regulatory approvals in the United States.

#### Note 6. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended June 30, 2014 were as follows (in millions, unaudited):

|   |          |
|---|----------|
| Balance as of December 31, 2013               | \$11,492 |
| Goodwill acquired                             | 3,155    |
| Goodwill reclassified to assets held for sale | (71)     |
| Goodwill adjustment                           | 10       |
| Balance as of June 30, 2014                   | \$14,586 |

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

|                                  | As of December 31, 2013 |                          |                    |
|----------------------------------|-------------------------|--------------------------|--------------------|
|                                  | Gross Carrying Amount   | Accumulated Amortization | Net Carrying Value |
| Patents and developed technology | \$7,282                 | \$2,102                  | \$5,180            |
| Customer relationships           | 1,770                   | 1,067                    | 703                |
| Trade names and other            | 534                     | 351                      | 183                |
| Total                            | \$9,586                 | \$3,520                  | \$6,066            |

  

|                                  | As of June 30, 2014               |                          |                    |
|----------------------------------|-----------------------------------|--------------------------|--------------------|
|                                  | Gross Carrying Amount (unaudited) | Accumulated Amortization | Net Carrying Value |
| Patents and developed technology | \$6,976                           | \$2,346                  | \$4,630            |
| Customer relationships           | 1,400                             | 1,085                    | 315                |
| Trade names and other            | 650                               | 361                      | 289                |
| Total                            | \$9,026                           | \$3,792                  | \$5,234            |

Goodwill and intangible assets to be disposed of as a result of our Motorola Mobile disposition were included in "Assets held for sale" on the Consolidated Balance Sheet as of June 30, 2014 and accordingly, are not included in the table above. Amortization of these intangible assets was stopped as of the date they were deemed to be held for sale. Amortization expense relating to acquisition-related intangible assets was \$246 million and \$525 million for the three and six months ended June 30, 2013 and \$266 million and \$536 million for the three and six months ended June 30,

2014. Such amounts do not include amortization expenses related to the intangible assets to be disposed of, which were included in "Net income (loss) from discontinued operations" when applicable.

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As of June 30, 2014, expected amortization expense relating to acquisition-related intangible assets for each of the next five years and thereafter was as follows (in millions, unaudited):

|                   |         |
|-------------------|---------|
| Remainder of 2014 | \$ 528  |
| 2015              | 911     |
| 2016              | 822     |
| 2017              | 734     |
| 2018              | 664     |
| Thereafter        | 1,575   |
|                   | \$5,234 |

#### Note 7. Discontinued Operations

##### Motorola Mobile

On January 29, 2014, we entered into an agreement with Lenovo providing for the disposition of the Motorola Mobile business for a total purchase price of approximately \$2.9 billion (subject to certain adjustments), including \$1.4 billion to be paid at close, comprised of \$660 million in cash and \$750 million in Lenovo ordinary shares (subject to a share cap and floor). The remaining \$1.5 billion will be paid in the form of an interest-free, three-year prepayable promissory note.

We will maintain ownership of the vast majority of the Motorola Mobile patent portfolio, including current patent applications and invention disclosures, which will be licensed back to Motorola Mobile for its continued operations. Additionally, in connection with the sale, we will indemnify Lenovo for certain potential liabilities of the Motorola Mobile business. The transaction is subject to the satisfaction of regulatory requirements, customary closing conditions and any other needed approvals and is expected to close in the second half of 2014.

As such, financial results of Motorola Mobile are presented as "Net income (loss) from discontinued operations" on the Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2014; and assets and liabilities of Motorola Mobile to be disposed of are presented as "Assets held for sale" and "Liabilities held for sale" on the Consolidated Balance Sheet as of June 30, 2014, respectively.

The following table presents financial results of the Motorola Mobile business included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013 and 2014 (in millions, unaudited):

|   | Three Months Ended June 30, |         | Six Months Ended June 30, |         |
|---|-----------------------------|---------|---------------------------|---------|
|   | 2013                        | 2014    | 2013                      | 2014    |
| Revenues  | \$998                       | \$1,806 | \$2,016                   | \$3,183 |
| Loss from discontinued operations before income taxes | (331)                       | (99)    | (602)                     | (373)   |
| Benefits from income taxes                            | 111                         | 31      | 178                       | 107     |
| Net loss from discontinued operations                 | \$(220)                     | \$(68)  | \$(424)                   | \$(266) |

The following table presents the aggregate carrying amounts of the major classes of assets and liabilities related to the Motorola Mobile business to be disposed of as of June 30, 2014 (in millions, unaudited):

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## Assets:

|  |         |
|--|---------|
| Cash and cash equivalents                      | \$ 160  |
| Accounts receivable                            | 1,122   |
| Inventories                                    | 134     |
| Prepaid expenses and other current assets      | 425     |
| Prepaid expenses and other assets, non-current | 275     |
| Property and equipment, net                    | 534     |
| Intangible assets, net                         | 947     |
| Goodwill                                       | 71      |
| Total assets                                   | \$3,668 |

## Liabilities:

|  |          |
|--|----------|
| Accounts payable                               | \$ 1,156 |
| Accrued compensation and benefits              | 82       |
| Accrued expenses and other current liabilities | 589      |
| Deferred revenue                               | 200      |
| Other long-term liabilities                    | 277      |
| Total liabilities                              | \$2,304  |

## Motorola Home

In December 2012, we entered into an agreement with Arris and certain other persons providing for the disposition of the Motorola Home business. The transaction closed on April 17, 2013 (the date of divestiture). As such, financial results of Motorola Home through the date of divestiture were included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013.

The following table presents financial results of the Motorola Home business included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013 (in millions, unaudited):

|   | Three Months<br>Ended June 30,<br>2013 <sup>(1)</sup> | Six Months<br>Ended June 30,<br>2013 <sup>(2)</sup> |
|---|---|---|
| Revenues  | \$66  | \$804   |
| Loss from discontinued operations before income taxes | (114)   | (67)  |
| Benefits from income taxes                            | 41  | 16  |
| Gain on disposal                                      | 747   | 747   |
| Net income from discontinued operations               | \$674   | \$696   |

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

<sup>(2)</sup> The operating results of Motorola Home were included in our Consolidated Statements of Income from January 1, 2013 through the date of divestiture.

## Note 8. Interest and Other Income, Net

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

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|   | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|---|--------------------------------|--------|------------------------------|--------|
|   | 2013                           | 2014   | 2013                         | 2014   |
| Interest income                                       | \$ 182                         | \$ 169 | \$ 362                       | \$ 337 |
| Interest expense                                      | (19)                           | ) (27  | ) (40                        | ) (51  |
| Realized gains on available-for-sale investments, net | 101                            | 48     | 161                          | 122    |
| Foreign currency exchange losses, net                 | (48)                           | ) (93  | ) (109                       | ) (202 |
| Realized gain on equity interest                      | 0                              | 23     | 0                            | 126    |
| Realized gain on non-marketable equity investments    | 0                              | 21     | 0                            | 138    |
| Other income (expense), net                           | 20                             | 4      | (4                           | ) 32   |
| Interest and other income, net                        | \$ 236                         | \$ 145 | \$ 370                       | \$ 502 |

## Note 9. Contingencies

## Legal Matters

## Antitrust Investigations

On November 30, 2010, the European Commission's (EC) Directorate General for Competition opened an investigation into various antitrust-related complaints against us. We believe we have adequately responded to all of the allegations made against us. We continue to cooperate with the EC and are pursuing a potential resolution that would avoid a finding of infringement and a fine. The EC has also opened an investigation into Motorola's licensing practices for standards-essential patents and use of standards-essential patents in litigation on the basis of complaints brought by Microsoft and Apple. On April 29, 2014, the EC issued a decision against Motorola stating that it has abused its dominant position with respect to standards-essential patents; however, it did not impose a fine.

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

State attorneys general from the states of Ohio and Mississippi have also issued Civil Investigative Demands relating to our business practices. We have completed our responses to the state attorneys general discovery demands, and we remain willing to cooperate with them if they have any further information requests. In May 2014, the Texas Attorney General's office informed us that it was closing its antitrust investigation, which began in July 2010, of our business practices.

## Patent and Intellectual Property Claims

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

prohibition on importation could have an adverse effect on us, including preventing us from importing many important products into the U.S. or necessitating workarounds that may limit certain features of our products.

Furthermore, many of our agreements with our customers and partners require us to indemnify them for certain intellectual property infringement claims against them, which would increase our costs as a result of defending such claims, and may require that we pay significant damages if there were an adverse ruling in any such claims. Our

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customers and partners may discontinue the use of our products, services, and technologies, as a result of injunctions or otherwise, which could result in loss of revenues and adversely impact our business.

### Other

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

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

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

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

### Taxes

We are under audit by the Internal Revenue Service (IRS) and various other tax authorities with regards to income tax and indirect tax matters. We have reserved for potential adjustments to our provision for income taxes and accrual of indirect 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 benefits in the period we determine the liabilities are no longer necessary. If our estimates of the federal, state, and foreign income tax liabilities and indirect tax liabilities are less than the ultimate assessment, it would result in a further charge to expense.

In March 2014, we received a tax assessment from the French tax authorities. We believe an adequate provision has been made and it is more likely than not that our tax position will be sustained. However, it is reasonably possible that resolution with the French tax authorities could result in an adjustment to our tax position.

### Note 10. Net Income Per Share of Class A and Class B Common Stock and Class C Capital Stock

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



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|   | Three Months Ended<br>June 30,<br>2013<br>(unaudited) |         |         |         |         |         | 2014    |         |         |
|---|---|---------|---------|---------|---------|---------|---------|---------|---------|
|   | Class A   | Class B | Class C | Class A | Class B | Class C | Class A | Class B | Class C |
| Basic net income (loss) per share:  |   |         |         |         |         |         |         |         |         |
| Numerator   |   |         |         |         |         |         |         |         |         |
| Allocation of undistributed earnings - continuing operations                                  | \$1,136   | \$251   | \$1,387 | \$1,459 | \$286   | \$1,745 |         |         |         |
| Allocation of undistributed earnings - discontinued operations                                | 186   | 41      | 227     | (28 )   | (6 )    | (34 )   |         |         |         |
| Total   | \$1,322   | \$292   | \$1,614 | \$1,431 | \$280   | \$1,711 |         |         |         |
| Denominator   |   |         |         |         |         |         |         |         |         |
| Number of shares used in per share computation  | 272,417   | 60,063  | 332,480 | 282,216 | 55,300  | 337,599 |         |         |         |
| Basic net income (loss) per share:  |   |         |         |         |         |         |         |         |         |
| Continuing operations   | \$4.17  | \$4.17  | \$4.17  | \$5.17  | \$5.17  | \$5.17  |         |         |         |
| Discontinued operations   | 0.68  | 0.68    | 0.68    | (0.10 ) | (0.10 ) | (0.10 ) |         |         |         |
| Basic net income per share  | \$4.85  | \$4.85  | \$4.85  | \$5.07  | \$5.07  | \$5.07  |         |         |         |
| Diluted net income (loss) per share:  |   |         |         |         |         |         |         |         |         |
| Numerator   |   |         |         |         |         |         |         |         |         |
| Allocation of undistributed earnings for basic computation - continuing operations            | \$1,136   | \$251   | \$1,387 | \$1,459 | \$286   | \$1,745 |         |         |         |
| Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares | 251   | 0       | 0       | 286     | 0       | 0       |         |         |         |
| Reallocation of undistributed earnings  | 0   | (5 )    | 0       | (3 )    | (5 )    | 3       |         |         |         |
| Allocation of undistributed earnings - continuing operations                                  | \$1,387   | \$246   | \$1,387 | \$1,742 | \$281   | \$1,748 |         |         |         |
| Allocation of undistributed earnings for basic computation - discontinued operations          | \$186   | \$41    | \$227   | \$(28 ) | \$(6 )  | \$(34 ) |         |         |         |
| Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares | 41  | 0       | 0       | (6 )    | 0       | 0       |         |         |         |
| Reallocation of undistributed earnings  | 0   | (1 )    | 0       | 0       | 1       | 0       |         |         |         |
| Allocation of undistributed earnings - discontinued operations                                | \$227   | \$40    | \$227   | \$(34 ) | \$(5 )  | \$(34 ) |         |         |         |
| Denominator   |   |         |         |         |         |         |         |         |         |
| Number of shares used in basic computation  | 272,417   | 60,063  | 332,480 | 282,216 | 55,300  | 337,599 |         |         |         |
| Weighted-average effect of dilutive securities  |   |         |         |         |         |         |         |         |         |
| Add:  |   |         |         |         |         |         |         |         |         |
| Conversion of Class B to Class A common shares outstanding                                    | 60,063  | 0       | 0       | 55,300  | 0       | 0       |         |         |         |
| Employee stock options, including warrants issued under Transferable Stock Option program     | 2,664   | 4       | 2,664   | 2,010   | 0       | 2,004   |         |         |         |
| Restricted stock units and other contingently issuable shares                                 | 3,193   | 0       | 3,193   | 3,104   | 0       | 4,130   |         |         |         |
| Number of shares used in per share computation  | 338,337   | 60,067  | 338,337 | 342,630 | 55,300  | 343,733 |         |         |         |
| Diluted net income (loss) per share:  |   |         |         |         |         |         |         |         |         |
| Continuing operations   | \$4.10  | \$4.10  | \$4.10  | \$5.09  | \$5.09  | \$5.09  |         |         |         |
| Discontinued operations   | 0.67  | 0.67    | 0.67    | (0.10 ) | (0.10 ) | (0.10 ) |         |         |         |
| Diluted net income per share  | \$4.77  | \$4.77  | \$4.77  | \$4.99  | \$4.99  | \$4.99  |         |         |         |



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|   | Six Months Ended<br>June 30,<br>2013<br>(unaudited) |         |         |          |         |          | 2014    |         |         |
|---|---|---------|---------|----------|---------|----------|---------|---------|---------|
|   | Class A   | Class B | Class C | Class A  | Class B | Class C  | Class A | Class B | Class C |
| Basic net income (loss) per share:  |   |         |         |          |         |          |         |         |         |
| Numerator   |   |         |         |          |         |          |         |         |         |
| Allocation of undistributed earnings - continuing operations                                  | \$2,572   | \$579   | \$3,151 | \$2,979  | \$590   | \$3,571  |         |         |         |
| Allocation of undistributed earnings - discontinued operations                                | 111   | 25      | 136     | (111 )   | (22 )   | (133 )   |         |         |         |
| Total   | \$2,683   | \$604   | \$3,287 | \$2,868  | \$568   | \$3,438  |         |         |         |
| Denominator   |   |         |         |          |         |          |         |         |         |
| Number of shares used in per share computation  | 270,582   | 60,885  | 331,467 | 281,160  | 55,702  | 336,989  |         |         |         |
| Basic net income (loss) per share:  |   |         |         |          |         |          |         |         |         |
| Continuing operations   | \$9.51  | \$9.51  | \$9.51  | \$10.59  | \$10.59 | \$10.59  |         |         |         |
| Discontinued operations   | 0.41  | 0.41    | 0.41    | (0.39 )  | (0.39 ) | (0.39 )  |         |         |         |
| Basic net income per share  | \$9.92  | \$9.92  | \$9.92  | \$10.20  | \$10.20 | \$10.20  |         |         |         |
| Diluted net income (loss) per share:  |   |         |         |          |         |          |         |         |         |
| Numerator   |   |         |         |          |         |          |         |         |         |
| Allocation of undistributed earnings for basic computation - continuing operations            | \$2,572   | \$579   | \$3,151 | \$2,979  | \$590   | \$3,571  |         |         |         |
| Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares | 579   | 0       | 0       | 590      | 0       | 0        |         |         |         |
| Reallocation of undistributed earnings  | 0   | (10 )   | 0       | (2 )     | (10 )   | 2        |         |         |         |
| Allocation of undistributed earnings - continuing operations                                  | \$3,151   | \$569   | \$3,151 | \$3,567  | \$580   | \$3,573  |         |         |         |
| Allocation of undistributed earnings for basic computation - discontinued operations          | \$111   | \$25    | \$136   | \$(111 ) | \$(22 ) | \$(133 ) |         |         |         |
| Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares | 25  | 0       | 0       | (22 )    | 0       | 0        |         |         |         |
| Reallocation of undistributed earnings  | 0   | (1 )    | 0       | 0        | 0       | 0        |         |         |         |
| Allocation of undistributed earnings - discontinued operations                                | \$136   | \$24    | \$136   | \$(133 ) | \$(22 ) | \$(133 ) |         |         |         |
| Denominator   |   |         |         |          |         |          |         |         |         |
| Number of shares used in basic computation  | 270,582   | 60,885  | 331,467 | 281,160  | 55,702  | 336,989  |         |         |         |
| Weighted-average effect of dilutive securities  |   |         |         |          |         |          |         |         |         |
| Add:  |   |         |         |          |         |          |         |         |         |
| Conversion of Class B to Class A common shares outstanding                                    | 60,885  | 0       | 0       | 55,702   | 0       | 0        |         |         |         |
| Employee stock options, including warrants issued under Transferable Stock Option program     | 2,896   | 8       | 2,896   | 2,216    | 0       | 2,210    |         |         |         |
| Restricted stock units and other contingently issuable shares                                 | 3,137   | 0       | 3,137   | 3,499    | 0       | 4,012    |         |         |         |
| Number of shares used in per share computation  | 337,500   | 60,893  | 337,500 | 342,577  | 55,702  | 343,211  |         |         |         |
| Diluted net income (loss) per share:  |   |         |         |          |         |          |         |         |         |
| Continuing operations   | \$9.34  | \$9.34  | \$9.34  | \$10.41  | \$10.41 | \$10.41  |         |         |         |
| Discontinued operations   | 0.40  | 0.40    | 0.40    | (0.39 )  | (0.39 ) | (0.39 )  |         |         |         |
| Diluted net income per share  | \$9.74  | \$9.74  | \$9.74  | \$10.02  | \$10.02 | \$10.02  |         |         |         |

The number of shares and per share amounts for the prior period presented have been retroactively restated to reflect the Stock Split.

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

Note 11. Stockholders' Equity

Stock Split Effected In Form of Stock Dividend

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In April 2012, our board of directors approved amendments to our certificate of incorporation that created a new class of non-voting capital stock (Class C capital stock). The amendments authorized 3 billion shares of Class C capital stock and also increased the authorized shares of Class A common stock from 6 billion to 9 billion. The amendments are reflected in our Fourth Amended and Restated Certificate of Incorporation (New Charter), the adoption of which was approved by stockholders at our 2012 Annual Meeting of Stockholders held on June 21, 2012. In January 2014, our board of directors approved a distribution of shares of the Class C capital stock as a dividend to our holders of Class A and Class B common stock (the Stock Split). The Stock Split had a record date of March 27, 2014 and a payment date of April 2, 2014.

Share and per share amounts disclosed as of June 30, 2014 and for all other comparative periods have been retroactively adjusted to reflect the effects of the Stock Split. The Class C capital stock has no voting rights, except as required by applicable law. Except as expressly provided in the New Charter, shares of Class C capital stock have the same rights and privileges and rank equally, share ratably and are identical in all other respects to the shares of Class A common stock and Class B common stock as to all matters including dividend and distribution rights. In accordance with a settlement of litigation involving the authorization to distribute the Class C capital stock, we may be obligated to make a payment (the Possible Adjustment Payment) to holders of the Class C capital stock if, on a volume-weighted average basis, the Class C capital stock trades below the Class A common stock during the first 365 days following the first date the Class C shares traded on NASDAQ (the Lookback Period), payable in cash, Class A common stock, Class C capital stock, or a combination thereof, at the discretion of the board of directors. The amount of the Possible Adjustment Payment is dependent on the percentage difference that develops, if any, between the volume-weighted average price (VWAP) of Class A and Class C shares during the Lookback Period, as supplied by NASDAQ Data-on-Demand. As the Class C shares were only recently issued, we cannot reliably predict what, if any, patterns will emerge over time with respect to the relative trading prices of Class A and Class C shares. Had we been obligated to make a payment based on the VWAP of the Class A and Class C shares from April 3, 2014 through the quarter ended June 30, 2014, the monetary value of the Possible Adjustment Payment would have been approximately \$564 million as of June 30, 2014.

At the end of the Lookback Period, the Possible Adjustment Payment, if any, will be allocated to the numerator for calculating net income per share of Class C capital stock from net income available to shareholders and any remaining undistributed earnings will be allocated on a pro rata basis to Class A and Class B common stock and Class C capital stock based on the number of shares used in the per share computation for each class of stock. In addition, the dilutive impact of the Possible Adjustment Payment, if any, is included in the weighted-average effect of dilutive securities for Class C capital stock.

The par value per share of our shares of Class A common stock and Class B common stock remained unchanged at \$0.001 per share after the Stock Split. On the effective date of the Stock Split, a transfer between retained earnings and common stock occurred and the amount transferred was equal to the \$0.001 par value of the Class C capital stock that was issued.

**Stock-Based Award Activities**

The following table presents the weighted-average assumptions used to estimate the fair values of the stock options granted in the periods presented. The weighted average estimated fair value of options granted has been retroactively adjusted to reflect the effects the Stock Split:

|                          | Three Months Ended June 30, |      | Six Months Ended June 30, |      |
|--------------------------|-----------------------------|------|---------------------------|------|
|                          | 2013<br>(unaudited)         | 2014 | 2013<br>(unaudited)       | 2014 |
| Risk-free interest rate  | N/A                         | N/A  | 0.9%                      | N/A  |
| Expected volatility      | N/A                         | N/A  | 29%                       | N/A  |
| Expected life (in years) | N/A                         | N/A  | 5.8                       | N/A  |

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|  |     |     |          |     |
|--|-----|-----|----------|-----|
| Dividend yield   | N/A | N/A | 0%       | N/A |
| Weighted-average estimated fair value of options granted during the period | N/A | N/A | \$107.20 | N/A |

There were 0 and 3,142 stock options (adjusted for the effects of the Stock Split) granted during the three and six months ended June 30, 2013. No options were granted during the three and six months ended June 30, 2014.

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The following table summarizes the activities for our stock options for the six months ended June 30, 2014 and has been retroactively adjusted to reflect the effects of the Stock Split:

|  | Options Outstanding |                                 | Weighted-Average Remaining Contractual Term<br>(in years) | Aggregate Intrinsic Value<br>(in millions) <sup>(1)</sup> |
|--|---------------------|---------------------------------|---|---|
|  | Number of Shares    | Weighted-Average Exercise Price |   |   |
|  | (unaudited)         |                                 |   |   |
| Balance as of December 31, 2013  | 10,065,726          | \$215.50                        |   |   |
| Granted  | 0                   | \$0.00                          |   |   |
| Exercised  | (1,607,444 )        | \$202.17                        |   |   |
| Forfeited/canceled   | (216,263 )          | \$320.65                        |   |   |
| Balance as of June 30, 2014  | 8,242,019           | \$215.77                        | 4.9   | \$ 3,001  |
| Exercisable as of June 30, 2014  | 6,572,803           | \$194.51                        | 4.2   | \$ 2,534  |
| Exercisable as of June 30, 2014 and expected to vest thereafter <sup>(2)</sup> | 8,034,944           | \$213.63                        | 4.9   | \$ 2,944  |

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards

<sup>(1)</sup> and the closing stock price of \$584.67 and \$575.28 for our Class A common stock and Class C capital stock, respectively, on June 30, 2014.

<sup>(2)</sup> Options expected to vest reflect an estimated forfeiture rate.

As of June 30, 2014, there was \$119 million of unrecognized compensation cost related to outstanding Google employee stock options. This amount is expected to be recognized over a weighted-average period of 1.6 years. To the extent the actual forfeiture rate is different from what we have estimated, stock-based compensation expense related to these awards will be different from our expectations.

The following table summarizes the activities for our unvested restricted stock units (RSUs) for the six months ended June 30, 2014 and has been retroactively adjusted to reflect the effects of the Stock Split:

|   | Unvested Restricted Stock Units |  |
|---|---------------------------------|--|
|   | Number of Shares                | Weighted-Average Grant-Date Fair Value |
|   | (unaudited)                     |  |
| Unvested as of December 31, 2013                    | 21,953,960                      | \$359.20                               |
| Granted   | 3,006,717                       | \$566.91                               |
| Vested  | (5,281,669 )                    | \$325.14                               |
| Forfeited/canceled                                  | (607,200 )                      | \$341.32                               |
| Unvested as of June 30, 2014                        | 19,071,808                      | \$401.47                               |
| Expected to vest after June 30, 2014 <sup>(1)</sup> | 16,725,976                      | \$401.47                               |

<sup>(1)</sup> RSUs expected to vest reflect an estimated forfeiture rate.

As of June 30, 2014, there was \$5.8 billion of unrecognized compensation cost related to unvested Google employee RSUs. This amount is expected to be recognized over a weighted-average period of 2.7 years. To the extent the actual forfeiture rate is different from what we have estimated, stock-based compensation expense related to these awards will be different from our expectations.





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We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Our total unrecognized tax benefits were \$2,571 million and \$2,914 million as of December 31, 2013 and June 30, 2014. Our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were \$2,378 million and \$2,564 million as of December 31, 2013 and June 30, 2014. Our existing tax positions will continue to generate an increase in liabilities for unrecognized tax benefits.

Our provision for income taxes and effective tax rate decreased from the three months ended June 30, 2013 to the three months ended June 30, 2014, primarily due to the increase in our projected annual effective tax rate forecasted as of June 30, 2013 relative to our projected annual effective tax rate forecasted as of March 31, 2013 as a result of a shift in projected mix of income to countries that have higher statutory tax rates for the year ended December 31, 2013. Our provision for income taxes and effective tax rate increased from the six months ended June 30, 2013 to the six months ended June 30, 2014, largely attributed to a discrete tax benefit related to the federal research and development credit recognized in the first quarter of 2013 which was as a result of a retroactive extension of the federal research and development credit in accordance with the American Taxpayer Act of 2012 that was signed into law on January 2, 2013, as well as the expiration of the federal research and development credit as of December 31, 2013.

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

#### Note 13. Information about Segments and Geographic Areas

On January 29, 2014, we entered into an agreement with Lenovo providing for the disposition of the Motorola Mobile business. Financial results of Motorola Mobile are included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013 and 2014. Therefore, Motorola Mobile is no longer presented as a separate segment in our consolidated financial statements.

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

|                   | Three Months Ended<br>June 30,<br>2013 |              | Six Months Ended<br>June 30,<br>2013 |          |
|-------------------|--|--------------|--------------------------------------|----------|
|                   | 2014                                   |              | 2014                                 |          |
|                   | (unaudited)                            |              |                                      |          |
| Revenues:         |  |              |                                      |          |
| United States     | \$5,896                                | \$6,630      | \$11,732                             | \$13,286 |
| United Kingdom    | 1,321                                  | 1,616        | 2,708                                | 3,199    |
| Rest of the world | 5,890                                  | 7,709        | 11,618                               | 14,890   |
| Total revenues    | \$13,107                               | \$15,955     | \$26,058                             | \$31,375 |
|                   |  | As of        | As of                                |          |
|                   |  | December 31, | June 30,                             |          |
|                   |  | 2013         | 2014                                 |          |
|                   |  |              | (unaudited)                          |          |

|                         |          |          |
|-------------------------|----------|----------|
| Long-lived assets:      |          |          |
| United States           | \$24,004 | \$29,435 |
| International           | 14,030   | 14,268   |
| Total long-lived assets | \$38,034 | \$43,703 |

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Long-lived assets to be disposed of as a result of our Motorola Mobile disposition are included in "Assets held for sale" on the Consolidated Balance Sheet as of June 30, 2014, and accordingly, are not included in this table.

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

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

### Overview

Google is a global technology leader focused on improving the ways people connect with information. We aspire to build products and provide services that improve the lives of billions of people globally. Our mission is to organize the world's information and make it universally accessible and useful. Our innovations in web search and advertising have made our website a top internet property and our brand one of the most recognized in the world. Google generates revenues primarily by delivering relevant, cost-effective online advertising. Businesses use our AdWords program and AdSense program to promote their products and services with advertising on both Google-owned properties and publishers' sites across the web.

In January 2014, we entered into an agreement with Lenovo Group Limited (Lenovo) providing for the disposition of the Motorola Mobile business. The transaction is expected to close in the second half of 2014. Financial results of Motorola Mobile are presented as "Net income (loss) from discontinued operations" on the Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2014; and assets and liabilities of Motorola Mobile to be disposed of are presented as "Assets held for sale" and "Liabilities held for sale" on the Consolidated Balance Sheet as of June 30, 2014, respectively. The Motorola Mobile business is focused on mobile wireless devices and related products and services and generates revenues primarily by selling hardware products.

In December 2012, we entered into an agreement for the disposition of the Motorola Home business. The transaction closed on April 17, 2013. Financial results through the date of divestiture related to Motorola Home were included within "Net income (loss) from discontinued operations" on the Consolidated Statements of Income for the three and six months ended June 30, 2013. The Motorola Home business was focused on technologies and devices that provide video entertainment services to consumers by enabling subscribers to access a variety of interactive digital television services.

### Trends in Our Businesses

Advertising transactions continue to shift from offline to online as the digital economy evolves. This has contributed to the rapid growth of our business since inception, resulting in substantially increased revenues, and we expect that our business will continue to grow. However, our revenue growth rate has generally declined over time, and it could do so in the future as a result of a number of factors, including increasing competition, our investments in new business strategies, products, services, and technologies, changes in our product mix, shifts in the geographic mix of our revenues, query growth rates and how users make queries, challenges in maintaining our growth rate as our revenues increase to higher levels, and the evolution of the online advertising market, including the increasing variety of online platforms for advertising, and other markets in which we participate.

Our users are increasingly connected to the internet and using multiple devices to access our products and services, a trend that has increased our global search queries and changed our platform mix. We expect that our revenue growth rate will continue to be affected by evolving consumer preferences, as well as by advertising trends, the acceptance by users of our products and services as they are delivered on diverse devices, and our ability to create a seamless experience for both users and advertisers in this multi-screen environment.

The main focus of our advertising programs is to help businesses reach people in the moments that matter across all devices with smarter ads that are relevant to their intent and context, reflecting our commitment to constantly improve their overall web experience. As a result, we expect to continue to take steps to improve the relevance of the ads

displayed on our websites and our Google Network Members' websites. These steps include not displaying ads that generate low click-through rates or that send users to irrelevant or otherwise low-quality websites, updating our advertising policies and ensuring their compliance, and terminating our relationships with those Google Network

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Members whose websites do not meet our quality requirements. We may also continue to take steps to reduce the number of accidental clicks by our users. These steps could negatively affect the growth rate of our revenues. Both seasonal fluctuations in internet usage and traditional retail seasonality have affected, and are likely to continue to affect, our business. Internet usage generally slows during the summer months, and commercial queries typically increase significantly in the fourth quarter of each year. These seasonal trends have caused, and will likely continue to cause, fluctuations in our quarterly results, including fluctuations in sequential revenues, as well as aggregate paid clicks and average cost-per-click growth rates.

The operating margin we realize on revenues generated from ads placed on our Google Network Members' websites through our AdSense program is significantly lower than the operating margin we realize from revenues generated from ads placed on our websites because most of the advertiser fees from ads served on Google Network Members' websites are shared with our Google Network Members. For the past five years, growth in advertising revenues from our websites has generally exceeded that from our Google Network Members' websites. This trend has had a positive impact on our operating margins, and we expect that this will continue for the foreseeable future, although the relative rate of growth in revenues from our websites compared to the rate of growth in revenues from our Google Network Members' websites may vary over time. Also, the margins on advertising revenues from mobile phones and other newer advertising formats are generally lower than those from desktop computers and tablets. We expect this trend to continue to pressure our margins, particularly if we fail to realize the opportunities we anticipate with the transition to a dynamic multi-screen environment.

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

From an overall business perspective, we continue to invest aggressively in areas of strategic focus, our systems, data centers, real estate and facilities, information technology infrastructure, and employees. We expect to continue to hire aggressively for the remainder of 2014 and provide competitive compensation programs to our employees. Our full-time employee headcount was 44,777 (which included 4,599 headcount from Motorola Mobile) at June 30, 2013, and 52,069 (which included 3,485 headcount from Motorola Mobile) at June 30, 2014. Acquisitions will also remain an important component of our strategy and use of capital. We expect our cost of revenues will increase in dollars and may increase as a percentage of revenues in future periods, primarily as a result of forecasted increases in traffic acquisition costs, manufacturing and inventory-related costs, data center costs, content acquisition costs, credit card and other transaction fees, and other costs. In particular, traffic acquisition costs as a percentage of advertising revenues may increase in the future if we are unable to continue to improve the monetization or generation of revenues from traffic on our websites and our Google Network Members' websites.

As we expand our advertising programs and other products to international markets, we continue to increase our exposure to fluctuations in foreign currency to U.S. dollar exchange rates. We have a foreign exchange risk management program that is designed to reduce our exposure to fluctuations in foreign currency exchange rates. However, this program will not fully offset the effect of fluctuations on our revenues and earnings.

Other revenues consist of non-advertising revenues including licensing, hardware, and digital content revenues. We expect other revenues to continue to grow. However, operating margin on other revenues is generally lower than that on advertising revenues.

### Results of Operations

We completed our acquisition of Motorola on May 22, 2012 (the acquisition date). In December 2012, we entered into an agreement with Arris and certain other persons providing for the disposition of the Motorola Home business. The transaction closed on April 17, 2013. Financial results of Motorola Home were included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013.

In January 2014, we entered into an agreement with Lenovo providing for the disposition of the Motorola Mobile business. The transaction is expected to close in the second half of 2014. Financial results of Motorola Mobile are presented as "Net income (loss) from discontinued operations" on the Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2014; and assets and liabilities of Motorola Mobile to be disposed of are

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presented as "Assets held for sale" and "Liabilities held for sale" on the Consolidated Balance Sheet as of June 30, 2014, respectively.

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

|   | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |   |
|---|--------------------------------|--------|------------------------------|--------|---|
|   | 2013                           | 2014   | 2013                         | 2014   |   |
|   | (unaudited)                    |        |                              |        |   |
| Consolidated Statements of Income Data:               |                                |        |                              |        |   |
| Revenues  | 100                            | % 100  | % 100                        | % 100  | % |
| Costs and expenses:                                   |                                |        |                              |        |   |
| Cost of revenues                                      | 39.6                           | 38.3   | 39.6                         | 38.5   |   |
| Research and development                              | 13.5                           | 14.0   | 13.0                         | 13.9   |   |
| Sales and marketing                                   | 12.1                           | 12.2   | 11.6                         | 11.7   |   |
| General and administrative                            | 8.4                            | 8.8    | 8.1                          | 9.2    |   |
| Total costs and expenses                              | 73.6                           | 73.3   | 72.3                         | 73.3   |   |
| Income from operations                                | 26.4                           | 26.7   | 27.7                         | 26.7   |   |
| Interest and other income, net                        | 1.8                            | 0.9    | 1.4                          | 1.6    |   |
| Income from continuing operations before income taxes | 28.2                           | 27.6   | 29.1                         | 28.3   |   |
| Provision for income taxes                            | 7.1                            | 5.7    | 4.9                          | 5.5    |   |
| Net income from continuing operations                 | 21.1                           | 21.9   | 24.2                         | 22.8   |   |
| Net income (loss) from discontinued operations        | 3.5                            | (0.4)  | 1.0                          | (0.8)  | ) |
| Net income  | 24.6                           | % 21.5 | % 25.2                       | % 22.0 | % |
| Revenues  |                                |        |                              |        |   |

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

|                            | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|----------------------------|--------------------------------|----------|------------------------------|----------|
|                            | 2013                           | 2014     | 2013                         | 2014     |
|                            | (unaudited)                    |          |                              |          |
| Advertising revenues:      |                                |          |                              |          |
| Websites                   | \$8,868                        | \$10,935 | \$17,508                     | \$21,404 |
| Network Members' websites  | 3,193                          | 3,424    | 6,455                        | 6,821    |
| Total advertising revenues | 12,061                         | 14,359   | 23,963                       | 28,225   |
| Other revenues             | 1,046                          | 1,596    | 2,095                        | 3,150    |
| Total revenues             | \$13,107                       | \$15,955 | \$26,058                     | \$31,375 |

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

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|   | Three Months Ended<br>June 30, |   |      |   | Six Months Ended<br>June 30, |   |      |   |
|---|--------------------------------|---|------|---|------------------------------|---|------|---|
|   | 2013                           |   | 2014 |   | 2013                         |   | 2014 |   |
|   | (unaudited)                    |   |      |   |                              |   |      |   |
| Advertising revenues:   |                                |   |      |   |                              |   |      |   |
| Websites  | 67.6                           | % | 68.5 | % | 67.2                         | % | 68.2 | % |
| Network Members' websites                                       | 24.4                           | % | 21.5 | % | 24.8                         | % | 21.8 | % |
| Total advertising revenues                                      | 92.0                           | % | 90.0 | % | 92.0                         | % | 90.0 | % |
| Websites revenues as % of advertising revenues                  | 73.5                           | % | 76.2 | % | 73.1                         | % | 75.8 | % |
| Network Members' websites revenues as % of advertising revenues | 26.5                           | % | 23.8 | % | 26.9                         | % | 24.2 | % |
| Other revenues  | 8.0                            | % | 10.0 | % | 8.0                          | % | 10.0 | % |

Our revenues increased \$2,848 million and \$5,317 million from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014. This increase resulted primarily from an increase in advertising revenues generated by Google websites and an increase in other revenues, and to a lesser extent, an increase in advertising revenues generated by Google Network Members' websites. The increase in other revenues was mainly driven by higher sales related to digital content and hardware products. The increase in advertising revenues for Google websites and Google Network Members' websites resulted primarily from an increase in the number of aggregate paid clicks through our advertising programs. The number of aggregate paid clicks increased approximately 25% and 25% from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014, respectively. The increase in the number of paid clicks generated through our advertising programs was due to certain monetization improvements including new and richer ad formats, an increase in aggregate traffic across all platforms, the continued global expansion of our products, advertisers, and user base, as well as an increase in the number of Google Network Members, partially offset by certain advertising policy changes. This impact of the increased paid clicks on our revenue growth was partially offset by a decrease in the average cost-per-click paid by our advertisers. The average cost-per-click decreased approximately 6% and 7% from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014, respectively. The decrease in the average cost-per-click paid by our advertisers was driven by various factors, such as the introduction of new products and changes in property mix, platform mix, and geographical mix.

Paid clicks on Google websites, which include clicks related to ads served on Google owned and operated properties across different geographies and form factors, including search, YouTube engagement ads like TrueView, and other owned and operated properties like Maps and Finance, increased approximately 33% and 35% from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014, respectively. Paid clicks on Google Network Members' websites, which include clicks related to ads served on non-Google properties participating in our AdSense for Search, AdSense for Content, and AdMob businesses, increased approximately 9% and 9% from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014, respectively. In addition, cost-per-click on Google websites decreased approximately 7% and 9% from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014, respectively. Cost-per-click on Google Network Members' websites decreased approximately 13% and 12% from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014, respectively.

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



Improvements in our ability to monetize increased traffic primarily relate to enhancing the end user experience, including providing end users with ads that are more relevant to their search queries or to the content on the Google Network Members' websites they visit. For instance, these improvements include displaying advertiser-nominated images that are relevant to the user query and creating a more engaging user shopping experience by enhancing search ads to include richer product information, such as product image, price, and merchant name. We believe that

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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, Google Network Members, and other partners.

Other revenues increased \$550 million and \$1,055 million from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014 and also increased as a percentage of total revenues. The increase was primarily due to growth of our digital content, such as apps, music and movies, and to a lesser extent, an increase in our hardware revenues.

**Revenues by Geography**

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

|                   | Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |   |
|-------------------|--------------------------------|------|------------------------------|------|---|
|                   | 2013<br>(unaudited)            | 2014 | 2013                         | 2014 |   |
| United States     | 45                             | % 42 | % 45                         | % 42 | % |
| United Kingdom    | 10                             | % 10 | % 10                         | % 10 | % |
| Rest of the world | 45                             | % 48 | % 45                         | % 48 | % |

The growth in revenues from the rest of the world as a percentage of total revenues from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014 resulted largely from increased acceptance of our advertising programs, and our continued progress in developing localized versions of our products for international markets.

**Foreign Exchange Impact on Revenues**

The general weakening of the U.S. dollar relative to certain foreign currencies (primarily the Euro and British pound) from the three months ended June 30, 2013 to the three months ended June 30, 2014 had a favorable impact on our international revenues, which was partially offset by the general strengthening of the U.S. dollar relative to other foreign currencies (primarily Japanese yen and Australian dollar). Had foreign exchange rates remained constant in these periods, our revenues from the United Kingdom would have been \$124 million or 8% lower and our revenues from the rest of the world would have been approximately \$4 million higher or remained relatively flat for the three months ended June 30, 2014. This is before consideration of hedging gains of \$6 million recognized to revenues from the rest of the world in the three months ended June 30, 2014.

The general strengthening of the U.S. dollar relative to certain foreign currencies (primarily Japanese yen and Australian dollar) from the six months ended June 30, 2013 to the six months ended June 30, 2014 had an unfavorable impact on our international revenues, which was partially offset by the general weakening of the U.S. dollar relative to other foreign currencies (primarily the Euro and British pound). Had foreign exchange rates remained constant in these periods, our revenues from the United Kingdom would have been \$195 million or 6% lower and our revenues from the rest of the world would have been approximately \$238 million or 2% higher in the six months ended June 30, 2014. This is before consideration of hedging gains \$14 million recognized to revenues from the rest of the world in the six months ended June 30, 2014.

Although we expect to continue to make investments in international markets, these investments may not result in an increase in our international revenues as a percentage of total revenues in the remainder of 2014 or thereafter. See Note 13 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 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



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queries to our website (collectively referred to as distribution arrangements). These amounts are primarily based on the revenue share and fixed fee arrangements with our Google Network Members and distribution partners. Certain distribution arrangements require us to pay our partners based on a fee per access point delivered and not exclusively -- or at all -- based on revenue share. These fees are non-refundable. Further, these arrangements are terminable at will, although under the terms of certain contracts we or our distribution partners may be subject to penalties in the event of early termination. We recognize fees under these arrangements over the estimated useful lives of the access points to the extent we can reasonably estimate those lives and they are one year or longer, or based on any contractual revenue share, if greater. Otherwise, the fees are charged to expense as incurred. The estimated useful life of the access points is based on the historical average period of time they generate traffic and revenues. Cost of revenues also includes the expenses associated with the operation of our data centers, including depreciation, labor, energy, and bandwidth costs; hardware inventory costs; credit card and other transaction fees related to processing customer transactions; amortization of acquisition-related intangible assets; and content acquisition costs. We have entered into arrangements with certain content providers under which we distribute or license their video and other content. In a number of these arrangements, we display ads on the pages of our websites from which the content is viewed and share most of the fees these ads generate with the content providers. We also license content on the pages of our websites from which the content is sold and share most of the fees these sales generate with content providers. To the extent we are obligated to make guaranteed minimum revenue share payments to our content providers, we recognize as content acquisition costs the contractual revenue share amount or the amount determined on a straight-line basis, whichever is greater, over the term of the agreements. The following tables present 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<br>June 30,<br>2013 |   | 2014    |   | Six Months Ended<br>June 30,<br>2013 |   | 2014     |   |
|---|--|---|---------|---|--------------------------------------|---|----------|---|
|   | (unaudited)                            |   |         |   |                                      |   |          |   |
| Cost of revenues  | \$5,195                                |   | \$6,114 |   | \$10,331                             |   | \$12,075 |   |
| Cost of revenues as a percentage of revenues                      | 39.6                                   | % | 38.3    | % | 39.6                                 | % | 38.5     | % |
|   | Three Months Ended<br>June 30,<br>2013 |   | 2014    |   | Six Months Ended<br>June 30,<br>2013 |   | 2014     |   |
|   | (unaudited)                            |   |         |   |                                      |   |          |   |
| Traffic acquisition costs related to AdSense arrangements         | \$2,307                                |   | \$2,400 |   | \$4,589                              |   | \$4,787  |   |
| Traffic acquisition costs related to distribution arrangements    | 706                                    |   | 893     |   | 1,386                                |   | 1,738    |   |
| Traffic acquisition costs   | \$3,013                                |   | \$3,293 |   | \$5,975                              |   | \$6,525  |   |
| Traffic acquisition costs as a percentage of advertising revenues | 25.0                                   | % | 22.9    | % | 24.9                                 | % | 23.1     | % |

Cost of revenues increased \$919 million and \$1,744 million from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014. The increase was partially due to increases in traffic acquisition costs of \$280 million and \$550 million from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014 resulting from more distribution fees paid, more fees paid for additional traffic directed to our websites, as well as more advertiser fees generated through our AdSense program driven primarily by an increase in advertising revenues. The remaining increase was primarily driven by an increase in data center costs, content acquisition costs as a result of increased activities related to YouTube and digital content, revenue share payments to mobile carriers and original equipment manufacturers (OEMs) and hardware inventory costs as a result of increased hardware sales. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily a result of a shift of mix between Google website revenue and Google Network Members' websites revenue.

We expect cost of revenues will increase in dollar amount and may increase as a percentage of total revenues in the remainder of 2014 and in future periods, primarily as a result of increases in traffic acquisition costs, data center costs, hardware inventory costs, content acquisition costs, credit card and other transaction fees, and other costs.

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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<br>June 30, |         | Six Months Ended<br>June 30, |         |   |
|---|--------------------------------|---------|------------------------------|---------|---|
|   | 2013                           | 2014    | 2013                         | 2014    |   |
|   | (unaudited)                    |         |                              |         |   |
| Research and development expenses                             | \$1,766                        | \$2,238 | \$3,383                      | \$4,364 |   |
| Research and development expenses as a percentage of revenues | 13.5                           | % 14.0  | % 13.0                       | % 13.9  | % |

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

Research and development expenses increased \$472 million and also increased as a percentage of revenues from the three months ended June 30, 2013 to the three months ended June 30, 2014. The increase was primarily due to an increase in labor and facilities-related costs of \$274 million, largely as a result of a 26% increase in research and development headcount, an increase in professional service fees of \$89 million, an increase in depreciation and equipment-related expenses of \$57 million, and an increase in stock-based compensation expense of \$46 million.

Research and development expenses increased \$981 million and also increased as a percentage of revenues from the six months ended June 30, 2013 to the six months ended June 30, 2014. The increase was primarily due to an increase in labor and facilities-related costs of \$517 million, largely as a result of a 25% increase in research and development headcount, an increase in stock-based compensation expense of \$164 million, an increase in professional service fees of \$145 million, and an increase in depreciation and equipment-related expenses of \$136 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 2014 and future periods because we expect to continue to invest in building the necessary employee and system infrastructure required to support the development of new, and to improve existing, products and services.

#### Sales and Marketing

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

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|  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |   |
|--|--------------------------------|---------|------------------------------|---------|---|
|  | 2013                           | 2014    | 2013                         | 2014    |   |
|  | (unaudited)                    |         |                              |         |   |
| Sales and marketing expenses                             | \$1,583                        | \$1,941 | \$3,018                      | \$3,670 |   |
| Sales and marketing expenses as a percentage of revenues | 12.1                           | % 12.2  | % 11.6                       | % 11.7  | % |

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 \$358 million and remained relatively flat as a percentage of revenues from the three months ended June 30, 2013 to the three months ended June 30, 2014. The increase was primarily due to an increase in advertising and promotional expenses of \$201 million, an increase in labor and facilities-related costs of \$120 million, largely as a result of a 13% increase in sales and marketing headcount, as well as an increase in stock-based compensation expense of \$33 million.

Sales and marketing expenses increased \$652 million and remained relatively flat as a percentage of revenues from the six months ended June 30, 2013 to the six months ended June 30, 2014. The increase was primarily due to an increase in advertising and promotional expenses of \$304 million, an increase in labor and facilities-related costs of \$240 million, largely as a result of a 12% increase in sales and marketing headcount, as well as an increase in stock-based compensation expense of \$62 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 2014 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<br>June 30, |         | Six Months Ended<br>June 30, |         |   |
|---|--------------------------------|---------|------------------------------|---------|---|
|   | 2013                           | 2014    | 2013                         | 2014    |   |
|   | (unaudited)                    |         |                              |         |   |
| General and administrative expenses                             | \$1,098                        | \$1,404 | \$2,113                      | \$2,893 |   |
| General and administrative expenses as a percentage of revenues | 8.4                            | % 8.8   | % 8.1                        | % 9.2   | % |

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, as well as fees for professional services. Professional services are principally comprised of outside legal, audit, information technology consulting, and outsourcing services. General and administrative expenses also include amortization of certain acquisition-related intangible assets.

General and administrative expenses increased \$306 million and also increased as a percentage of revenues from the three months ended June 30, 2013 to the three months ended June 30, 2014. The increase was primarily due to an increase in labor and facilities-related costs of \$105 million, largely as a result of a 25% increase in general and administrative headcount, an increase in professional service fees and legal expenses of \$96 million, and an increase in stock-based compensation expense of \$68 million.

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General and administrative expenses increased \$780 million and also increased as a percentage of revenues from the six months ended June 30, 2013 to the six months ended June 30, 2014. The increase was primarily due to an increase in professional service fees and legal expenses of \$322 million, an increase in labor and facilities-related costs of \$238 million, largely as a result of a 23% increase in general and administrative headcount, and an increase in stock-based compensation expense of \$109 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 2014 and in future periods.

**Stock-Based Compensation**

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

|  | Three Months Ended              |       | Six Months Ended |         |
|--|---------------------------------|-------|------------------|---------|
|  | June 30,<br>2013<br>(unaudited) | 2014  | June 30,<br>2013 | 2014    |
| Stock-based compensation                             | \$743                           | \$880 | \$1,398          | \$1,719 |
| Stock-based compensation as a percentage of revenues | 5.7                             | % 5.5 | % 5.4            | % 5.5   |

Stock-based compensation increased \$137 million and \$321 million from the three and six months ended June 30, 2013 to the three and six months ended June 30, 2014. These increases were primarily due to additional stock awards issued to existing and new employees.

We estimate stock-based compensation for Google employees to be approximately \$3.3 billion in 2014 and \$4.4 billion thereafter. This estimate does not include expenses to be recognized related to employee stock awards that are granted after June 30, 2014 or non-employee stock awards that have been or may be granted. In addition, to the extent forfeiture rates are different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

**Interest and Other Income, Net**

Interest and other income, net, decreased \$91 million from the three months ended June 30, 2013 to the three months ended June 30, 2014. This decrease was primarily driven by a decrease in realized gains on available-for-sale investments of \$53 million and an increase in foreign currency exchange losses of \$45 million.

Interest and other income, net, increased \$132 million from the six months ended June 30, 2013 to the six months ended June 30, 2014. This increase was primarily driven by realized gains on non-marketable equity investments of \$138 million and previously-held equity interests of \$126 million, partially offset by an increase in foreign currency exchange losses of \$93 million.

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

As we expand our international business, we believe costs related to hedging activities under our foreign exchange risk management program may increase in dollar amount in the remainder of 2014 and future periods.

**Provision for Income Taxes**

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



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|                            | Three Months Ended<br>June 30,<br>2013<br>(unaudited) |        | Six Months Ended<br>June 30,<br>2013 |         | 2014 |   |
|----------------------------|---|--------|--------------------------------------|---------|------|---|
| Provision for income taxes | \$927   | \$913  | \$1,281                              | \$1,735 |      |   |
| Effective tax rate         | 25.0  | % 20.7 | % 16.9                               | % 19.5  | %    | % |

Our provision for income taxes and effective tax rate decreased from the three months ended June 30, 2013 to the three months ended June 30, 2014, primarily due to the increase in our projected annual effective tax rate forecasted as of June 30, 2013 relative to our projected annual effective tax rate forecasted as of March 31, 2013 as a result of a shift in projected mix of income to countries that have higher statutory tax rates for the year ended December 31, 2013.

Our provision for income taxes and effective tax rate increased from the six months ended June 30, 2013 to the six months ended June 30, 2014, largely attributed to a discrete tax benefit related to the federal research and development credit recognized in the first quarter of 2013 which was as a result of a retroactive extension of the federal research and development credit in accordance with the American Taxpayer Act of 2012 that was signed into law on January 2, 2013, as well as the expiration of the federal research and development credit as of December 31, 2013.

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

See Critical Accounting Policies and Estimates below for additional information about our provision for income taxes.

#### Net Income (Loss) from Discontinued Operations

##### Motorola Mobile

On January 29, 2014, we entered into an agreement with Lenovo providing for the disposition of the Motorola Mobile business for a total purchase price of approximately \$2.9 billion (subject to certain adjustments), including \$1.4 billion to be paid at close, comprised of \$660 million in cash and \$750 million in Lenovo ordinary shares (subject to a share cap and floor). The remaining \$1.5 billion will be paid in the form of an interest-free, three-year prepayable promissory note.

We will maintain ownership of the vast majority of the Motorola Mobile patent portfolio, including current patent applications and invention disclosures, which will be licensed back to Motorola Mobile for its continued operations. Additionally, in connection with the sale, we will indemnify Lenovo for certain potential liabilities of the Motorola Mobile business. The transaction is subject to the satisfaction of regulatory requirements, customary closing conditions and any other needed approvals and is expected to close in the second half of 2014.

As such, financial results of Motorola Mobile are presented as "Net income (loss) from discontinued operations" on the Consolidated Statements of Income for the three and six months ended June 30, 2013 and 2014; and assets and liabilities of Motorola Mobile to be disposed of are presented as "Assets held for sale" and "Liabilities held for sale" on the Consolidated Balance Sheet as of June 30, 2014, respectively.

The following table presents financial results of the Motorola Mobile business included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013 and 2014 (in millions, unaudited):

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|   | Three Months Ended June 30, |         | Six Months Ended June 30, |          |
|---|-----------------------------|---------|---------------------------|----------|
|   | 2013                        | 2014    | 2013                      | 2014     |
| Revenues  | \$998                       | \$1,806 | \$2,016                   | \$3,183  |
| Loss from discontinued operations before income taxes | (331                        | ) (99   | ) (602                    | ) (373   |
| Benefits from income taxes                            | 111                         | 31      | 178                       | 107      |
| Net loss from discontinued operations                 | \$(220                      | ) \$(68 | ) \$(424                  | ) \$(266 |

## Motorola Home

In December 2012, we entered into an agreement with Arris and certain other persons providing for the disposition of the Motorola Home business. The transaction closed on April 17, 2013 (the date of divestiture). Financial results of Motorola Home through the date of divestiture were included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013.

The following table presents financial results of the Motorola Home business included in "Net income (loss) from discontinued operations" for the three and six months ended June 30, 2013 (in millions, unaudited):

|   | Three Months Ended June 30, 2013 <sup>(1)</sup> | Six Months Ended June 30, 2013 <sup>(2)</sup> |
|---|---|---|
| Revenues  | \$66  | \$804   |
| Loss from discontinued operations before income taxes | (114  | ) (67   |
| Benefits from income taxes                            | 41  | 16  |
| Gain on disposal                                      | 747   | \$747   |
| Net income from discontinued operations               | \$674   | \$696   |

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

<sup>(2)</sup> The operating results of Motorola Home were included in our Consolidated Statements of Income from January 1, 2013 through the date of divestiture.

## Liquidity and Capital Resources

As of June 30, 2014, we had \$61.4 billion of cash, cash equivalents, and marketable securities after including \$160 million of cash and cash equivalents classified as "Assets held for sale". Cash equivalents and marketable securities are comprised of time deposits, money market and other funds, including cash collateral received related to our securities lending program, fixed-income bond funds, highly liquid debt instruments of the U.S. government and its agencies, debt instruments issued by foreign governments, debt instruments issued by municipalities in the U.S., corporate securities, mortgage-backed securities, asset-backed securities, and marketable equity securities.

As of June 30, 2014, \$40.2 billion of the \$61.4 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. As of June 30, 2014, we had unused letters of credit of approximately \$517 million. We believe that our sources of funding will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months. Our liquidity could be negatively affected by a decrease in demand for our products and services. In addition, we may make acquisitions or license products and technologies complementary to our business and may need to raise additional capital through future debt or equity financing to provide for greater flexibility to fund any such acquisitions and licensing activities. Additional financing may not be available at all or on terms favorable to us.

We have a debt financing program of up to \$3.0 billion through the issuance of commercial paper. Net proceeds from this program are used for general corporate purposes. As of June 30, 2014, we had \$2.0 billion of commercial paper outstanding recorded as short-term debt, with a weighted-average interest rate of 0.1% that mature at various dates through August 2014. Average commercial paper borrowings during the quarter were \$2.0 billion and the maximum amount outstanding during the quarter was \$2.0 billion. In conjunction with this program, we have a \$3.0 billion revolving credit facility expiring in July 2016. The interest rate for the credit facility is determined based on a formula using certain market rates. As of June 30, 2014, we were in compliance with the financial covenant in the credit facility and no amounts were outstanding.

In May 2011, we issued \$3.0 billion of unsecured senior notes (2011 Notes) in three equal tranches, due in 2014, 2016, and 2021. In February 2014, we issued \$1.0 billion of unsecured senior notes (2014 Notes) due in 2024. The net proceeds from the sale of the 2011 Notes were used to repay a portion of our outstanding commercial paper and for general corporate purposes. On May 19, 2014, we repaid \$1.0 billion on the first tranche of our 2011 Notes upon maturity. We used the net proceeds from the issuance of the 2014 Notes to repay this tranche and for general corporate purposes.

As of June 30, 2014, the total carrying value and estimated fair value of the 2011 and 2014 notes were \$3.0 billion and \$3.1 billion, respectively. The fair value was determined based on observable market prices of identical instruments in less active markets. We are not subject to any financial covenants under the notes.

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In August 2013, we entered into a \$258 million capital lease obligation on certain property expiring in 2028 with an option to purchase in 2016. The effective rate of the capital lease obligation approximates the market rate. The estimated fair value of the capital lease obligation approximated its carrying value as of June 30, 2014.

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

|   | Six Months Ended |          |
|---|------------------|----------|
|   | June 30,         |          |
|   | 2013             | 2014     |
|   | (unaudited)      |          |
| Net cash provided by operating activities | \$8,338          | \$10,018 |
| Net cash used in investing activities     | (6,244)          | (8,487)  |
| Net cash used in financing activities     | (622)            | (640)    |
| Cash Provided by Operating Activities     |                  |          |

Our largest source of cash provided by operating cash flows is advertising revenues generated by Google websites and Google Network Members' websites. We also generate cash from sales of our hardware products, primarily in the Motorola Mobile business, and revenues from digital content and licensing. Our primary uses of cash from operating activities include payments to our Google Network Members and distribution partners, which are based on the revenue share or fixed fee arrangements, payments for manufacturing and inventory-related costs primarily for the Motorola Mobile business, as well as content acquisition costs. In addition, uses of cash from operating activities include compensation and related costs, other general corporate expenditures and income taxes.

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

Net cash provided by operating activities increased from the six months ended June 30, 2013 to the six months ended June 30, 2014, primarily due to increased net income adjusted for depreciation expense and loss on disposal of property and equipment and stock-based compensation expense offset by gains on divestiture of businesses, equity interest and sale of non-marketable securities. In addition, there was a net increase in cash from changes in working capital from the six months ended June 30, 2013 to the six months ended June 30, 2014 primarily due to the impact from changes in prepaid and other assets, as well as accrued expenses and other liabilities, offset by the impact from changes in accounts receivable.

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

#### Cash Used In Investing Activities

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

Cash used in investing activities increased from the six months ended June 30, 2013 to the six months ended June 30, 2014, primarily attributable to an increase in spend related to acquisitions and a decrease in proceeds received related to divestiture of businesses, offset by a net decrease in purchases of marketable securities. In addition, there was an increase in capital expenditures primarily related to data centers, real estate, and production equipment.

In order to manage expected increases in internet traffic, advertising transactions, and new products and services, and to support our overall global business expansion, we expect to make significant investments in production equipment, our systems, data centers, corporate facilities, and information technology infrastructure in 2014 and thereafter.

However, the amount of our capital expenditures has fluctuated and may continue to fluctuate on a quarterly basis.

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



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### Cash Used In Financing Activities

Cash used in financing activities consists primarily of net proceeds or payments from issuance or repayments of debt and net proceeds or payments and excess tax benefits from stock-based award activities.

Cash used in financing activities increased modestly from the six months ended June 30, 2013 to the six months ended June 30, 2014, primarily driven by an increase in net payments for stock-based award activities and a decrease in net repayments of debt.

### Contractual Obligations

We had long-term taxes payable of \$3.0 billion as of June 30, 2014 primarily related to tax positions for which the timing of the ultimate resolution is uncertain. At this time, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing of tax audit outcomes.

### Critical Accounting Policies and Estimates

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

### Income Taxes

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

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

Our effective tax rates have differed from the statutory rate primarily due to the tax impact of foreign operations, state taxes, certain benefits realized related to stock-based award activities, and research and development tax credits. The effective tax rates were 25.0% and 20.7% for the three months ended June 30, 2013 and 2014 and 16.9% and 19.5% for the six months ended June 30, 2013 and 2014, respectively. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries that have lower statutory rates and higher than anticipated in countries that have higher statutory rates, the net gains and losses recognized by legal entities on certain hedges and related hedged intercompany and other transactions under our foreign exchange risk management program, changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws, regulations, or accounting principles, as well as certain discrete items. In addition, we are subject to the continuous examination of our income tax returns by the IRS and other tax authorities which may assert assessments against us. We regularly assess the likelihood of adverse outcomes resulting from these examinations and assessments to determine the adequacy of our provision for income taxes.

### Loss Contingencies

We are regularly subject to claims, suits, government investigations, and other proceedings involving competition and antitrust, intellectual property, privacy, indirect taxes, labor and employment, commercial disputes, content generated by our users, goods and services offered by advertisers or publishers using our platforms, and other matters. Certain of these matters include speculative claims for substantial or indeterminate amounts of damages. We record a liability when we believe that it is both probable that a loss has been incurred, and the amount can be reasonably estimated. If

we determine that a loss is possible and a range of the loss can be reasonably estimated, we disclose

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the range of the possible loss in the Notes to the Consolidated Financial Statements. We evaluate, on a monthly basis, developments in our legal matters that could affect the amount of liability that has been previously accrued, and the matters and related ranges of possible losses disclosed, and make adjustments and changes to our disclosures as appropriate. Significant judgment is required to determine both likelihood of there being and the estimated amount of a loss related to such matters. Until the final resolution of such matters, there may be an exposure to loss in excess of the amount recorded, and such amounts could be material. Should any of our estimates and assumptions change or prove to have been incorrect, it could have a material impact on our business, consolidated financial position, results of operations, or cash flows. See Note 9 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information regarding contingencies.

### Business Combinations

We allocate the fair value of purchase consideration to the tangible assets acquired, liabilities assumed and intangible assets acquired based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets. Critical estimates in valuing certain intangible assets include but are not limited to future expected cash flows from customer relationships and acquired patents and developed technology; and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Other estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed, as more fully discussed in Note 5 of Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

### Goodwill

Goodwill is allocated to reporting units expected to benefit from the business combination. We test goodwill for impairment at the reporting unit level at least annually, or more frequently if events or changes in circumstances occur that would more likely than not reduce the fair value of a reporting unit below its carrying value. We evaluate our reporting units on an annual basis and, if necessary, reassign goodwill using a relative fair value allocation approach. Goodwill impairment tests require judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. As of June 30, 2014, no impairment of goodwill has been identified.

### Impairment of Marketable and Non-Marketable Securities

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

### Available Information



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

We webcast our earnings calls and certain events we participate in or host with members of the investment community on our investor relations website. Additionally, we 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 as well as on our investor relations Google+ page (<https://plus.google.com/+GoogleInvestorRelations/posts>). Investors and others can receive notifications of new information posted on our investor relations website in real time by signing up for email alerts and RSS feeds. Further corporate governance information, including our certificate of incorporation, bylaws, governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website under the heading "Corporate Governance." The content of our websites are not incorporated by reference into this Quarterly Report on Form 10-Q or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

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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

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

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

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that changes in exchange rates of 20% for our foreign currency options could be experienced in the near term. If the U.S. dollar weakened by 20%, the amount recorded in AOCI before tax effect would have been approximately \$15 million lower at June 30, 2014, and the total amount of expense recorded as "Interest and other income, net", would have been approximately \$73 million higher at June 30, 2014. If the U.S. dollar strengthened by 20%, the amount recorded in accumulated AOCI before tax effect would have been approximately \$1.6 billion higher at June 30, 2014, and the total amount of expense recorded as "Interest and other income, net", would have been approximately \$79 million higher at June 30, 2014. The impact in AOCI would offset our hedged exposures as they occur.

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

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that adverse changes in exchange rates of 20% for all currencies could be experienced in the near term. These changes would have resulted in an adverse impact on income before income taxes of approximately \$51 million at June 30, 2014. The adverse impact at June 30, 2014 is after consideration of the offsetting effect of approximately \$1.0 billion from foreign exchange contracts in place for the month of June 30, 2014. These reasonably possible adverse changes in exchange rates of 20% were applied to total monetary assets and liabilities denominated in currencies other than the local currencies at the balance sheet dates to compute the adverse impact these changes would have had on our income before income taxes in the near term.

Interest Rate Risk

Our investment strategy is to achieve a return that will allow us to preserve capital and maintain liquidity requirements. We invest primarily in U.S. government and its agency securities, money market and other funds, fixed-income bond funds, corporate debt securities, mortgage-backed securities, debt instruments issued by foreign governments, municipal securities, time deposits, and asset backed securities. By policy, we limit the amount of credit exposure to any one issuer. Our investments in both fixed rate and floating rate interest earning securities carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in

interest rates, while floating rate securities may produce less income than predicted if interest rates fall. As of June 30, 2014, unrealized losses on our marketable debt securities were primarily due to temporary interest rate fluctuations as a result of higher market interest rates compared to the fixed interest rates on our debt securities. We account for both fixed and variable rate securities at fair value with changes on gains and losses recorded in AOCI until the securities are sold. We use interest rate derivative contracts to hedge realized gains and losses on our securities. These derivative contracts are accounted for at fair value with changes in fair value recorded in "Interest and other income, net".

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We considered the historical volatility of interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term. A hypothetical 1.00% (100 basis points) increase in interest rates would have resulted in a decrease in the fair values of our marketable securities and interest rate derivative contracts of approximately \$1.0 billion at June 30, 2014.

**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, 2014, 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, 2014 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.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For a description of our material pending legal proceedings, please refer to Note 9 “Contingencies - Legal Matters” of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business and Industry

We face intense competition. If we do not continue to innovate and provide products and services that are useful to users, we may not remain competitive, and our revenues and operating results could be adversely affected.

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

We have many competitors in different industries, including general purpose search engines, vertical search engines and e-commerce sites, social networking sites, traditional media companies, wireless mobile device companies, and providers of online products and services. Our current and potential competitors range from large and established companies to emerging start-ups. Established companies have longer operating histories and more established relationships with customers and users, and they can use their experience and resources in ways that could affect our competitive position, including by making acquisitions, investing aggressively in research and development, aggressively initiating intellectual property claims (whether or not meritorious) and competing aggressively for advertisers and websites. Emerging start-ups may be able to innovate and provide products and services faster than we can.

Our competitors are constantly developing innovations in web search, online advertising, wireless mobile devices, and web-based products and services. The research and development of new, technologically advanced products is also a complex and uncertain process requiring high levels of innovation and investment, as well as the accurate anticipation of technology, market trends and consumer needs. As a result, we must continue to invest significant resources in research and development, including through acquisitions, in order to enhance our web search technology and our existing products and services, and introduce new products and services that people can easily and effectively use. If we are unable to provide quality products and services, then acceptance rates for our products and services could decline and affect consumer and advertiser perceptions of our brand. In addition, these new products and services may present new and difficult technological and legal challenges, and we may be subject to claims if users of these offerings experience service disruptions or failures or other issues. Our operating results would also suffer if our innovations are not responsive to the needs of our users, advertisers, and Google Network Members, are not appropriately timed with market opportunities, or are not effectively brought to market. As technology continues to develop, our competitors may be able to offer user experiences that are, or that are seen to be, substantially similar to or better than ours. This may force us to compete in different ways and expend significant resources in order to remain competitive. If our competitors are more successful than we are in developing compelling products or in attracting and

retaining users, advertisers, and content providers, our revenues and operating results could be adversely affected.

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

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

More people are using devices other than desktop computers to access the internet and accessing new devices to make search queries. If manufacturers and users do not widely adopt versions of our web search technology, products, or operating systems developed for these devices, our business could be adversely affected.

The number of people who access the internet through devices other than desktop computers, including mobile phones, smartphones, handheld computers such as netbooks and tablets, video game consoles, and television set-top devices, is increasing dramatically. The lower resolution, functionality, and memory associated with some alternative devices make the use of our products and services through such devices more difficult and the versions of our products and services developed for these devices may not be compelling to users, manufacturers, or distributors of alternative devices. Each manufacturer or distributor may establish unique technical standards for its devices, and our products and services may not work or be viewable on these devices as a result. Some manufacturers may also elect not to include our products on their devices. In addition, search queries are increasingly being undertaken via “apps” tailored to particular devices or social media platforms, which could affect our share of the search market over time. As new devices and platforms are continually being released, it is difficult to predict the problems we may encounter in adapting our products and services and developing competitive new products and services. We expect to continue to devote significant resources to the creation, support, and maintenance of products and services across multiple platforms and 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 and platforms, we will fail to capture the opportunities available as consumers and advertisers transition to a dynamic, multi-screen environment.

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

We generated 91% of Google revenues from our advertisers in 2013 and 90% in the six months ended June 30, 2014. Our advertisers can generally terminate their contracts with us at any time. Advertisers will not continue to do business with us if their investment in advertising with us does not generate sales leads, and ultimately customers, or if we do not deliver their advertisements in an appropriate and effective manner. If we are unable to remain competitive and provide value to our advertisers, they may stop placing ads with us, which would adversely affect our revenues and business.

In addition, expenditures by advertisers tend to be cyclical, reflecting overall economic conditions and budgeting and buying patterns. Adverse macroeconomic conditions can also have a material negative impact on the demand for advertising and cause our advertisers to reduce the amounts they spend on advertising, which could adversely affect our revenues and business.

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

Our revenue growth rate could decline over time as a result of a number of factors, including as a result of:

increasing competition,  
changes in property mix, platform mix, and geographical mix,  
the challenges in maintaining our growth rate as our revenues increase to higher levels,  
the evolution of the online advertising market, including the increasing variety of online platforms for advertising, and  
the other markets in which we participate, and  
the success of our investments in new businesses, products, services, and technologies.

The revenue growth rate of our Motorola Mobile business will also depend on a number of factors, including the success of our new products, our reliance on several large customers, the absence of long-term exclusivity arrangements with such customers, our ability to gain significant market share in the mobile devices space, our reliance



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on third-party distributors, representatives and retailers to sell certain of our products and the successful implementation of our product and operating system strategies. Furthermore, consolidation in the telecommunications industry could negatively impact our business because there would be fewer network operators and it could be more difficult to replace any lost customers. Any of these factors could have a negative impact on our Motorola Mobile business and have an adverse effect on our consolidated financial results.

We believe our operating margin will experience downward pressure as a result of increasing competition and increased expenditures for many aspects of our business, including Motorola, and new lines of business. For instance, our operating margin will experience downward pressure if a greater percentage of our revenues comes from ads placed on our Google Network Members' websites compared to revenues generated through ads placed on our own websites or if we spend a proportionately larger amount to promote the distribution of certain products, including Google Chrome. Both the margin on revenues we generate from our Google Network Members and the margin on revenues from our Motorola business are significantly less than the margin on revenues we generate from advertising on our websites. Also, the margin on the sale of digital content and apps, advertising revenues from mobile devices and newer advertising formats are generally less than the margin on revenues we generate from advertising on our websites on traditional formats. Additionally, the margin we earn on revenues generated from our Google Network Members could decrease in the future if we pay an even larger percentage of advertising fees to our Google Network Members.

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

The growth of our company and our expansion into a variety of new fields implicate a variety of new regulatory issues, and we have experienced increased regulatory scrutiny as we have grown. We continue to cooperate with the European Commission (EC) and other regulatory authorities around the world in investigations they are conducting with respect to our business and its impact on competition. Legislators and regulators may make legal and regulatory changes, or interpret and apply existing laws, in ways that make our products and services less useful to our users, require us to incur substantial costs, expose us to unanticipated civil or criminal liability, or cause us to change our business practices. These changes or increased costs could negatively impact our business and results of operations in material ways.

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

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

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

functionalities, products, or services, requiring a change in our business practices or product recalls or other field action, or requiring development of non-infringing or otherwise altered products or technologies. Any of these consequences could adversely affect our business and results of operations.

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

Acquisitions are an important element of our overall corporate strategy and use of capital, and these transactions could be material to our financial condition and results of operations. We expect to continue to evaluate and enter into discussions regarding a wide array of potential strategic transactions. The process of integrating an

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acquired company, business, or technology has created, and will continue to create, unforeseen operating difficulties and expenditures. The areas where we face risks include:

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

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

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

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

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

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

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

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

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

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

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

Our acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, or amortization expenses, or impairment of goodwill and purchased long-lived assets, and restructuring charges, any of which could harm our financial condition or results. Also, the anticipated benefit of many of our acquisitions may not materialize.

Our business depends on a strong brand, and failing to maintain and enhance our brand would hurt our ability to expand our base of users, advertisers, Google Network Members, and other partners.

The brand identity that we have developed has significantly contributed to the success of our business. Maintaining and enhancing the “Google” brand is critical to expanding our base of users, advertisers, Google Network Members, and other partners. We believe that the importance of brand recognition will increase due to the relatively low barriers to entry in the internet market. Our brand may be negatively impacted by a number of factors, including data protection and security issues, service outages, and product malfunctions. If we fail to maintain and enhance the “Google” brand, or if we incur excessive expenses in this effort, our business, operating results, and financial condition will be materially and adversely affected. Maintaining and enhancing our brand will depend largely on our ability to be a technology leader and continue to provide high-quality innovative products and services, which we may not do successfully.

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

We are subject to numerous U.S. and foreign laws and regulations covering a wide variety of subject matters. New laws and regulations (or new interpretations of existing laws and regulations) may also impact our business. The costs of compliance with these laws and regulations are high and are likely to increase in the future. Any failure on our part

to comply with these laws and regulations can result in negative publicity and diversion of management time and effort and may subject us to significant liabilities and other penalties.

Furthermore, many of these laws were adopted prior to the advent of the internet and related technologies and, as a result, do not contemplate or address the unique issues of the internet and related technologies. The laws that do reference the internet are being interpreted by the courts, but their applicability and scope remain uncertain. For example, the laws relating to the liability of providers of online services are currently unsettled both within the U.S. and abroad. Claims have also been, or may be, threatened and filed against us under both U.S. and foreign laws for

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defamation, invasion of privacy and other tort claims, unlawful activity, patent, copyright and trademark infringement, or other theories based on the nature and content of the materials searched and the ads posted by our users, our products and services, or content generated by our users. Moreover, current and new patent laws such as U.S. patent laws and European patent laws may affect the ability of companies, including us, to protect their innovations and defend against claims of patent infringement.

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

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

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

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

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

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

operations, or cash flows.

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

Our patents, trademarks, trade secrets, copyrights, and other intellectual property rights are important assets for us. Various events outside of our control pose a threat to our intellectual property rights, as well as to our products, 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.

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

We also seek to maintain certain intellectual property as trade secrets. The secrecy could be compromised by outside parties, or by our employees, which could cause us to lose the competitive advantage resulting from these trade secrets.

We also face risks associated with our trademarks. For example, there is a risk that the word “Google” could become so commonly used that it becomes synonymous with the word “search.” If this happens, we could lose protection for this trademark, which could result in other people using the word “Google” to refer to their own products, thus diminishing our brand.

Any significant impairment of our intellectual property rights could harm our business and our ability to compete. Also, protecting our intellectual property rights is costly and time consuming. Any increase in the unauthorized use of our intellectual property could make it more expensive to do business and harm our operating results.

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

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

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

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

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

In addition, as nearly all of our products and services are web-based, the amount of data we store for our users on our servers (including personal information) has been increasing. Any systems failure or compromise of our security that

results in the release of our users' data could seriously limit the adoption of our products and services, as well as harm our reputation and brand and, therefore, our business. We expect to continue to expend significant resources to protect against security breaches. The risk that these types of events could seriously harm our business is likely to increase as we expand the number of web-based products and services we offer, and operate in more countries.

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



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applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could have an adverse effect on our business and results of operations. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

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

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

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

In the past, Motorola, like many electronics manufacturers, has experienced supply shortages and price increases driven by raw material availability, manufacturing capacity, labor shortages, industry allocations, natural disasters and significant changes in the financial or business condition of its suppliers. Workaround plans to address shortages have entailed in the past, and could entail in the future, increased freight costs for expedited shipments. There is no assurance that we will not experience shortages or other supply chain disruptions in the future or that they will not negatively impact our operations. In addition, some of the components we use in our products are available only from a single source or limited sources, and there is no assurance that we would be able to find replacement vendors on favorable terms or at all in the event of a supply chain disruption.

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

We also require our suppliers and business partners to comply with law and company policies regarding workplace and employment practices, environmental compliance and intellectual property licensing, but we do not control them or their practices. If any of them violates laws or implements practices regarded as unethical, we could experience supply chain disruptions, canceled orders, terminations of or damage to key relationships, and damage to our reputation. If any of them fails to procure necessary license rights to third-party intellectual property, legal action could ensue that could impact the saleability of our products and expose us to financial obligations to third parties.

The Dodd-Frank Wall Street Reform and Consumer Protection Act includes disclosure requirements regarding the use of certain minerals mined from the Democratic Republic of Congo and adjoining countries (DRC) and procedures pertaining to a manufacturer's efforts regarding the source of such minerals. SEC rules implementing these requirements may have the effect of reducing the pool of suppliers who can supply DRC "conflict free" components and parts, and we may not be able to obtain DRC conflict free products or supplies in sufficient quantities for our operations. Since our supply chain is complex, we may face reputational challenges with our customers, stockholders

and other stakeholders if we are unable to sufficiently verify the origins for the minerals used in our products.

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

Our products and services involve the storage and transmission of users' and customers' proprietary information, and security breaches expose us to a risk of loss of this information, litigation, and potential liability. We experience cyber attacks of varying degrees on a regular basis, and as a result, unauthorized parties have obtained,

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

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

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

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

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

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

Our international operations are significant to our revenues and net income, and we plan to continue to grow internationally. International revenues accounted for approximately 58% of our consolidated revenues in the six months ended June 30, 2014. In certain international markets, we have limited operating experience and may not

benefit from any first-to-market advantages or otherwise succeed.

Most of our Motorola products are manufactured outside the U.S., primarily in China, Taiwan and Brazil. If our manufacturing in these countries is disrupted, our overall capacity could be reduced and sales or profitability could be negatively impacted. We require suppliers and business partners to comply with the law and company policies regarding workplace and employment practices, environmental compliance and intellectual property licensing, but we do not control them or their practices. If any of them violates laws or implements practices regarded as unethical, we could experience supply chain disruptions, canceled orders, terminations of or damage to key relationships, and damage to

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our reputation. If any of them fails to procure necessary license rights to third-party intellectual property, legal action could ensue that could impact the salability of our products and expose us to financial obligations to third parties.

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

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

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

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

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

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

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

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

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

• Revenue fluctuations caused by changes in property mix, platform mix, and geographical mix.

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

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

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

• The results of our investments in risky projects, including new businesses, products, services, technologies and acquisitions.

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

• Our ability to generate significant revenues from services in which we have invested considerable time and resources.

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

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

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

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

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

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

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, including legal actions, 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.



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

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

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

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

We may have exposure to greater than anticipated tax liabilities.

Our future income taxes could be adversely affected by earnings being lower than anticipated in jurisdictions that have lower statutory tax rates and higher than anticipated in jurisdictions that have higher statutory tax rates, by changes in the valuation of our deferred tax assets and liabilities, as a result of gains on our foreign exchange risk management program, or changes in tax laws, regulations, or accounting principles, as well as certain discrete items. We are subject to regular review and audit by both domestic and foreign tax authorities. Any adverse outcome of such a review or audit could have a negative effect on our operating results and financial condition. In addition, the determination of our worldwide provision for income taxes and other tax liabilities requires significant judgment, and there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

### Risks Related to Ownership of Our Stock

The trading price for our Class A common stock may continue to be volatile and the trading price for our newly distributed non-voting Class C capital stock may also be volatile.

The trading price of our stock has at times experienced substantial price volatility and may continue to be volatile. For example, from July 1, 2013 through June 30, 2014, the post-split closing price of our Class A common stock ranged from \$423.87 per share to \$610.70 per share.

In addition, following the settlement of litigation involving the authorization to distribute our non-voting Class C capital stock, our board of directors approved a distribution of shares of Class C capital stock as a dividend to our holders of Class A and Class B common stock with a payment date of April 2, 2014, and on April 3, 2014, Class C capital stock was listed on The NASDAQ Global Select Market. We expect that the market price for the shares of Class A common stock will continue to generally reflect the effect of the Stock Split. In accordance with the settlement, we may be obligated to make a payment to holders of Class C capital stock if, on average, Class C capital stock trades below Class A common stock during the first 365 days following the Class C dividend. While we expect that the market price for the shares of Class A common stock and Class C capital stock will trade in roughly the same range, we cannot reliably predict what, if any, patterns will emerge over time with respect to the relative trading prices of Class A common stock and Class C capital stock, and we may be obligated to make such a payment to holders of the Class C stock in cash, Class A stock, Class C stock, or a combination thereof, at the discretion of the board of directors. For further disclosure regarding this potential payment, please refer to Note 11 "Stockholders' Equity - Stock

Split Effectuated in Form of Stock Dividend” of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

The trading price of our Class A common stock and Class C capital stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include, among others:

Quarterly variations in our results of operations or those of our competitors.

• Announcements by us or our competitors of acquisitions, new products, significant contracts, commercial relationships, or capital commitments.

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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 and Class C capital stock available for public sale.

• Sales of Class A common stock and Class C capital 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 and Class C capital stock.

• The perceived values of Class A common stock and Class C capital stock relative to one another.

In addition, the stock market in general, and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may harm the market price of our Class A common stock and our Class C capital stock regardless of our actual operating performance.

The concentration of our stock ownership limits our stockholders' ability to influence corporate matters.

Our Class B common stock has 10 votes per share, our Class A common stock has one vote per share, and our Class C capital stock has no voting rights. As of June 30, 2014, Larry, Sergey, and Eric beneficially owned approximately 92.5% of our outstanding Class B common stock and represented approximately 61.1% of the voting power of our outstanding capital stock. Larry, Sergey, and Eric therefore have significant influence over management and affairs and over all matters requiring stockholder approval, including the election of directors and significant corporate transactions, such as a merger or other sale of our company or our assets, for the foreseeable future. In addition, because our Class C capital stock carries no voting rights (except as required by applicable law), the issuance of the Class C capital stock, including in future stock-based acquisition transactions and to fund employee equity incentive programs, could prolong the duration of Larry and Sergey's current relative ownership of our voting power and their ability to elect all of our directors and to determine the outcome of most matters submitted to a vote of our stockholders. Together with Eric, they would also continue to be able to control any required stockholder vote with respect to certain change in control transactions involving Google (including an acquisition of Google by another company).

This concentrated control limits or severely restricts our stockholders' ability to influence corporate matters and, as a result, we may take actions that our stockholders do not view as beneficial. As a result, the market price of our Class A common stock and our Class C capital stock could be adversely affected.

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

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

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

transaction that other stockholders may view as beneficial. As noted above, the issuance of the Class C capital stock could have the effect of prolonging the influence of Larry, Sergey, and Eric.

Our board of directors has the right to elect directors to fill a vacancy created by the expansion of the board of directors or the resignation, death, or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors.

Our stockholders may not act by written consent. As a result, a holder, or holders, controlling a majority of our capital stock would not be able to take certain actions without holding a stockholders' meeting.

Our certificate of incorporation prohibits cumulative voting in the election of directors. This limits the ability of minority stockholders to elect director candidates.

Stockholders must provide advance notice to nominate individuals for election to the board of directors or to propose matters that can be acted upon at a stockholders' meeting. These provisions may discourage or deter

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a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of our company.

Our board of directors may issue, without stockholder approval, shares of undesignated preferred stock. The ability to issue undesignated preferred stock makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

As a Delaware corporation, we are also subject to certain Delaware anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its outstanding voting stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

**ITEM 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.

Date: July 24, 2014

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

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\*        Filed herewith.

†        Furnished herewith.