RCG COMPANIES INC
Form S-3
October 28, 2004

As filed with the Securities and Exchange Commission on October 28, 2004

Registration No.________________

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM S-3

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933
RCG COMPANIES INCORPORATED
(Exact name of Registrant as specified in its charter)

Delaware	23-2265039
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

6836 MORRISON BOULEVARD
SUITE 200
CHARLOTTE, NC 28211
(704) 366-5054

(Address and telephone number of Registrant's principal executive offices)

MICHAEL D. PRUITT
CHIEF EXECUTIVE OFFICER
RCG COMPANIES INCORPORATED
6836 MORRISON BOULEVARD
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CHARLOTTE, NC 28211
(704) 366-5054
(Name, address and telephone number of agent for service)

Copies of all communications, including all communications sent to the agent for service, should be sent to:

JOEL D. MAYERSOHN, ESQ.
ADORNO & YOSS, P.A.
350 EAST LAS OLAS BOULEVARD, SUITE 1700
FORT LAUDERDALE, FLORIDA 33301
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Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. [ ]

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [ ]

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED	PROPOSED MAXIMUM OFFERING PRICE PER SECURITY		PROPOSED MAXIMUM AGGREGATE OFFERING PRICE	
Common Stock, $.04 par value	4,610,538	$1.15	(1)	$5,302,118	
Common Stock, $.04 par value	1,436,617	$1.21	(2)	$1,738,307	
Common Stock, $.04 par value	3,430,851	$1.15	(3)	$3,945,479	
Common Stock, $.04 par value	4,574,468	$1.15	(4)	$5,260,638	
Total Registration Fee					$

(1) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(c) under the Securities Act. Based upon the average of the high and low prices of the registrant's Common Stock on October 25, 2004, as reported by the American Stock Exchange.

(2) Estimated solely for purposes of calculating the registration fee pursuant to Rule 457(g). Based upon the exercise price of the Common Stock underlying the warrants which is higher than the average of the high and low prices of the registrant's Common Stock on October 25, 2004, as reported by the American Stock Exchange.

(3) Estimated solely for purposes of calculating the registration fee pursuant to Rule 457(g). Based upon the average of the high and low prices of the registrant's Common Stock on October 25, 2004, as reported by the American Stock Exchange, which is higher than the exercise price of the Common Stock underlying the additional investment rights.

(4) Estimated solely for purposes of calculating the registration fee pursuant to Rule 457(g). Based upon the average of the high and low prices of the registrant's Common Stock on October 25, 2004, as reported by the American Stock Exchange, which is higher than the conversion price of the Common Stock underlying the series a convertible preferred stock.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933, AS AMENDED OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE SECURITIES AND EXCHANGE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

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PROSPECTUS

SUBJECT TO COMPLETION, DATED OCTOBER 28, 2004

The information in this Prospectus is not complete, and it may be changed. These securities will not be publicly resold until the registration statement, of which this Prospectus is a part, is filed with the Securities and Exchange Commission and has become effective. This Prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where such offer or sale is not permitted.

RCG COMPANIES INCORPORATED
14,052,474
COMMON STOCK

This Prospectus relates to the resale of up to 14,052,474 shares of our Common Stock, par value $.04 per share, by certain stockholders. The shares that may be resold pursuant to this Prospectus include 690,000 shares of Common Stock, 4,574,468 shares of Common Stock underlying shares of Series A 6% Convertible Preferred Stock, 910,588 shares issuable as dividends for three years if Company elects to, and is permitted to, pay such dividends in kind; 1,186,617 shares of Common Stock underlying Common Stock Purchase Warrants exercisable at $1.20, 200,000 shares of Common Stock underlying a Common Stock Purchase Warrant exercisable at $0.94, 50,000 shares of Common Stock underlying Warrants to Purchase Common Stock exercisable at $2.44, 3,430,851 shares of Common Stock underlying Additional Investment Rights exercisable at $1.03 per share and 3,009,950 additional shares are being registered in order to register 130% of the total registrable securities as required by the Registration rights Agreement.

Our Common Stock is traded on the American Stock Exchange under the symbol "RCG." The closing sales price of our Common Stock on October 25, 2004, was $1.15 per share.

INVESTING IN THE COMMON STOCK INVOLVES CERTAIN RISKS. SEE "RISK FACTORS" BEGINNING ON PAGE 1 FOR INFORMATION THAT YOU SHOULD CONSIDER.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION, HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this Prospectus is October 28, 2004.

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Ex-4.1 Securities Purchase Agreement ....

Ex-4.2 Certificate of Designation of Preferences, Rights and
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Ex-4.3 Form of Common Stock Purchase Warrant Exercisable at $1.20 ....

Ex-4.4 Form of Additional Investment Rights Agreement.......................

Ex-4.5 Form of Registration Rights Agreement...............................

Ex-4.6 Form of Warrant to Purchase Common Stock exercisable at $2.44 ....

Ex-4.7 Common Stock Purchase Warrant exercisable at $0.94 (initially $2.44)..

Ex-5.1 Legal Opinion of Adorno & Yoss, P.A.................................

Ex 10.1-Independent Consulting Agreement ....

Ex-23.1 Consent of Adorno & Yoss, P.A (included in Exhibit 5.1).............

Ex-23.2 Consent of BDO Seidman LLP..

If this form is filed to register additional securities for an offering pursu to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering. [ ]

If the delivery of the Prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

RISK FACTORS

You should carefully consider the risk factors set forth below, as well as the other information in this Prospectus, in evaluating whether to invest in our Shares.

WE RECEIVED A GOING CONCERN OPINION FROM OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM.

We received from our independent registered public accounting firm and included in this report an opinion on our consolidated financial statements that raises substantial doubt as to our ability to continue as a going concern as a result of recurring losses from operations and a deficiency in working capital at June 30, 2004.

WE MAY NEED TO RAISE ADDITIONAL FUNDS IN ORDER TO CONTINUE TO OPERATE AND GROW OUR BUSINESS.

If we are unable to grow our business or improve our operating cash flows as expected; If we suffer significant losses on our investments; or if we are unable to realize adequate proceeds from those investments, we will then need to secure alternative equity or debt financing to provide us with additional working capital. However, there can be no assurance that we will be able to complete such financing if required. If we raise funds through debt financing, then we will incur additional interest expense going forward. If we raise additional funds by issuing additional equity securities, then the percentage ownership of our current stockholders will be diluted. We cannot be certain that additional financing will be available when and to the extent required, or that, if available, it will be on acceptable terms. In addition, our ability to complete future financings may be affected by the market price of our Common Stock. If adequate funds are not available on acceptable terms, then we will be unable to continue to fund our existing businesses or planned expansion, or take other steps necessary to enhance our business or continue our operations.

WE HAVE BEEN INCURRING OPERATING LOSSES AND THERE CAN BE NO ASSURANCE THAT WE WILL ACHIEVE OR SUSTAIN PROFITABILITY.

We have incurred operating losses since inception. Certain of our operating businesses have incurred and continue to incur operating losses. We expect to continue to incur significant operating costs in connection with our efforts to expand our existing businesses and to grow through acquisitions. As a result of these costs and uncertain revenue growth, there can be no assurance that we will achieve or be able to sustain profitability.

THE PRICE OF OUR COMMON STOCK HAS BEEN VOLATILE AND IF THE MARKET PRICE OF OUR COMMON STOCK DECREASES, STOCKHOLDERS MAY NOT BE ABLE TO SELL THEIR SHARES OF COMMON STOCK AT A PROFIT.

The trading price of our Common Stock during our last fiscal year, as reported by the American Stock Exchange, fluctuated from a high of $3.16 to a low of $0.46. Fluctuations in the price of our Common Stock may occur, among other reasons, in response to:

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- operating results;
- regulatory changes;
- economic changes;
- market valuation of firms in related businesses; and
- general market conditions.

In addition, the volume of shares of our Common Stock bought and sold on any trading day has been subject to wide fluctuations which also contribute to fluctuations in the trading price of our Common Stock. The trading price of our Common Stock could continue to be subject to wide fluctuations in response to these or other factors, many of which are beyond our control.

WE MAY BE UNABLE TO MAINTAIN OUR LISTING ON THE AMERICAN STOCK EXCHANGE AND IF WE ARE DELISTED THE TRADING OF OUR COMMON STOCK COULD BE MORE DIFFICULT.

Our Common Stock is presently listed and trading on the American Stock Exchange. We believe that we meet the standards for continued listing but such a determination is subjective and the Exchange may not agree. If our Common Stock is delisted from the Exchange trading in our securities could be more difficult and trading of our Common Stock could be subject to the "penny stock" rules. The U.S. Securities and Exchange Commission (the "SEC") has adopted regulations that generally define a penny stock to be any equity security that has a market price of less than $5.00 per share, subject to certain exceptions (including trading on the American Stock Exchange). These rules require that any broker-dealer who recommends our securities to persons other than prior customers and accredited investors must, prior to the sale, make a special written suitability determination for the purchaser and receive the purchaser's written agreement to execute the transaction. Unless an exception is available, the regulations require the delivery, prior to any transactions involving a penny stock, of a disclosure schedule explaining the penny stock market and the risks associated with trading in the penny stock market. In addition, broker-dealers must disclose commissions payable to both the broker-dealer and the registered representative and current quotations for the securities they offer. The additional burdens imposed upon broker-dealers by such requirements may discourage broker-dealers from recommending transactions in our securities, which could severely limit the liquidity of our securities and consequently adversely affect the market price for our securities.

IF WE CANNOT INTEGRATE OUR RECENT OR FUTURE ACQUISITIONS, WE MAY BE UNABLE TO SUCCESSFULLY EXECUTE OUR STRATEGY.

We anticipate that a portion of our future growth will be accomplished through acquisitions. The success of our plan depends upon our ability to:

- identify suitable acquisition opportunities;
- effectively integrate acquired personnel, operations, products and technologies into our organization;
- retain and motivate the personnel of acquired businesses;
- retain customers of acquired business; and
- obtain necessary financing on acceptable terms or use our securities as consideration for acquisitions.

Turbulence in financial markets and the current U.S. economy may result in a diminished pool of companies that meet our criteria for acquisition. Even if we are successful in acquiring companies, we may be unable to integrate them into our business model or achieve the expected synergies.

WE FACE COMPETITION FROM OTHER ACQUIRORS AND INVESTORS, WHICH MAY PREVENT US FROM REALIZING STRATEGIC OPPORTUNITIES.

We plan to acquire or invest in existing companies to fulfill our business plan. In pursuing these opportunities, we face competition from other capital providers and operators of companies, including publicly traded companies, venture capital companies and large corporations. Some of these competitors have greater financial, operational and human resources than we do. This competition may limit our opportunity to acquire interests in companies that we believe could help us fulfill our business plan and increase our value.

OUR ACQUISITION STRATEGY HAS AND WILL CONTINUE TO DILUTE OUR CURRENT STOCKHOLDERS' OWNERSHIP.

Our acquisition strategy contemplates that we may issue our securities to make strategic acquisitions and attempt to grow our business. Each of the acquisitions that we complete in the future, involving the issuance of securities, will further dilute our current stockholders' ownership interest in the Company.

OUR GROWTH PLACES STRAIN ON OUR MANAGERIAL, OPERATIONAL AND FINANCIAL RESOURCES.

Our growth has placed, and is expected to continue to place, a significant strain on our managerial, operational and financial resources. Further growth will increase this strain on our managerial, operational and financial resources, which may inhibit our ability to successfully implement our business plan.

WE DEPEND ON CERTAIN IMPORTANT EMPLOYEES, AND THE LOSS OF ANY OF THOSE EMPLOYEES MAY HARM OUR BUSINESS.

Our performance is substantially dependent on the performance of our executive officers and other key employees. The familiarity of these key employees with their respective industries makes those employees especially critical to our success. In addition, our success is dependent on our ability to attract, train, retain and motivate high quality personnel, especially for our management team. The loss of the services of any of our executive officers or key employees may harm our business. Our success also depends on our continuing ability to attract, train, retain and motivate other highly qualified technical and managerial personnel. Competition for such personnel is intense and our limited resources are likely to make it more difficult for us to attract and retain such personnel.

WE DEPEND ON CERTAIN AIRLINE CONTRACTS.

Our travel services business generally contracts with three carriers for charter tour operator contracts. While this concentration generally reduces the costs of the carrier service, if one or more of these carriers are unable to perform under its contract, our travel services business may experience service interruptions that could reduce its revenue. Additionally, our travel services business may be forced to replace such a carrier, which could result in higher operating costs for the carrier services, thereby reducing profitability.

INCREASES IN FUEL COSTS AFFECT OUR OPERATING COSTS AND COMPETITIVENESS.

Fuel is a major component of our operating expenses. Both the cost and availability of fuel are influenced by many economic and political factors and events occurring in oil producing countries throughout the world, and fuel costs fluctuate widely. Recently the price per barrel of oil is as at an all-time high and has significantly impacted our results of operations. We cannot predict our future cost and availability of fuel, which affects our ability to compete. The unavailability of adequate fuel supplies could have a material adverse effect on our operations and profitability. In addition, larger airlines may have a competitive advantage because they pay lower prices for fuel. We generally follow industry trends by imposing a fuel surcharge in response to significant fuel price increases. However, our ability to pass on increased fuel costs is limited by economic and competitive conditions.

PURSUANT TO THE TERMS OF OUR ACQUISITION OF VACATION EXPRESS WE HAVE INCURRED SUBSTANTIAL DEBT WHICH IS SECURED BY CERTAIN OF OUR INVESTMENT HOLDINGS.

Under the terms of our acquisition of Vacation Express we issued a $10,000,000 seven-year promissory note which is secured by certain of our investment holdings. In addition, under the terms of the acquisition we have made a commitment to purchase $4,500,000 of travel related services. If we are unable to repay the note or satisfy the commitment, we may forfeit certain of our investment holdings. In addition, the debt may put a strain on our working capital. If we are unable to repay the debt, our financial position will be negatively impacted.

FUTURE EVENTS SIMILAR TO THOSE OF SEPTEMBER 11, 2001 MAY HAVE AN ADVERSE EFFECT ON OUR BUSINESSES.

The terrorist attack against the United States on September 11, 2001 produced great uncertainty in the economy in general and in the aviation industry in particular. These events are still having a negative impact on the air travel industry. These events may drastically alter the long-term demand for charter services. In addition, these events may lead the Federal Aviation Administration to place additional restrictions on charter flight operators, which may increase the cost of private charter services. The long-term impact of these events on the aviation industry and the chartered services segment of that industry are not known. These events could have a material adverse effect on our aviation travel services business.

GOVERNMENT REGULATION OF THE TRAVEL INDUSTRY COULD IMPACT OUR AVIATION TRAVEL SERVICES' BUSINESS OPERATIONS.

Certain segments of the travel industry are regulated by the United States Government and, while we are not currently required to be certified or licensed under such regulation, certain services offered by our aviation travel services business are affected by such regulation. Charter flights operators, upon which our aviation travel services business depends, are subject to vigorous and continuous certification requirements by the Federal Aviation Administration. Changes in the regulatory framework for charter aviation travel could adversely affect our aviation travel services business' operations and financial condition.

OUR AVIATION TRAVEL SERVICES BUSINESS FACES INTENSE COMPETITION FROM COMMERCIAL AIRLINERS AND OTHER TOUR OPERATORS FOR CUSTOMERS.

We provide leisure charter jet travel and tour services and face intense competition from commercial airlines and other tour operators for the potential customers who travel to these locations and other locations that we may serve in the future. These commercial airlines have greater resources, marketing efforts and brand equity than we do and they also offer a potential customer more flights to these locations. Furthermore, travelers have numerous choices of location when choosing travel destinations. Since we offer only limited travel destinations, we face intense competition from travel agents, commercial airlines, hotels, resorts, casinos and other organizations in the travel industry that offer alternative travel destinations to those offered by us. Many competitors possess far greater capital and human resources, marketing efforts and brand equity than we do. If we are unable to compete effectively with these various competitors in the travel industry, we may not be able to achieve and maintain profitability.

OUR TECHNOLOGY SOLUTIONS BUSINESS MAY NOT BE ABLE TO KEEP UP WITH THE CONTINUOUS TECHNOLOGICAL CHANGE IN ITS MARKET.

The success of our technology solutions business will depend, in part, on its ability to respond to technological advances. This business may not be successful in responding quickly, cost-effectively and sufficiently to these developments. Many of the competitors of our technology solutions business are larger than we are and have significantly more financial resources to invest in advances in technology, products and other areas central to providing technology and Internet solutions. Our technology solutions business will not be able to compete effectively or meet its growth objectives if it is unable, for technical, financial or other reasons, to adapt in a timely manner in response to technological advances. In addition, employee time allocated to responding to technological advances will not be available for client engagements.

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THE SUCCESS OF OUR TECHNOLOGY SOLUTIONS BUSINESS IS LARGELY DEPENDENT UPON ITS ABILITY TO RETAIN ITS MANUFACTURER AUTHORIZATIONS THAT ALLOW IT TO SELL SOFTWARE TO EDUCATIONAL CUSTOMERS AT DISCOUNTED PRICING AND ITS LINES OF CREDIT.

Our technology solutions business has been accumulating authorizations from key software manufacturers that allow it to sell products to educational facilities at deep discounts. If our technology solutions business were to lose any of these authorizations, its ability to sell computer products to educational customers would be adversely impacted, which could have a similar impact on its sales, profitability and ability to expand within this business line. In addition, this business uses credit lines extended by banks, software and hardware manufacturers and distributors. The loss of any of these credit lines would limit the ability of our technology solutions business to meet customer demand, thereby reducing sales and profits.

THE EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND CONVERTIBLE PREFERRED STOCK COULD SUBSTANTIALLY DILUTE EXISTING STOCKHOLDERS AND COULD HAVE A NEGATIVE EFFECT ON OUR STOCK PRICE.

We have adopted the RCG Companies Incorporated Stock Option Plan (the "Plan") and our stockholders have authorized the issuance of options to acquire up to 20,000,000 shares of Common Stock under the Plan. As of June 30, 2004, we have outstanding options for 2,261,657 shares, under the Plan that have been granted to our officers, directors, employees and other service providers of which options for 1,820,229 shares are vested. There have been zero options exercised for fiscal year 2004 of Common Stock that were issued under the Plan. In addition to options issued under the Plan, we currently have outstanding warrants as of June 30, 2004 for 6,421,963 shares, including 6,000 that were exercised during this fiscal year. Our outstanding options and warrants have exercise prices ranging from $0.28 to $28.00. As of the filing date, we currently have outstanding convertible preferred shares for 4,574,468 common shares at a conversion price of $.94 per share, none of which have been converted as of the filing date. The exercise of these options, warrants or preferred shares will dilute the percentage ownership of our current stockholders and the potential sale of shares issued upon the exercise of these warrants, options or preferred shares could have a negative impact on the market price of our Common Stock.

THE FUTURE SALES OF RESTRICTED SECURITIES COULD HAVE A NEGATIVE EFFECT ON OUR STOCK PRICE.

The market price of our Common Stock could be negatively affected by the future sale of shares of restricted Common Stock, including shares of restricted Common Stock underlying options and warrants that have been or will be issued by us. As of June 30, 2004 and June 30, 2003, approximately 4,800,000 of our 21,289,004, and 2,100,000 of our 13,948,160, respectively, issued and outstanding shares of Common Stock are believed to be restricted securities as defined in Rule 144 promulgated under the Securities Act of 1933, as amended (the "Securities Act") or otherwise not available for trading by the public. Rule 144 provides generally that restricted securities must be held for a one-year period prior to resale and provides certain additional limitations on the sale of such shares, including limitations on the volume of such shares that a beneficial owner may sell in any three-month period thereafter. Generally, non-affiliated stockholders may sell restricted shares that have been held for at least two years without any limitations. In addition, Rule 145 permits the sale by non-affiliates of restricted securities issued in connection with certain business combinations one year after such shares are issued. As restricted shares become eligible for resale pursuant to Rule 144 or Rule 145, the number of sellers of our Common Stock could increase significantly and, as a result, the market price of our Common Stock could decrease.

IF WE ARE NOT ABLE TO PROTECT OUR INTELLECTUAL PROPERTY, PROPRIETARY RIGHTS AND TECHNOLOGY, WE COULD LOSE THOSE RIGHTS AND INCUR SUBSTANTIAL COSTS POLICING AND DEFENDING THOSE RIGHTS.

We rely primarily on a combination of intellectual property laws and contractual provisions to protect our proprietary rights and technologies, brand and marks. These laws and contractual provisions provide only limited protection of proprietary rights and technology. Our means of protecting our intellectual property, proprietary rights and technology may not be adequate.

IF THE SELLING STOCKHOLDERS SELL A SUBSTANTIAL AMOUNT OF THEIR SHARES, THESE SALES COULD HAVE AN ADVERSE IMPACT ON OUR STOCK PRICE.

If some or all of the Selling Stockholders sell a substantial amount of their Common Stock under this Prospectus, such sales could have a significant negative impact on the market price of our Common Stock. This Prospectus could result in a large number of shares of our Common Stock being sold in the market which, in turn, could result in a reduction in the market price of our Common Stock.

FORWARD-LOOKING STATEMENTS

THIS PROSPECTUS CONTAINS FORWARD-LOOKING STATEMENTS THAT MAY PROVE NOT TO BE ACCURATE. This Prospectus (including information included or incorporated by reference herein) contains certain "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which represent our expectations or beliefs concerning future events that involve risks and uncertainties. All statements other than statements of historical facts included in this Prospectus (including, without limitation, the statements under the section of this document titled "About the Company" and elsewhere herein) and in our filings that are incorporated by reference herein are forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Such forward-looking statements are subject to risks, uncertainties and other factors which could cause actual future results or trends to differ materially from future results or trends expressed or implied by such forward-looking statements. The most significant of such risks, uncertainties and other factors are discussed under the section of this document titled "Risk Factors," beginning on page 1 of this Prospectus. Prospective investors are urged to consider carefully such factors.

OFFERING SUMMARY

We entered into a Securities Purchase Agreement effective as of September 13, 2004 (the "Securities Purchase Agreement") with institutional and accredited investors (collectively the "Investors"). Pursuant to the terms of the

Securities Purchase Agreement, we are to initially issue the following securities to the Investors in consideration for the Investors making payment to us in the aggregate amount of $4,300,000: (i) 4,300 shares of Series A 6% Convertible Preferred Stock, (ii) Warrants to purchase approximately 1,143,617 shares of Common Stock at an exercise price of $1.20 per share, and (iii) Additional Investment Rights to purchase approximately 3,430,851 shares of Common Stock at an exercise price of $1.03 per share.

We have agreed to file a registration statement (the "Registration Statement") with the SEC registering for resale 130% of all shares of Common Stock underlying the Series A Preferred Stock, the Warrants, and the Additional Investment Rights, and shares issuable as dividends for 3 years.

The transaction was approved by our Board of Directors on August 24, 2004, and closed on September 14, 2004. The shares of Series A Preferred Stock, the Warrants, and the Additional Investment Rights, the shares of Common Stock underlying such securities, and shares issuable as dividends will be issued pursuant to the exemption from registration provided by Section 4(2) of the Securities Act.

ABOUT THE COMPANY

WHO WE ARE

RCG Companies Incorporated and its subsidiaries ("RCG", "We" or the "Company") is a network of travel and technology services companies brought together under one operating company to benefit from synergistic relationships and the infusion of intellectual and capital resources. We are engaged in the operation of travel services and technology solutions businesses. Incorporated in 1982, RCG is a Delaware corporation headquartered in Charlotte, North Carolina. Our fiscal year ends on June 30.

On November 14, 2003, we changed our name from eResource Capital Group, Inc. to RCG Companies Incorporated to better reflect the nature and evolution of our business strategy. In fiscal year 2001, we brought in new executive management and modified our business plan to focus on acquiring and enhancing travel and technology services companies. We also brought in new management to our aviation business and completed the acquisition of an aviation services company that, together, have expanded that business into a highly specialized travel organization that delivers a unique turnkey air service. We have increased our focus on the travel and entertainment sector and plan to continue to operate, enhance and acquire substantial interests in the value of expansion phase companies operating in the travel and entertainment sector.

Through our wholly owned subsidiary, Flightserv, Inc. ("Flightserv"), we concluded the acquisition of substantially all of the assets and liabilities of VE Holdings, Inc. ("Vacation Express") and SunTrips, Inc. ("SunTrips") (the "Acquired Companies"), effective October 31, 2003. These acquired companies were integrated into Flightserv, our existing travel services business, to form our largest operating segment. We had previously provided services to the Acquired Companies.

The Acquired Companies provide specialized distribution of leisure travel products and services. Vacation Express, based in Atlanta, Georgia, sells air and hotel packages to Mexican and Caribbean destinations. SunTrips, based in San Jose, California, sells air and hotel packages for Mexico, the Dominican Republic, Costa Rica, Hawaii and the Azores. The flights originate in Oakland, California and/or Denver, Colorado.

Logisoft Corp. ("Logisoft"), our technology solutions business, provides integrated products and services to assist customers in meeting their strategic technology initiatives. Our products and services include distribution of third-party-published software titles for the educational market and corporate customers, full-service Internet development, Internet Web site hosting and co-location, and Internet business development services encompassing partner-site management and marketing. In our Internet business development and marketing services business, we generally participate in the development and implementation of the business plan in exchange for revenue sharing and/or equity-based arrangements.

On November 5, 2003, Logisoft completed the acquisition of SchoolWorld Software, a Pittsburgh, Pennsylvania-based educational software company.

During the third quarter of 2004, our Board of Directors (the "Board") authorized the disposition of our investment in Lifestyle Innovations, Inc. ("LFSI"), a full-service home technology integration company. Accordingly, the operations of LFSI were reclassified to "discontinued operations" for all periods presented. During the fourth quarter, we contributed approximately 4 million shares to the treasury of LFSI, a substantial portion of which were reissued to certain LFSI investors to settle certain contingent claims. LFSI also issued other shares, which resulted in our interest in LFSI being reduced to an effective 45.5% beneficial ownership. Considering the substantial reduction in ownership and the lack of control over LFSI, the investment in LFSI is now recorded using the equity method and is no longer a consolidated subsidiary. The change resulted in RCG restoring its negative carrying value during the forth quarter.

OUR ADDRESS AND PHONE NUMBER

Our principal executive offices are located at 6836 Morrison Boulevard, Suite 200, Charlotte, North Carolina 28211. Our telephone number is (704) 366-5054.

OUR BUSINESSES

GENERAL

In fiscal 2001, we brought in new executive management and modified our business plan to focus on acquiring and enhancing travel and entertainment and technology services companies and, as a result, acquired companies in the telecommunications call center, home technology and technology solutions business segments. We also brought in new management to our aviation business and completed the acquisition of an aviation services company that, together, have expanded that business into a highly specialized travel organization that

delivers a unique turnkey air service. This aviation travel services business generated $165 million and $62 million in revenue in fiscal years 2004 and 2003, respectively. As a result of this growth, we have increased our focus on the travel and entertainment sector and plan to continue to acquire substantial interests in, operate and enhance the value of companies operating in the travel and entertainment sectors. We are in the early phases of our expanded strategy and continue to focus on existing operations as well as our efforts to implement this strategy.

At different times prior to fiscal 2000, we operated businesses in several industries including drug screening, computer software and residential and commercial real estate development, all of which have now been discontinued.

During fiscal 2000, our Company, under the name flightserv.com, Inc. was engaged in the development of an Internet website to provide access to private aviation travel services. In March 2000, we launched our private aviation program, called Private SeatsTM. We were able to generate only minimal customer bookings through the Private SeatsTM program and did not book any flights under this program after June 2000.

AVIATION TRAVEL SERVICES

We acquired Internet Aviation Services, Ltd. ("IASL"), a leisure and business travel services company which provided charter aviation services, in August 2000. IASL was integrated into our aviation travel services business through our Flightserv subsidiary.

Flightserv, headquartered in Atlanta, GA, is a nationally recognized airline and travel program management company providing tour operators, corporate travel departments, sports teams and casinos with cost effective and reliable charter air transportation on a scheduled and ad-hoc basis. Flightserv acts as a program manager by providing turnkey charter services including aircraft and related services such as ground support and aircraft fueling, passenger service and support, and real-time flight tracking. Flightserv differentiates itself in the charter travel industry by focusing on full program management services, which combines the functions of aircraft brokerage, flight operations, airport operations, contract negotiation between clients and air service providers, airport subsidy negotiations and consumer marketing. Flightserv does not own or operate any aircraft.

Flightserv had an agreement with Vacation Express, a member of the MyTravel Group, ending in December 2004, to operate a passenger hub at Atlanta Hartsfield Airport. Pursuant to the terms of the agreement, six commercial jet aircraft originate in six eastern and mid-western cities and serve six Caribbean destinations. Also, in July 2002, Flightserv entered into a three-year agreement with SunTrips, Inc., a sister company of Vacation Express in the MyTravel Group, to operate scheduled weekly flights between three west coast cities and two Mexican destinations. The majority of the revenue of Flightserv was historically generated pursuant to these contracts.

On October 31, 2003, VE Holdings, Inc. and SunTrips, Inc. both wholly-owned subsidiaries of MyTravel USA Holdings, Inc., entered into an amended and restated asset purchase agreement with FS Tours, Inc. and FS SunTours, Inc., which are wholly-owned direct subsidiaries of Flightserv.

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Under the terms of the asset purchase agreement, FS Tours and FS SunTours acquired substantially all of the assets and certain liabilities of Vacation Express and SunTrips, except for certain excluded items, for $12 million, of which $10 million is in the form of a seven-year non interest bearing promissory note from Flightserv secured by certain of our investment holdings.

In conjunction with the asset purchase, we entered into a three-year agreement with MyTravel Canada Holidays, Inc., for certain services, including the purchasing of hotel accommodations for our company on an exclusive basis. Under the asset purchase agreement we are required to pay MyTravel Canada approximately $4.5 million over three years.

Additionally, we were required to obtain replacement letters of credit in the aggregate principal amount of $3 million.

With the closing of these acquisitions, SunTrips and Vacation Express will continue to operate from their current locations, with FS Tours and FS SunTours assuming operational control. Air and hotel vacation packages will continue to be marketed and sold under the SunTrips and Vacation Express brands.

SunTrips, based in San Jose, California, sells air and hotel vacation packages to Mexico, Dominican Republic, Costa Rica, Hawaii and the Azores out of Oakland, California and/or Denver, Colorado. Vacation Express, based in Atlanta, Georgia, sells air and hotel packages to Mexico and Caribbean destinations, including Aruba, Bahamas, Costa Rica, Dominican Republic, Jamaica, and St. Martin. SunTrips and Vacation Express together generated revenues of approximately $200 million for the twelve months ended September 30, 2003. Both companies were air charter customers of Flightserv.

In fiscal 2002 and 2003, Flightserv developed and implemented a trial scheduled charter flight operation d/b/a Interstate Jet. Initial service began between Allentown PA/ Newburgh NY and Las Vegas NV and Los Angeles CA. The origination cities were chosen as a result of direct cash subsidies and marketing support from the respective airport authorities. The trials of these cities did not yield adequate passenger loads and yields to break even and were discontinued.

TECHNOLOGY SOLUTIONS

Our technology solutions business is the result of our acquisition of Logisoft Corp. (f/k/a Logisoft Computer Products Corp.), and its wholly-owned subsidiary eStorefronts.net Corp. in June 2001.

Our technology solutions business provides integrated products and services to assist customers in meeting their strategic technology initiatives. Our products and services include distribution of third-party published software titles to the educational market and corporate customers, full service Internet development, Internet site hosting and co-location and Internet business development services encompassing partner site management and marketing. In our Internet business development and marketing services business, we generally participate in the development and implementation of the business plan in exchange for revenue sharing and/or equity-based arrangements.

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On June 6, 2001, we acquired Logisoft in exchange of 785,714 shares of Common Stock pursuant to that certain agreement and plan of merger. The total purchase price aggregated $5,504,879 and the transaction was recorded using the purchase method of accounting. The excess value of the purchase price over the fair value of Logisoft's net assets on the acquisition date aggregating $4,146,000 was allocated to goodwill. The aggregate purchase price and goodwill were both adjusted in fiscal 2002 by $42,000 to reflect the issuance of earn-out shares to certain members of Logisoft's management.

On June 10, 2003 eStorefronts.net Corporation, 100% owned by Logisoft, purchased a 75% interest in Premier Shoe Group, LLC for $187,000. A one-year 10% note of $147,000 was signed at closing and $40,000 cash was paid. Premier Shoe Group operates a website named 123Shoes.com which sells brand name shoes. The results of Premier Shoe Group are consolidated on Logisoft's financial statements and the portion of income or loss attributable to the minority interest as an increase or decrease to the minority interest recorded.

On October 31, 2003, Logisoft acquired substantially all of the assets of Computer Inventory Control, Inc. ("CIC"), a Pittsburgh, Pennsylvania based educational software company, in consideration of up to 225,000 shares of the Company's Common Stock valued at $380,000. On October 31, 2003, the purchase price was 174,312 shares of the Company's Common Stock, which was determined by dividing $380,000 by the average closing price of the Company's Common Stock on the American Stock Exchange for the previous three consecutive business days ending on the day prior to the closing of the acquisition agreement. Since the gross sales price from the sale of the 174,312 shares of the Company's Common Stock was less than $380,000, the Company issued to CIC 50,000 additional shares of Company Common Stock which equaled the difference between $380,000 and the aggregate sales price. Pursuant to the acquisition agreement, Logisoft acquired the "SchoolWorld Software" trademark, software licenses as well as all of the accounts, databases and related inventory of CIC. CIC is a full service source for educational software.

TELECOMMUNICATIONS CALL CENTER

We operated our telecommunications call center which provided telemarketing, help desk and other services to companies through our subsidiary DM Marketing, Inc. ("DMM"). In December 2002, our aviation travel services business assumed operational responsibility of the call center operations located in Pensacola FL. The call center provided support to aviation travel services as a reservations and customer care center for airlines, tour operators and for internal programs for which the Company took reservations from travelers. On September 1, 2003, we closed our Pensacola, FL call center facility.

In January 2003, DMM was operated and managed by Flightserv and provided in-bound reservations call center services to Southeast Airlines and Flightserv's Interstate Jet. From January through June 2003 DMM booked approximately 65,000 passenger segment reservations for Southeast Airlines and Interstate Jet.

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USE OF PROCEEDS

All of the shares of our Common Stock offered hereby are being sold by the Selling Stockholders. We will not receive any of the proceeds from the sale of the shares. However, this Prospectus includes 1,186,617 shares of Common Stock underlying Common Stock Purchase Warrants exercisable at $1.20 per share, 200,000 shares of Common Stock underlying a Common Stock Purchase Warrant exercisable at $0.94, 50,000 shares of Common Stock underlying Warrants to Purchase Common Stock exercisable at $2.44 per shares, and 3,430,851 shares of common stock underlying Additional Investment Rights exercisable at $1.03 per share. If any of the Common Stock Purchase Warrants or Additional Investment Rights are exercised and no cashless exercise is available, we would receive the gross proceeds from payment of the exercise price. We intend to use these proceeds for working capital.

DESCRIPTION OF COMMON STOCK

We are authorized to issue 200,000,000 shares of Common Stock, par value $.04. As of the date of this Prospectus, 21,169,038 shares are issued and outstanding. The outstanding shares of Common Stock are fully paid and non-assessable. The holders of our Common Stock are entitled to one vote per share for the election of directors and with respect to all other matters submitted to a vote of shareholders. Shares of our Common Stock do not have cumulative voting rights, which means that the holders of more than 50% of such shares voting for the election of directors can elect 100% of the directors if they choose to do so and, in such event, the holders of the remaining shares so voting will not be able to elect any directors.

Upon any liquidation, dissolution or winding-up, our assets, after the payment of our debts and liabilities and any liquidation preferences of, and unpaid dividends on, any class of preferred stock then outstanding, will be distributed pro-rata to the holders of our Common Stock. The holders of our Common Stock do not have preemptive or conversion rights to subscribe for any of our securities and have no right to require us to redeem or purchase their shares. The holders of our Common Stock are entitled to share equally in dividends if, as and when declared by our board of directors, out of funds legally available therefore, subject to the priorities accorded any class of preferred stock which may be issued. A consolidation or merger, or a sale, transfer or lease of all or substantially all of our assets, which does not involve distribution by us of cash or other property to the holders of our Common Stock, will not be a liquidation, dissolution or winding up of our Company.

SELLING STOCKHOLDERS

DESCRIPTION OF FINANCING TRANSACTION

On September 13, 2004, we entered into a Securities Purchase Agreement with the Investors. Pursuant to the terms of the Securities Purchase Agreement, we are to initially issue the following securities to the Investors in consideration for the Investors making payment to us in the aggregate amount of $4,300,000: (i) 4,300 shares of Series A 6% Convertible Preferred Stock, (ii) Warrants to purchase approximately 1,143,617 shares of our Common Stock at an exercise price of $1.20 per share, and (iii) Additional Investment Rights to purchase approximately 3,430,851 shares of our Common Stock at an exercise price of $1.03 per share.

The Securities Purchase Agreement provides the Investors with certain rights to participate in our future financings, and contains negative covenants limiting our rights to engage in certain types of future financings.

The Company has agreed to file the Registration Statement with the SEC registering for resale 130% of all shares of our Common Stock underlying the Series A Preferred Stock, the Warrants, and the Additional Investment Rights, and shares issuable as dividends for 3 years.

The transaction was approved by our Board of Directors on August 24, 2004, and closed on September 14, 2004. The shares of Series A Preferred Stock, the Warrants, and the Additional Investment Rights, the shares of our Common Stock underlying such securities, and shares issuable as dividends will be issued pursuant to the exemption from registration provided by Section 4(2) of the Securities Act.

DESCRIPTION OF SERIES A PREFERRED STOCK

The following is a summary of the material terms of the Series A Preferred Stock and is qualified by its entirety by the Certificate of Designation of Preferences, Rights and Limitations of Series A 6% Convertible Preferred Stock (the "Certificate") filed as an exhibit to Form 8-K filed by the Company with the U.S. Securities and Exchange Commission on September 16, 2004.

AMOUNT, STATED VALUE, AND DEFINITIONS

The number of shares of Series A Preferred Stock designated was 6,000. Each share of Series A Preferred Stock shall have a stated value equal to $1,000 (the "Stated Value"). Capitalized terms not otherwise defined in this

Description of Series A Preferred Stock section shall have the meaning given such terms in the Certificate.

DIVIDENDS

Holders shall be entitled to receive and the Company shall pay, cumulative dividends at the rate per share (as a percentage of the Stated Value per share) of 6% per annum from the date of issuance, payable quarterly on March 1, June 1, September 1 and December 1, beginning with December 1, 2004 and on any Conversion Date pursuant to the terms of the Certificate ("Dividend Payment Date"). The form of dividend payments to each Holder shall be made in the following order: (i) if funds are legally available for the payment of dividends and the Equity Conditions (which Equity Conditions include the following: (a) all conversions have been honored or cured; (b) the registration statement covering the shares is effective; (c) the Common Stock is listed on the Company's trading market; (d) all liquidated damages and other amounts owing including dividends in respect of the preferred stock shall have been paid or will be paid; (e) there is a sufficient number of authorized and unissued shares to cover all conversions; (f) no Triggering Event has occurred and is continuing; (g) the issuable conversion shares won't violate the applicable ownership limitations; and (h) no public announcement of a pending Fundamental

Transaction or Change of Control Transaction has occurred that hasn't been consummated) have not been met, in cash only, (ii) if funds are legally available for the payment of dividends and the Equity Conditions have been met, at the sole election of the Company, in cash or shares of Common Stock which shall be valued solely for such purpose at 90% of the average of the 5 VWAPs immediately prior to the Dividend Payment Date; (iii) if funds are not legally available for the payment of dividends and the Equity Conditions have been met, in shares of Common Stock which shall be valued at 90% of the average of the 5 VWAPs immediately prior to the Dividend Payment Date; (iv) if funds are not legally available for the payment of dividends and the Equity Conditions relating to registration have been waived by such Holder, as to such Holder only, in unregistered shares of Common Stock which shall be valued at 90% of the average of the 5 VWAPs immediately prior to the Dividend Payment Date; and (v) if funds are not legally available for the payment of dividends and the Equity Conditions have not been met, then, at the election of such Holder, such dividends shall accrue to the next Dividend Payment Date or shall be accreted to the outstanding Stated Value. As of the Closing Date, the Company shall pay the dividends in shares of Common Stock. Dividends on the Series A Preferred Stock shall be calculated on the basis of a 360-day year, shall accrue daily commencing on the Original Issue Date, and shall be deemed to accrue from such date whether or not earned or declared and whether or not there are profits, surplus or other funds of the Company legally available for the payment of dividends.

So long as any Series A Preferred Stock shall remain outstanding, neither the Company nor any subsidiary thereof shall redeem, purchase or otherwise acquire directly or indirectly any Junior Securities. So long as any Series A Preferred Stock shall remain outstanding, neither the Company nor any subsidiary thereof shall directly or indirectly pay or declare any dividend or make any distribution (other than a dividend or distribution described in the Section titled "Conversion" below or dividends due and paid in the ordinary course on Series A Preferred Stock of the Company at such times when the Company is in compliance with its payment and other obligations) upon, nor shall any distribution be made in respect of, any Junior Securities so long as any dividends currently due on the Series A Preferred Stock remain unpaid, nor shall any monies be set aside for or applied to the purchase or redemption (through a sinking fund or otherwise) of any Junior Securities or shares pari passu with the Series A Preferred Stock.

VOTING RIGHTS

Except as otherwise provided in the Certificate and as otherwise required by law, the Series A Preferred Stock shall have no voting rights. However, so long as any shares of Series A Preferred Stock are outstanding, the Company shall not, without the affirmative vote of the Holders of the shares of the Series A Preferred Stock then outstanding, (a) alter or change adversely the powers, preferences or rights given to the Series A Preferred Stock or alter or amend this Certificate of Designation, (b) authorize or create any class of stock ranking as to dividends, redemption or distribution of assets upon a Liquidation senior to the Series A Preferred Stock, (c) amend its certificate of incorporation or other charter documents so as to affect adversely any rights of the Holders, (d) increase the authorized number of shares of Series A Preferred Stock, or (e) enter into any agreement with respect to the foregoing.

LIQUIDATION

Upon any liquidation, dissolution or winding-up of the Company, whether voluntary or involuntary (a "Liquidation"), the Holders shall be entitled to receive out of the assets of the Company, whether such assets are capital or surplus, for each share of Series A Preferred Stock an amount equal to the Stated Value per share plus any accrued and unpaid dividends thereon and any other fees or liquidated damages owing thereon before any distribution or payment shall be made to the holders of any Junior Securities, and if the assets of the Company shall be insufficient to pay in full such amounts, then the entire assets to be distributed to the Holders shall be distributed among the Holders ratably in accordance with the respective amounts that would be payable on such shares if all amounts payable thereon were paid in full.

CONVERSION

Conversions at Option of Holder. Each share of Series A Preferred Stock shall be convertible into that number of shares of Common Stock (subject to the limitations set forth below) determined by dividing the Stated Value of such share of Series A Preferred Stock by the Set Price.

Beneficial Ownership Limitation. The Company shall not effect any conversion of the Series A Preferred Stock, and the Holder shall not have the right to convert any portion of the Series A Preferred Stock to the extent that after giving effect to such conversion, the Holder (together with the Holder's affiliates), as set forth on the applicable Conversion Notice, would beneficially own in excess of 4.99% of the number of shares of the Common Stock outstanding immediately after giving effect to such conversion.

Limitation on Number of Shares Issuable. Notwithstanding anything herein to the contrary, the Company shall not issue to any Holder any shares of Common Stock, including pursuant to any rights herein, including, without limitation, any conversion rights or right to issue shares of Common Stock in payment of dividends, to the extent such shares, when added to the number of shares of Common Stock previously issued upon conversion of any shares of Series A Preferred Stock would exceed 3,875,188, or such greater or lesser number of shares of Common Stock permitted pursuant to the corporate governance rules of the Trading Market that is at the time the principal trading exchange or market for the Common Stock (the "Maximum Aggregate Share Amount"), unless the Company first obtains shareholder approval permitting such issuances in accordance with the Trading Market rules ("Shareholder Approval").

Forced Conversion. If after the date that the registration statement which registers for resale all of the Conversion Shares (the "Conversion Shares Registration Statement") is declared effective (the "Effective Date") the VWAP for each of any 10 consecutive Trading Days ("Threshold Period"), which 10 consecutive Trading Day period shall have commenced only after the Effective Date, exceeds 200% of the then effective Set Price (defined below), the Company may, within 2 Trading Days after any such Threshold Period, deliver a notice to all Holders (a "Forced Conversion Notice" and the date such notice is received by the Holders, the "Forced Conversion Notice Date") to cause the Holders to immediately convert all or part of the then outstanding shares of Series A Preferred Stock pursuant to Section 5 of the Certificate and the Holders shall surrender (if all Series A Preferred Stock is converted) their respective shares of Series A Preferred Stock to the Company for conversion within 5 Trading Days of the Forced Conversion Notice Date. The Company may only effect a Forced Conversion Notice if all of the Equity Conditions have been met during the Threshold Period through the Forced Conversion Notice Date.

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The conversion price shall equal $0.94 (the "Set Price"), subject to the following adjustments.

* if the Company, at any time while the Series A Preferred Stock is outstanding: (A) shall pay a stock dividend or otherwise make a distribution or distributions on shares of its Common Stock or any other equity or equity equivalent securities payable in shares of Common Stock, (B) subdivide outstanding shares of Common Stock into a larger number of shares, (C) combine (including by way of reverse stock split) outstanding shares of Common Stock into a smaller number of shares, or (D) issue by reclassification of shares of the Common Stock any shares of capital stock of the Company, then the Set Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock Outstanding before such event and of which the denominator shall be the number of shares of Common Stock Outstanding after such event. Any adjustment made pursuant to the section of the Certificate shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution and shall become effective immediately after the effective date in the case of a subdivision, combination or reclassification.

* if the Company, at any time while the Series A Preferred Stock is outstanding, shall issue rights, options or warrants to all holders of Common Stock (and not to Holders) entitling them to subscribe for or purchase shares of Common Stock at a price per share less than the VWAP at the record date mentioned below, then the Set Price shall be multiplied by a fraction, of which the denominator shall be the number of shares of the Common Stock Outstanding on the date of issuance of such rights or warrants plus the number of additional shares of Common Stock offered for subscription or purchase, and of which the numerator shall be the number of shares of the Common Stock Outstanding on the date of issuance of such rights or warrants plus the number of shares which the aggregate offering price of the total number of shares so offered (assuming receipt by the Company in full of all consideration payable upon exercise of such rights, options or warrants) would purchase at such VWAP. Such adjustment shall be made whenever such rights or warrants are issued, and shall become effective immediately after the record date for the determination of stockholders entitled to receive such rights, options or warrants.

* if the Company or any subsidiary thereof at any time while any of the Series A Preferred Stock is outstanding, shall sell, grant any option or

warrant to purchase or sell or grant any right to reprice its securities, or otherwise dispose of or issue any Common Stock or any equity or equity equivalent securities (including any equity, debt or other instrument that is at any time over the life thereof convertible into or exchangeable for Common

Stock) (collectively, "Common Stock Equivalents") entitling any Person to acquire shares of Common Stock, at an effective price per share less than the Set Price (a "Dilutive Issuance"), as adjusted (if the holder of the Common Stock or Common Stock Equivalent so issued shall at any time, whether by operation of purchase price adjustments, reset provisions, floating conversion, exercise or exchange prices or otherwise, or due to warrants, options or rights per share which are issued in connection with such issuance, be entitled to receive shares of Common Stock at a price per share which is less than the Set Price, such issuance shall be deemed to have occurred for less than the Set Price), then the Set Price shall be reduced to equal the effective conversion, exchange or purchase price for such Common Stock or Common Stock Equivalents (including any reset provisions thereof) at issue. Such adjustment shall be made whenever such Common Stock or Common Stock Equivalents are issued. The Company shall notify the Holder in writing, no later than the second Trading Day following the issuance of any Common Stock or Common Stock Equivalent, indicating therein the applicable issuance price, or of applicable reset price, exchange price, conversion price and other pricing terms. For purposes of this subsection, a Dilutive Issuance shall be deemed to have occurred when binding agreements have been closed by the Company and any purchaser therein.

* if the Company, at any time while the Series A Preferred Stock is outstanding, shall distribute to all holders of Common Stock (and not to Holders) evidences of its indebtedness or assets or rights or warrants to subscribe for or purchase any security other than the Common Stock (which shall be subject to Section 5(c)(iii) of the Certificate), then in each such case the Set Price shall be adjusted by multiplying the Set Price in effect immediately prior to the record date fixed for determination of stockholders entitled to receive such distribution by a fraction of which the denominator shall be the VWAP determined as of the record date mentioned above, and of which the numerator shall be such VWAP on such record date less the then per share fair market value at such record date of the portion of such assets or evidence of indebtedness so distributed applicable to one outstanding share of the Common Stock as determined by the Board of Directors in good faith. In either case the adjustments shall be described in a statement provided to the Holders of the portion of assets or evidences of indebtedness so distributed or such subscription rights applicable to one share of Common Stock. Such adjustment shall be made whenever any such distribution is made and shall become effective immediately after the record date mentioned above.

No adjustment shall be made in connection with an Exempt Issuance.

REDEMPTION UPON TRIGGERING EVENTS

Upon the occurrence of a Triggering Event, each Holder shall have the right to require the Company to redeem all of the Series A Preferred Stock then held by such Holder for a redemption price, in cash, equal to the Triggering Redemption Amount. The Triggering Redemption Amount shall be due and payable within 5 Trading Days of the date on which the notice for the payment therefor is provided by a Holder (the "Triggering Redemption Payment Date"). If the Company fails to pay the Triggering Redemption Amount in full the Company will pay interest thereon at a rate of 18% per annum, accruing daily from such date until the Triggering Redemption Amount, plus all such interest thereon, is paid in full.

"Triggering Event" means any one or more of the following events:

* the failure of a Conversion Shares Registration Statement to be declared effective by the Commission on or prior to the 180th day after the Original Issue Date;

* if, during the Effectiveness Period, the effectiveness of the Conversion Shares Registration Statement lapses for any reason for more than an aggregate of 60 calendar days (which need not be consecutive days) during any 12 month period, or the Holder shall not be permitted to resell Registrable Securities under the Conversion Shares Registration Statement other than as a result of any action or inaction of a Holder for more than an aggregate of 60 calendar days (which need not be consecutive days) during any 12 month period (the Effectiveness Period is that period commencing with the Effectiveness Date and continuing until all securities covered by the Conversion Shares Registration Statement have been sold or may be sold without volume restrictions pursuant to Rule 144(k));

* the Company shall fail to deliver certificates representing Conversion Shares issuable upon a conversion prior to the 10th Trading Day after such shares are required to be delivered, or the Company shall provide written notice to any Holder, including by way of public announcement, at any time, of its intention not to comply with requests for conversion of any shares of Series A Preferred Stock in accordance with the terms hereof;

* if either of the following events shall not have been cured to the satisfaction of the Holders prior to the expiration of 15 days from the Event Date (as defined in the Registration Rights Agreement) relating thereto (other than an Event resulting from a failure of a Conversion Shares Registration Statement to be declared effective by the Commission on or prior to the 180th day after the Original Issue Date, which is covered above): (i) a Registration Statement is not filed on or prior to its Filing Date (as defined in the Registration Rights Agreement), or (ii) the Company fails to file with the Commission a request for acceleration in accordance with Rule 461 promulgated under the Securities Act, within five Trading Days of the date that the Company is notified (orally or in writing, whichever is earlier) by the Commission that a Registration Statement will not be "reviewed," or not subject to further review;

* the Company shall fail for any reason to pay in full the amount of cash due pursuant to a Buy-In within 5 Trading Days after notice therefor is delivered or shall fail to pay all amounts owed on account of an Event within five days of the date due (for purposes hereof an Event includes the following events: (i) a registration statement is not timely filed, (ii) the Company fails to timely file with the Commission a request for acceleration after being notified that a Registration Statement will not be "reviewed," or is not subject to further review, (iii) prior to its Effectiveness Date, the Company fails to file a pre-effective amendment and otherwise respond in writing to comments made by the Commission in respect of such Registration Statement within 20 Trading Days after the receipt of comments by or notice from the SEC that such amendment is required in order for a Registration Statement to be declared effective, (iv) a registration statement filed or required to be filed is not declared effective by the Commission by its Effectiveness Date, or (v) after the Effectiveness Date, a registration statement ceases for any reason to remain continuously effective as to all registrable securities for which it is required to be effective, or the Holders are not permitted to utilize the prospectus therein to resell such registrable securities for 15 consecutive days or an aggregate of 25

days during any 12-month period, which need not be consecutive days);

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* the Company shall fail to have available a sufficient number of authorized and unreserved shares of Common Stock to issue to such Holder upon a conversion unless the Company has complied with Section 4.10(b) of the Purchase Agreement (which section provides the Company an opportunity to amend the Company's certificate of incorporation to increase the number of shares the Company is authorized to issue);

* the Company shall fail to observe or perform any other material covenant, agreement or warranty contained in, or otherwise commit any breach of the Transaction Documents, and such material failure or breach shall not, if subject to the possibility of a cure by the Company, have been remedied within 30 calendar days after the date on which written notice of such failure or breach shall have been given;

* the Company shall be a party to any Change of Control Transaction or the Company shall redeem more than a deminimis number of Junior Securities;

* there shall have occurred a Bankruptcy Event;

* any breach of the officer's/director's voting agreement delivered to the initial Holders at the Closing; or

* the Common Stock shall fail to be listed or quoted for trading on a Trading Market for more than 5 consecutive Trading Days.

FUNDAMENTAL TRANSACTIONS

If a Fundamental Transaction occurs, then upon any subsequent conversion of shares of Series A Preferred Stock, the Holder shall have the right to receive, for each Conversion Share that would have been issuable upon such conversion absent such Fundamental Transaction, the Alternate Consideration. For purposes of any such conversion, the determination of the Set Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Company shall apportion the Set

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Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any conversion of shares of Series A Preferred Stock following such Fundamental Transaction. To the extent necessary to effectuate the foregoing provisions, any successor to the Company or surviving entity in such Fundamental Transaction shall issue to the Holder new Series A Preferred Stock consistent with the foregoing provisions and evidencing the Holder's right to convert such Series A Preferred Stock into Alternate Consideration. The terms of any agreement pursuant to which a Fundamental Transaction is effected shall include terms requiring any such successor or surviving entity to comply with the provisions of this provision and insuring that the Series A Preferred Stock (or any such replacement security) will be similarly adjusted upon any subsequent transaction analogous to a Fundamental Transaction.

DESCRIPTION OF WARRANTS

The following is a summary of the material terms of the Warrants and is qualified by its entirety by the form of Warrant filed as an exhibit to Form 8-K filed by the Company with the U.S. Securities and Exchange Commission on September 16, 2004.

NUMBER, TERM, AND DEFINITIONS

The Warrants entitle the holders thereof to initially purchase up to a total of approximately 1,186,617 shares of the Common Stock of the Company.

The Warrants are exercisable at any time on or after the Initial Exercise Date and on or prior to the close of business on the three-year anniversary of the Initial Exercise Date. The Exercise Period shall be extended for the number of Trading Days during such period in which (x) trading in the Common Stock is suspended by any Trading Market, or (y) following the Effective Date, the Registration Statement is not effective or the prospectus included in the Registration Statement may not be used by the Purchasers for the resale of the Warrant Shares.

Capitalized terms used and not otherwise defined in this Description of Warrants Section shall have the meanings set forth in Section 1 of the Warrant.

EXERCISE

t 6 0 Exercise of Warrant. Exercise of the Warrants may be made at any time or times on or after the Initial Exercise Date and on or before the Termination Date by delivery to the Company of a duly executed facsimile copy of the Notice of Exercise Form annexed to the Warrant.

Exercise Price. The exercise price of each share of Common Stock under the Warrants shall be $1.20, subject to adjustment (the "Warrant Exercise Price").

Cashless Exercise. If at any time after one year from the date of issuance of the Warrants there is no effective Registration Statement registering the resale of the Warrant Shares by the Holder, then the Warrants may also be exercised at such time by means of a "cashless exercise."

Holder's Restrictions. Each Holder shall not have the right to exercise any portion of their Warrant, pursuant to Section 2(c) of the Warrants or otherwise, to the extent that after giving effect to such issuance after exercise, the Holder (together with the Holder's affiliates), as set forth on the applicable Notice of Exercise, would beneficially own in excess of 4.99% of the number of shares of the Common Stock outstanding immediately after giving effect to such issuance.

Call Provision. Subject to the provisions of Section 2(f) of the Warrants, if after the Effective Date the Measurement Price exceeds 200% of the then Warrant Exercise Price (subject to adjustment as set forth herein) (the "Threshold Price), then the Company may, within ten Trading Days of such period, call for cancellation of all or any portion of the Warrants for which a Notice of Exercise has not yet been delivered (such right, a "Call"). To exercise this right, the Company must deliver to the Holder an irrevocable written notice (a "Call Notice"), indicating therein the portion of unexercised portion of the Warrants to which such notice applies. If the conditions set forth below for such Call are satisfied from the period from the date of the Call Notice through and including the Call Date (as defined below), then any portion of the Warrant subject to such Call Notice for which a Notice of Exercise shall not have been received from and after the date of the Call Notice will be cancelled at 6:30 p.m. (New York City time) on the tenth Trading Day after the date the Call Notice is received by the Holder (such date, the "Call Date"). Any unexercised portion of the Warrant to which the Call Notice does not pertain will be unaffected by such Call Notice. Notwithstanding anything to the contrary set forth in the Warrant, the Company may not deliver a Call Notice or require the cancellation of the Warrant (and any Call Notice will be void), unless, from the beginning of the 20 consecutive Trading Days used to determine whether the Common Stock has achieved the Threshold Price through the Call Date, the Equity Conditions (as defined in the Certificate of Designation) have been met. The Company's right to Call the Warrant shall be exercised ratably among the Purchasers based on each Purchaser's initial purchase of Common Stock pursuant to the Purchase Agreement.

CERTAIN ADJUSTMENTS.

Stock Dividends and Splits. If the Company, at any time while the Warrants are outstanding: (A) pays a stock dividend or otherwise make a distribution or distributions on shares of its Common Stock or any other equity or equity equivalent securities payable in shares of Common Stock (which, for avoidance of doubt, shall not include any shares of Common Stock issued by the Company pursuant to the Warrants), (B) subdivides outstanding shares of Common Stock into a larger number of shares, (C) combines (including by way of reverse stock split) outstanding shares of Common Stock into a smaller number of shares, or (D) issues by reclassification of shares of the Common Stock any shares of capital stock of the Company, then in each case the Warrant Exercise Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock (excluding treasury shares, if any) outstanding before such event and of which the denominator shall be the number of shares of Common Stock outstanding after such event and the number of Warrant Shares issuable upon exercise of the Warrants shall be proportionately adjusted. Any adjustment made pursuant to Section 3(a) of the Warrants shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution and shall become effective immediately after the effective date in the case of a subdivision, combination or re-classification.

Subsequent Equity Sales. If the Company or any Subsidiary thereof, as applicable, at any time while the Warrants are outstanding, shall sell, grant any option to purchase, sell or grant any right to reprice its securities, or otherwise dispose of or issue any Common Stock or Common Stock Equivalents entitling any Person to acquire shares of Common Stock, at an effective price per share less than the then Warrant Exercise Price (such lower price, the "Base Share Price" and such issuances collectively, a "Dilutive Issuance"), as adjusted (if the holder of the Common Stock or Common Stock Equivalents so issued shall at any time, whether by operation of purchase price adjustments, reset provisions, floating conversion, exercise or exchange prices or otherwise, or due to warrants, options or rights per share which is issued in connection with such issuance, be entitled to receive shares of Common Stock at an effective price per share which is less than the Warrant Exercise Price, such issuance shall be deemed to have occurred for less than the Warrant Exercise Price), then, the Warrant Exercise Price shall be reduced to equal the Base Share Price; provided, however, in no event shall the Warrant Exercise Price be less than $1.00, subject to adjustment for reverse and forward stock splits, stock dividends, stock combinations and other similar transactions of the Common Stock that occur after the date of the Securities Purchase Agreement. Such adjustment shall be made whenever such Common Stock or Common Stock Equivalents are issued. The Company shall notify the Holder in writing, no later than the second Trading Day following the issuance of any Common Stock or Common Stock Equivalents, indicating therein the applicable issuance price, or of applicable reset price, exchange price, conversion price and other pricing terms.

Pro Rata Distributions. If the Company, at any time prior to the Termination Date, shall distribute to all holders of Common Stock (and not to Holders of the Warrants) evidences of its indebtedness or assets or rights or warrants to subscribe for or purchase any security other than the Common Stock (which shall be subject to Section 3(b) of the Warrants), then in each such case the Warrant Exercise Price shall be adjusted by multiplying the Warrant Exercise Price in effect immediately prior to the record date fixed for determination of stockholders entitled to receive such distribution by a fraction of which the denominator shall be the VWAP determined as of the record date mentioned above, and of which the numerator shall be such VWAP on such record date less the then per share fair market value at such record date of the portion of such assets or evidence of indebtedness so distributed applicable to one outstanding share of the Common Stock as determined by the Board of Directors in good faith. In either case the adjustments shall be described in a statement provided to the Holders of the portion of assets or evidences of indebtedness so distributed or such subscription rights applicable to one share of Common Stock. Such adjustment shall be made whenever any such distribution is made and shall become effective immediately after the record date mentioned above.

Fundamental Transaction. If, at any time while the Warrants are outstanding, (A) the Company effects any merger or consolidation of the Company with or into another Person, in which the Company is not the surviving entity, or the Company's then existing shareholders will own less than 51% of the surviving entity, (B) the Company effects any sale of all or substantially all of its assets in one or a series of related transactions, (C) any tender offer or exchange offer (whether by the Company or another Person) is completed pursuant to which holders of Common Stock are permitted to tender or exchange their shares for other securities, cash or property, or (D) a Fundamental Transaction, then, upon any subsequent conversion of the Warrant, the Holder shall have the right to receive, for each Warrant Share that would have been issuable upon such exercise absent such Fundamental Transaction, at the option of the Holder, (a) upon exercise of the Warrants, the number of shares of Common Stock of the successor or acquiring corporation or of the Company, if it is the surviving corporation, and Alternate Consideration receivable upon or as a

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result of such reorganization, reclassification, merger, consolidation or disposition of assets by a Holder of the number of shares of Common Stock for which the Warrants are exercisable immediately prior to such event or (b) only in the event the Company is acquired in an all cash acquisition, cash equal to the value of the Warrants as determined in accordance with the Black-Scholes option pricing formula. For purposes of any such exercise, the determination of the Warrant Exercise Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Company shall apportion the Warrant Exercise Price among the Alternate Consideration in a reasonable manner reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any exercise of the Warrant following such Fundamental Transaction. To the extent necessary to effectuate the foregoing provisions, any successor to the Company or surviving entity in such Fundamental Transaction shall issue to the Holder a new warrant consistent with the foregoing provisions and evidencing the Holder's right to exercise such warrant into Alternate Consideration upon the payment thereof. The terms of any agreement pursuant to which a Fundamental Transaction is effected shall include terms requiring any such successor or surviving entity to comply with the provisions of this paragraph and insuring that the Warrant (or any such replacement security) will be similarly adjusted upon any subsequent transaction analogous to a Fundamental Transaction.

DESCRIPTION OF ADDITIONAL INVESTMENT RIGHTS

The following is a summary of the material terms of the Additional Investment Rights and is qualified by its entirety by the form of Additional Investment Rights Agreement filed as an exhibit to Form 8-K filed by the Company with the U.S. Securities and Exchange Commission on September 16, 2004.

NUMBER, TERM, AND DEFINITIONS

The Additional Investment Rights entitle the holders thereof to initially purchase up to a total of approximately 3,430,851 shares of the Common Stock of the Company.

The Additional Investment Rights are exercisable at any time on or after the Initial Exercise Date and on or prior to the close of business on the earlier of (a) the later of (i) the 181st day after the Effective Date and (ii) the 181st day after the Initial Exercise Date and (b) the 2nd year anniversary of the date of the Purchase Agreement (the "Termination Date" and the period from the Initial Exercise Date until the Termination Date

Capitalized terms used and not otherwise defined in this Description of Additional Investment Rights Section shall have the meanings set forth in Section 1 of the Additional Investment Rights.

EXERCISE.

Exercise of Additional Investment Right. Exercise of the purchase rights represented by the Additional Investment Rights may be made at any time or times on or after the Initial Exercise Date and on or before the Termination Date by delivery to the Company of a duly executed facsimile copy of the Notice of Exercise Form annexed to the Additional Investment Rights agreement.

Exercise Price. The exercise price of each share of Common Stock under the Additional Investment Rights shall be $1.03, subject to adjustment (the "AIR Exercise Price").

Holder's Restrictions. The Holder shall not have the right to exercise any portion of the Additional Investment Rights, pursuant to Section 2(c) of the Additional Investment Rights thereof or otherwise, to the extent that after giving effect to such issuance after exercise, the Holder (together with the Holder's affiliates), as set forth on the applicable Notice of Exercise, would beneficially own in excess of 4.99% of the number of shares of the Common Stock outstanding immediately after giving effect to such issuance.

Call Provision. Subject to the provisions of Section 2(f) of the Additional Investment Rights, if after the Effective Date the Measurement Price is greater than or equal to the Threshold Price, then the Company may, in its sole discretion, within ten Trading Days of such period, exercise its Call right. To exercise this right, the Company must deliver to the Holder an irrevocable Call Notice, indicating therein the portion of unexercised portion of the Additional Investment Rights to which such notice applies. If the conditions set forth below for such Call are satisfied from the period from the date of the Call Notice through and including the Call Date (as defined below), then any portion of the Additional Investment Rights subject to such Call Notice for which a Notice of Exercise shall not have been received from and after the date of the Call Notice will be cancelled at 6:30 p.m. (New York City time) on the Call Date. Any unexercised portion of the Additional Investment Rights to which the Call Notice does not pertain will be unaffected by such Call Notice. Notwithstanding anything to the contrary set forth in the Additional Investment Rights, the Company may not deliver a Call Notice or require the cancellation of the Additional Investment Rights (and any Call Notice will be void), unless, from the beginning of the 20 consecutive Trading Days used to determine whether the Common Stock has achieved the Threshold Price through the Call Date, the Equity Conditions have been met. The Company's right to Call the Additional Investment Right shall be exercised ratably among the Purchasers based on each Purchaser's initial purchase of Common Stock pursuant to the Securities Purchase Agreement.

CERTAIN ADJUSTMENTS.

Stock Dividends and Splits. If the Company, at any time while the Additional Investment Rights are outstanding: (A) pays a stock dividend or otherwise make a distribution or distributions on shares of its Common Stock or any other equity or equity equivalent securities payable in shares of Common Stock (which, for avoidance of doubt, shall not include any shares of Common Stock issued by the Company pursuant to the Additional Investment Rights), (B) subdivides outstanding shares of Common Stock into a larger number of shares, (C) combines (including by way of reverse stock split) outstanding shares of Common Stock into a smaller number of shares, or (D) issues by reclassification of shares of the Common Stock any shares of capital stock of the Company, then in each case the AIR Exercise Price shall be multiplied by a fraction of which the numerator shall be the number of shares of Common Stock (excluding treasury shares, if any) outstanding before such event and of which the denominator shall

be the number of shares of Common Stock outstanding after such event and the number of Additional Investment Right Shares issuable upon exercise of the Additional Investment Rights shall be proportionately adjusted. Any adjustment made pursuant to Section 3(a) of the Additional Investment Rights shall become effective immediately after the record date for the determination of stockholders entitled to receive such dividend or distribution and shall become effective immediately after the effective date in the case of a subdivision, combination or re-classification.

Pro Rata Distributions. If the Company, at any time prior to the Termination Date, shall distribute to all holders of Common Stock (and not to Holders of the Additional Investment Rights) evidences of its indebtedness or assets or rights or Additional Investment Rights to subscribe for or purchase any security other than the Common Stock (which shall be subject to Section 3(b) of the Additional Investment Rights), then in each such case the AIR Exercise Price shall be adjusted by multiplying the AIR Exercise Price in effect immediately prior to the record date fixed for determination of stockholders entitled to receive such distribution by a fraction of which the denominator shall be the VWAP determined as of the record date mentioned above, and of which the numerator shall be such VWAP on such record date less the then per share fair market value at such record date of the portion of such assets or evidence of indebtedness so distributed applicable to one outstanding share of the Common Stock as determined by the Board of Directors in good faith. In either case the adjustments shall be described in a statement provided to the Holders of the portion of assets or evidences of indebtedness so distributed or such subscription rights applicable to one share of Common Stock. Such adjustment shall be made whenever any such distribution is made and shall become effective immediately after the record date mentioned above.

Fundamental Transaction. If, at any time while the Additional Investment Rights are outstanding, (A) the Company effects any merger or consolidation of the Company with or into another Person, in which the Company is not the surviving entity, or the Company's then existing shareholders will own less than 51% of the surviving entity, (B) the Company effects any sale of all or substantially all of its assets in one or a series of related transactions, (C) any tender offer or exchange offer (whether by the Company or another Person) is completed pursuant to which holders of Common Stock are permitted to tender or exchange their shares for other securities, cash or property, or (D) a Fundamental Transaction, then, upon any subsequent conversion of the Additional Investment Rights, the Holder shall have the right to receive, for each Additional Investment Right Share that would have been issuable upon such exercise absent such Fundamental Transaction, at the option of the Holder, (a) upon exercise of the Additional Investment Rights, the number of shares of Common Stock of the successor or acquiring corporation or of the Company, if it is the surviving corporation, and Alternate Consideration receivable upon or as a result of such reorganization, reclassification, merger, consolidation or disposition of assets by a Holder of the number of shares of Common Stock for which the Additional Investment Rights are exercisable immediately prior to such event or (b) only in the event the Company is acquired in an all cash acquisition, cash equal to the value of the Additional Investment Rights as determined in accordance with the Black-Scholes option pricing formula. For purposes of any such exercise, the determination of the AIR Exercise Price shall be appropriately adjusted to apply to such Alternate Consideration based on the amount of Alternate Consideration issuable in respect of one share of Common Stock in such Fundamental Transaction, and the Company shall apportion the AIR Exercise Price among the Alternate Consideration in a reasonable manner

reflecting the relative value of any different components of the Alternate Consideration. If holders of Common Stock are given any choice as to the securities, cash or property to be received in a Fundamental Transaction, then the Holder shall be given the same choice as to the Alternate Consideration it receives upon any exercise of the Additional Investment Rights following such Fundamental Transaction. To the extent necessary to effectuate the foregoing provisions, any successor to the Company or surviving entity in such Fundamental Transaction shall issue to the Holder a new Additional Investment Right consistent with the foregoing provisions and evidencing the Holder's right to exercise such Additional Investment Right into Alternate Consideration upon the payment thereof. The terms of any agreement pursuant to which a Fundamental Transaction is effected shall include terms requiring any such successor or surviving entity to comply with the provisions of paragraph and insuring that the Additional Investment Rights (or any such replacement security) will be similarly adjusted upon any subsequent transaction analogous to a Fundamental Transaction.

DESCRIPTION OF ADDITIONAL ISSUANCES

In addition we are registering 690,000 shares of our Common Stock, including 200,000 shares of Common Stock underlying a Common Stock Purchase Warrant exercisable at $0.94, 50,000 shares of Common Stock underlying Warrants to Purchase Common Stock exercisable at $2.44 per share, 400,000 shares of Common Stock issued pursuant to an Independent Consulting Agrement with The Del Mar Consulting Group, and 125,000 shares of Common Stock issued to the Jonathan

Chase Gordon Educatinal Trust and 125,000 shares of Common Stock issued to the David Christopher Gordon Educatinal Trust in connection with a private placement. The terms of the agreements with respect to the Common Stock and the Warrants provided the investors with piggy-back registration rights.

The table below identifies each Selling Stockholder and sets forth information, to the best of our knowledge, regarding each Selling Stockholders' beneficial ownership of shares of our Common Stock. This information is based upon information provided by each respective Selling Stockholder and public accounts filed with the SEC.

The shares offered by this Prospectus may be offered for sale from time to time by the Selling Stockholders. Because the Selling Stockholders may offer all, some or none of the shares pursuant to this Prospectus, and because there are currently no agreements, arrangements or understandings with respect to the sale of any Shares, no estimate can be given as to the number of shares of Common Stock that will be held by the Selling Stockholders after the completion of this offering, unless it is assumed that all the Shares offered pursuant to this and any other effective Prospectus are sold.

The number of shares of Common Stock beneficially owned by the Selling Stockholders includes the shares of Common Stock beneficially owned by the Selling Stockholders as of the date of this Prospectus and shares of Common Stock underlying warrants or options held by Selling Stockholders that are exercisable within sixty (60) days of the date of this Prospectus. Except as otherwise indicated, to our knowledge, the Selling Stockholders have sole voting and investment power with respect to all shares of Common Stock beneficially owned by them, or with respect to the shares underlying options or warrants, will have sole voting and investment power at the time such shares are sold. The percentages shown in the table below are based upon 21,289,004 shares of our Common Stock outstanding as of June 30, 2004.

SELLING STOCKHOLDERS	NUMBER OF SHARES BENEFICIALLY OWNED BEFORE OFFERING	NUMBER OF SHARES THAT MAY BE OFFERED PURSUANT TO THIS PROSPECTUS	NUMBER O BENEFI OWNED OFFE
Alpha Capital AG Pradafat 7, Furstentums 9490 Vaduz, Liechtenstein	250,000	1,520,626(1)	250,000
Bristol Investment Fund, Ltd. c/o Bristol Capital Advisors, LLC 10990 Wilshire Blvd., Suite 1410 Los Angeles, CA 90024	312,500	3,041,252(2)	312,500
Crescent International Ltd. c/o GreenLight (Switzerland) SA 84 Avenue Louis-Casai CH 1216 Cointrin, Geneva Switzerland	468,750	2,280,938(3)	468,750

Palisades Master Fund, L.P. C/o Beacon Fund Advisors, Ltd. Harbour House, Waterfront Drive Road Town, Tortola, British Virgin Islands	456,250	5,322,190(4)	456,250
Perfect Timing, LLC 4390 River Bottom Drive Norcross, GA 30092	300,000	904,468(5)	300,000
The Del Mar Consulting Group, Inc. 2455 El Amigo Rd Del Mar, CA 92014	501,000	400,000(6)	101,000
PEF Advisors Ltd. C/o Beacon Fund Advisors, Ltd. Harbour House, Waterfront Drive Road Town, Tortola, British Virgin Islands	40,000	40,000(7)	0
Jonathan Chase Gordon Educational Trust 7633 E 63rd Place, Suite 220 Tulsa, OK 74133	325,000	125,000(8)	200,000
David Christopher Gordon Educational Trust 7633 E 63rd Place Suite 220 Tulsa, OK 74133	325,000	125,000(9)	200,000
K. Wesley M. Jones Sr. 6945 N Baltusrol Lane Charlotte, NC 28210	241,072	12,500(10)	203,572
Aubrey John Elam Jr. c/o Five Oaks Capital Partners, LLC 4201 Congress Street, Suite 145 Charlotte, North Carolina 28209	13,450	12,500(10)	0
Stefano Piraino c/o Five Oaks Capital Partners, LLC 4201 Congress Street, Suite 145 Charlotte, North Carolina 28209	12,500	12,500(10)	0
Greg Currie c/o Five Oaks Capital Partners, LLC 4201 Congress Street, Suite 145 Charlotte, North Carolina 28209	12,500	12,500(10)	0
HPC Capital Management 200 Mansell Court East, Suite 550 Roswell, GA 30076	200,000	243,000(11)	0
TOTAL:		14,052,474	

* Indicates no remaining beneficial ownership of the outstanding shares of Common Stock.

(1) Konrad Ackerman has investment and voting control over the securities held by Alpha Capital AG. Includes 531,915 shares issuable upon conversion of shares of 6% Convertible Preferred Stock; 105,882 shares issuable as dividends for three years if Company elects to, and is permitted to, pay such dividends in kind; 132,979 shares issuable upon exercise of Common Stock Purchase Warrants exercisable at $1.20 per share; 398,936 shares issuable upon exercise of Additional Investment Rights exercisable at $1.03 per share; and 350,914 additional shares are being registered in order to register 130% of the total registrable securities as required by the Registration Rights Agreement.

(2) Paul Kessler has investment and voting control over the securities held by Bristol Investment Fund, Ltd. Includes 1,063,830 shares issuable upon conversion of shares of 6% Convertible Preferred Stock; 211,765 shares issuable as dividends for three years if Company elects to, and is permitted to, pay such dividends in kind; 265,957 shares issuable upon exercise of Common Stock Purchase Warrants exercisable at $1.20 per share; 797,872 shares issuable upon exercise of Additional Investment Rights exercisable at $1.03 per share; and 701,827 additional shares are being registered in order to register 130% of the total registrable securities as required by the Registration rights Agreement.

(3) Maxi Brezzi and Mel Craw, in their capacity as managers of GreenLight (Switzerland) SA, the investment advisor to Crescent International Ltd., have investment and voting control over the securities held by Crescent International Ltd. Includes 797,872 shares issuable upon conversion of shares of 6% Convertible Preferred Stock; 158,824 shares issuable as dividends for three years if Company elects to, and is permitted to, pay such dividends in kind; 199,468 shares issuable upon exercise of Common Stock Purchase Warrants exercisable at $1.20 per share; 598,404 shares issuable upon exercise of Additional Investment Rights exercisable at $1.03 per share; and 526,370 additional shares are being registered in order to register 130% of the total registrable securities as required by the Registration Rights Agreement.

(4) Murray Todd has investment and voting control over the securities held by Palisades Master Fund, L.P. Includes 1,861,702 shares issuable upon conversion of shares of 6% Convertible Preferred Stock; 370,588 shares issuable as dividends for three years if Company elects to, and is permitted to, pay such dividends in kind; 465,426 shares issuable upon exercise of Common Stock Purchase Warrants exercisable at $1.20 per share; 1,396,276 shares issuable upon exercise of Additional Investment Rights exercisable at $1.03 per share; and 1,228,198 additional shares are being registered in order to register 130% of the total registrable securities as required by the Registration Rights Agreement.

(5) Lisa E. Mannion has investment and voting control over the securities held by Perfect Timing, LLC. Includes 319,149 shares issuable upon conversion of shares of 6% Convertible Preferred Stock; 63,529 shares issuable as dividends for three years if Company elects to, and is permitted to, pay such dividends in kind; 79,787 shares issuable upon exercise of Common Stock Purchase Warrants exercisable at $1.20 per share; 239,362 shares issuable upon exercise of Additional Investment Rights exercisable at $1.03 per share; and 202,641 additional shares are being registered in order to register 130% of the total registrable securities as required by the Registration Rights Agreement.

(6) Robert B. Prag has investment and voting control over the securities held

by The Del Mar Consulting Group. Includes 400,000 shares of Common Stock issued pursuant to an Independent Consulting Agreement.

(7) Paul Mannion or Andy Reckles have investment and voting control over the securities which were issued as a finders' fee in connection with The Del Mar Consulting Group Independent Consulting Agreement referenced above.

(8) James R. Ross has investment and voting control over the securities which were issued pursuant to a private placement.

(9) Susan Willis has investment and voting control over the securities which were issued pursuant to a private placement.

(10) Shares issuable upon exercise of Warrants to purchase Common Stock exercisable at $2.44 per share issued in connection with a Letter of Credit transaction entered into on March 1, 2004 whereby 4 investors provided Flightserv, Inc. with two letters of credit to replace existing letters of credit.

(11) Vince Sbarra has investment and voting control over the securities, 200,000 of which were issued as placement fees in connection with the October 2003 private placement and 43,000 of which were issued as placement fees in connection with the September 2004 private placement.

None of the selling security holders has, or within the past three years has had, any position, office or other material relationship with us or any of our predecessors or affiliates other than as set forth above. Paul Mannion, Jr. is a principal of PEF Advisors Ltd. and of HPC Capital Management, which serves as our investment bank and acted as placement agent in connection with our recent financings. HPC Capital Management is a registered broker-dealer. Mr. Mannion's wife is the principal of Perfect Timing, LLC, which purchased the securities being registered under this Prospectus as disclosed under footnote 5. To our knowledge, neither Mr. Mannion, nor HPC Capital Management has any arrangement with any person to participate in the distribution of such securities. The Del Mar Consulting Group is the Company's investor communications and public relations consultant. K. Wesley M. Jones Sr. was appointed a Director of the Company on April 15, 2004. Mr. Jones was 1 of 4 investors in a March 1, 2004 Letter of Credit transaction which benefited a subsidiary of the Company. Mr. Jones received 12,500 Warrants in connection with this transaction.

We have agreed to pay the full costs and expenses in connection with the issuance, offer, sale and delivery of the shares, including all fees and expenses in preparing, filing and printing the registration statement and Prospectus and related exhibits, amendments and supplements thereto and mailing of those items. We will not pay selling commissions and expenses associated with any sale by the Selling Stockholders.

PLAN OF DISTRIBUTION

Each Selling Stockholder (the "Selling Stockholders") of our Common Stock and any of their pledgees, assignees and successors-in-interest may, from time to time, sell any or all of their shares of Common Stock on the Trading Market or any other stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. A Selling Stockholder may use any one or more of the following methods when selling shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;
- settlement of short sales entered into after the date of this prospectus;
- broker-dealers may agree with the Selling Stockholders to sell a specified number of such shares at a stipulated price per share;

- a combination of any such methods of sale;
- through the writing or settlement of options or other hedging transactions, whether through an options exchange or otherwise; or
- any other method permitted pursuant to applicable law.

The Selling Stockholders may also sell shares under Rule 144 under the Securities Act, if available, rather than under this prospectus.

Broker-dealers engaged by the Selling Stockholders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the Selling Stockholders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated. Each Selling Stockholder does not expect these commissions and discounts relating to its sales of shares to exceed what is customary in the types of transactions involved.

In connection with the sale of our Common Stock or interests therein, the Selling Stockholders may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the Common Stock in the course of hedging the positions they assume. The Selling Stockholders may also sell shares of our Common Stock short and deliver these securities to close out their short positions, or loan or pledge the Common Stock to broker-dealers that in turn may sell these securities. The Selling Stockholders may also enter into option or other transactions with broker-dealers or other financial institutions or the creation of one or more derivative securities which require the delivery to such broker-dealer or other financial institution of shares offered by this prospectus, which shares such broker-dealer or other financial institution may resell pursuant to this prospectus (as supplemented or amended to reflect such transaction).

The Selling Stockholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be "underwriters" within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Each Selling Stockholder has informed the Company that it does not have any agreement or understanding, directly or indirectly, with any person to distribute the Common Stock.

The Company is required to pay certain fees and expenses incurred by it incident to the registration of the shares. The Company has agreed to indemnify the Selling Stockholders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act.

Because Selling Stockholders may be deemed to be "underwriters" within the meaning of the Securities Act, they will be subject to the prospectus delivery requirements of the Securities Act. In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 under the Securities Act may be sold under Rule 144 rather than under this prospectus. Each Selling Stockholder has advised us that they have not entered into any agreements, understandings or arrangements with any underwriter or broker-dealer regarding the sale of the resale shares. There is no underwriter or coordinating broker acting in connection with the proposed sale of the resale shares by the Selling Stockholders.

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We agreed to use our commercially reasonable efforts to keep this prospectus effective until the earlier of (i) the date on which the shares may be resold by the Selling Stockholders without registration and without regard to any volume limitations by reason of Rule 144(k) under the Securities Act or any other rule of similar effect or (ii) all of the shares have been sold pursuant to the prospectus or Rule 144 under the Securities Act or any other rule of similar effect. The resale shares will be sold only through registered or licensed brokers or dealers if required under applicable state securities laws. In addition, in certain states, the resale shares may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

Under applicable rules and regulations under the Exchange Act, any person engaged in the distribution of the resale shares may not simultaneously engage in market making activities with respect to our Common Stock for a period of two business days prior to the commencement of the distribution. In addition, the Selling Stockholders will be subject to applicable provisions of the Exchange Act and the rules and regulations thereunder, including Regulation M, which may limit the timing of purchases and sales of shares of our Common Stock by the Selling Stockholders or any other person. We will make copies of this prospectus available to the Selling Stockholders and have informed them of the need to deliver a copy of this prospectus to each purchaser at or prior to the time of the sale.

LEGAL MATTERS

The validity of the Common Stock offered hereby will be passed upon for us by the law firm of Adorno & Yoss, P.A, Fort Lauderdale, Florida.

EXPERTS

BDO Seidman LLP, our independent registered public accounting firm, have audited our consolidated financial statements included in our Annual Report on Form 10-K for the years ended June 30, 2004, 2003, and 2002, as set forth in their report, which is incorporated by reference in this Prospectus. Our financial statements are incorporated by reference in reliance on BDO Seidman LLP's report, given on their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the SEC. You can inspect and copy the registration statement of which this Prospectus is a part, as well as such reports, proxy statements and other information, at the public reference room maintained by the SEC at Judiciary Plaza, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549. Copies of such material can be obtained from the public reference room of the SEC at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. You may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330. We are also required to file electronic versions of these documents with the SEC, which may be accessed through the SEC's Web site at http://www.sec.gov. You may also inspect reports, proxy and information statements and other information about us at the American Stock Exchange at 86 Trinity Place, New York, New York 10006.

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INFORMATION INCORPORATED BY REFERENCE

The SEC allows us to "incorporate by reference" the information we file with it, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this Prospectus, and later information that we file with the SEC will automatically update and supercede this information. We incorporate by reference the documents listed below and any future filings made with the SEC under Sections 13(a), 13(c), 14, or 15(d) of the Exchange Act until the earlier of the date the Selling Stockholders sell all the Shares or such other date as the offering is terminated and any unsold Shares are deregistered by the filing of a post-effective amendment:

- Our Annual Report on Form 10-K for the year ended June 30, 2004;
- Our Quarterly Report on Form 10-Q for the quarter ended September 30, 2003;
- Our Quarterly Report on From 10-Q and Form 10-Q/A for the quarter ended December 31, 2003;
- Our Quarterly Report on From 10-Q for the quarter ended March 31, 2004;
- Our Current Reports and Amendments thereto on Form 8-K and Form 8-K/A, respectively, filed with the SEC:

October 16, 2003;	March 23, 2004;
October 21, 2003;	April 2, 2004;
November 17, 2003;	April 21, 2004;
January 9, 2004;	May 11, 2004;
January 20, 2004;	May 25, 2004;
February 9, 2004;	August 18, 2004;
February 24, 2004;	September 3, 2004;
February 27, 2004;	September 16, 2004; and
March 3, 2004;	September 27, 2004

- Our Definitive Proxy Statement for our Annual Meeting of Stockholders held on November 14, 2003, filed with the SEC on October 20, 2003; and

- The description of our Common Stock contained in our Registration Statement on Form 8-A filed with the SEC on July 19, 1996.

You may request a copy of these filings, at no cost, by writing or telephoning us at the following address and telephone number:

RCG Companies Incorporated
6836 Morrison Boulevard
Suite 200
Charlotte, NC 28211

Attention: Controller

Telephone: (704) 366-5054

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This Prospectus provides you with a general description of the securities that may be offered for sale, but does not contain all of the information that is in the registration statement that we filed with the SEC. Statements contained herein concerning the provisions of certain documents filed with, or incorporated by reference in, the registration statement are not necessarily complete and each such statement is qualified in its entirety by references to the applicable document filed with the SEC.

You should rely only on the information incorporated by reference or provided in this Prospectus or any supplement. We have not authorized anyone else to provide you with different information. The Selling Stockholders will not make an offer of these Shares in any state where the offer is not permitted. You should not assume that the information in this Prospectus or any supplement is accurate as of any date other than the date on the front of the respective document.

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PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 14. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION.

The estimated expenses to be paid in connection with the offering of the securities being registered are as follows and will be borne by the Company:

SEC Registration Fee	$ 2,059
Legal Fees and Expenses	*$ 15,000
Accounting and other Miscellaneous Fees and Expenses	*$ 10,000
Total	$ 27,059

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* Estimated

ITEM 15. INDEMNIFICATION OF DIRECTORS AND OFFICERS.

Section 145 of the Delaware General Corporation Law ("DGCL") provides that, to the extent a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding, whether civil, criminal, administrative or investigative or in defense of any claim, issue, or matter therein (hereinafter a "Proceeding"), by reason of the fact that person is or was a director, officer, employee or agent of a corporation or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or of a partnership, joint venture, trust or other enterprise (collectively an "Agent" of the corporation) that person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith.

The DGCL also provides that a corporation may indemnify any person who was or is a party or is threatened to be made a party to any threatened Proceeding by reason of the fact that person is or was an Agent of the corporation, against expenses (including attorneys' fees), judgment, fines and amounts paid in settlement actually and reasonably incurred by that person in connection with such action, suit or proceeding if that person acted in good faith and in a manner that person reasonably believed to be in, or not opposed to, the best interest of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe that person's conduct was unlawful; provided, however, that in an action by or in the right of the corporation, the corporation may not indemnify such person in respect of any claim, issue, or matter as to which that person is adjudged to be liable to the corporation unless, and only to the extent that, the Court of Chancery or the court in which such proceeding was brought determined that, despite the adjudication of liability but in view of all the circumstances of the case, such person is reasonably entitled in indemnity.

Article VI of our Restated Certificate of Incorporation limits the liability of our directors to the fullest extent permitted by the DGCL. Specifically, no director will be personally liable to us or any stockholder for monetary damages for breach of a fiduciary duty as a director, except liability for (i) any breach of the duty of loyalty to us or our stockholders; (ii) acts or omissions not in good faith; (iii) acts that involve intentional misconduct or a knowing violation of law; or (iv) any transaction from which the director derives an improper personal benefit.

Article 5 of our Amended and Restated Bylaws provides that we will indemnify, to the fullest extent permitted by applicable law, any Agent who was or is made or is threatened to be made a party to a Proceeding against all liability and loss suffered and expenses reasonably incurred by such Agent; provided, however, we will be required to indemnify an Agent in connection with a Proceeding initiated by such Agent only if the Proceeding was authorized by our Board of Directors. Our Amended and Restated Bylaws further provide that we will pay the expenses incurred in defending any Proceeding in advance of its final disposition; provided, however, that the payment of expenses incurred by an officer or director in advance of the final disposition of a Proceeding is made only upon our receipt of an undertaking by the director or officer to repay all amounts advanced if it is ultimately determined that such officer or director is not entitled to be indemnified.

We maintain directors' and officers' liability insurance, including a reimbursement policy in our favor. Additionally, we have entered into separate indemnifications agreements with certain of our directors and officers which provide, on a contractual basis, for generally the same rights to indemnification as set forth in our Amended and Restated Bylaws.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or controlling persons of the Company pursuant to the foregoing provisions, or otherwise, we have been informed that, in the opinion of the SEC, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

ITEM 16. EXHIBITS.

4.1 Securities Purchase Agreement, dated September 13, 2004 (previously filed with the SEC on Form 8-K Current Report dated September 16, 2004)

4.2 Certificate of Designation of Preferences, Rights and Limitations of Series A 6% Convertible Preferred Stock (previously filed with the SEC on Form 8-K Current Report dated September 16, 2004)

4.3 Form of Common Stock Purchase Warrant exercisable at $1.20 (previously filed with the SEC on Form 8-K Current Report dated September 16, 2004)

4.4 Form of Additional Investment Rights Agreement (previously filed with the SEC on Form 8-K Current Report dated September 16, 2004)

4.5 Form of Registration Rights Agreement (previously filed with the SEC on Form 8-K Current Report dated September 16, 2004)

4.6 Form of Warrant to Purchase Common Stock exercisable at $2.44

4.7 Common Stock Purchase Warrant exercisable at $0.94 (initially $2.44)

5.1 Legal Opinion with respect to due issuance and Consent of Adorno & Yoss, P.A.

10.1 Independent Consulting Agreement

23.1 Consent of Adorno & Yoss, P.A. (included in Exhibit 5.1)

23.2 Consent of BDO Seidman, LLP

ITEM 17. UNDERTAKINGS.

The undersigned Registrant hereby undertakes:

(1) To file, during any period in which it offers or sells securities, a post-effective amendment to this registration statement:

(i) To include any Prospectus required by Section 10(a)(3) of the Securities Act;

(ii) To reflect in the Prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in the volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of Prospectus filed with the SEC pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20 percent change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement; and

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change in such information in the registration statement.

Provided, however, that (1)(i) and (1)(ii) do not apply if the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed by the Registrant pursuant to Section 13 or Section 15(d) of the Exchange Act that are incorporated by reference into this registration statement.

(2) That, for the purpose of determining any liability under the Securities Act, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

(4) For purposes of determining any liability under the Securities Act, the information omitted from the form of Prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of Prospectus filed by Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective.

(5) For purposes of determining any liability under the Securities Act, each filing of the Registrant's annual report pursuant to Section 13(a) or 15(d) of the Exchange Act (and, where applicable, each filing of an employee benefit plan's annual report pursuant to Section 15(d) of the Exchange Act) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted as to directors, officers and controlling persons of the Registrant pursuant to the provisions described under Item 15 above or otherwise, the Registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer, or controlling person of the Registrant in the successful defense of any action, suit, or proceeding) is asserted by such director, officer, or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized in Charlotte, North Carolina, on this October 28, 2004.

RCG Companies Incorporated,
a Delaware corporation

By: /s/ Michael D. Pruitt

Michael D. Pruitt
Chief Executive Officer and President

Pursuant to the requirements of the Securities Act, this Registration Statement has been signed by the following persons in the capacities indicated:

Date: October 28, 2004	/s/ Michael D. Pruitt Michael D. Pruitt President and Chief Executive Officer and Principal Executive Officer
Date: October 28, 2004	/s/ Jeffrey F. Willmott Jeffrey F. Willmott Chairman of the Board
Date: October 28, 2004	/s/ Dr. James A. Verbrugge Dr. James A. Verbrugge Director
Date: October 28, 2004	/s/ P. Roger Byer P. Roger Byer Director
Date: October 28, 2004	/s/ J. Michael Carroll J. Michael Carroll Director
Date: October 28, 2004	/s/ K. Wesley M. Jones, Sr. K. Wesley M. Jones, Sr. Director
Date: October 28, 2004	/s/ William W. Hodge William W. Hodge Chief Financial Officer and Principal Financial Officer

INDEX TO EXHIBITS

EXHIBIT NUMBER	EXHIBIT

4.1	Securities Purchase Agreement, dated September 13, 2004 (previously filed with the SEC on Form 8-K Current Report dated September 16, 2004)
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10.1	Independent Consulting Agreement
23.1	Consent of Adorno & Yoss, P.A. (included in Exhibit 5.1)
23.2	Consent of BDO Seidman, LLP

NT FACE="Times New Roman" SIZE="2">4,491,167

Time deposits

500,000 500,000

Auction rate preferred securities

48,703 20,160

Total marketable securities

8,137,020 5,614,759

Total cash, cash equivalents and marketable securities

$14,218,613 $12,134,508

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

	As of December 31, 2007			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government notes	$ 472,040	$ 3,745	$ (4)	$ 475,781
U.S. government agencies	2,102,710	18,306	(44)	2,120,972
Municipal securities	4,975,587	16,308	(331)	4,991,564
Time deposits	500,000			500,000
Auction rate preferred securities	48,703			48,703
Total marketable securities	$ 8,099,040	$ 38,359	$ (379)	$ 8,137,020

	As of March 31, 2008			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(unaudited)		
U.S. government notes	$ 86,712	$ 87	$ (120)	$ 86,679
U.S. government agencies	515,597	1,307	(151)	516,753
Municipal securities	4,462,630	42,422	(13,885)	4,491,167
Time deposits	500,000			500,000
Auction rate preferred securities	21,000		(840)	20,160
Total marketable securities	$ 5,585,939	$ 43,816	$ (14,996)	$ 5,614,759

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Bank time deposits were held by institutions outside the U.S. at December 31, 2007 and at March 31, 2008.

Gross unrealized gains and losses on cash equivalents were not material at December 31, 2007 and March 31, 2008. We recognized gross realized gains of $50.8 million and losses of $4.2 million on our marketable securities during the three months ended March 31, 2008. Gross realized gains and losses were not material in the three months ended March 31, 2007. There were no other-than-temporary impairments to our marketable securities in the three months ended March 31, 2007 and 2008. Realized gains and losses are included in interest income and other, net in our accompanying Consolidated Statements of Income.

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

	As of December 31, 2007	As of March 31, 2008 (unaudited)
Due within 1 year	$ 1,964,325	$ 1,216,282
Due in 1 to 5 years	3,359,472	2,591,340
Due in 5 to 10 years	310,332	202,496
Due after 10 years	2,454,188	1,584,481
Total marketable debt securities	$ 8,088,317	$ 5,594,599

In accordance with EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, the following table shows gross unrealized losses and fair value for those investments that were in an unrealized loss position as of December 31, 2007 and March 31, 2008, aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in thousands):

	As of December 31, 2007					
	Less than 12 Months		12 Months or Greater		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government notes	$ 30,525	$ (4)	$	$	$ 30,525	$ (4)
U.S. government agencies	98,682	(41)	19,993	(3)	118,675	(44)
Municipal securities	270,708	(227)	54,832	(104)	325,540	(331)
Total	$ 399,915	$ (272)	$ 74,825	$ (107)	$ 474,740	$ (379)

	As of March 31, 2008 (unaudited)			
	Less than 12 Months		Total	
Security Description	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. government notes	$ 50,407	$ (120)	$ 50,407	$ (120)
U.S. government agencies	97,468	(151)	97,468	(151)
Municipal securities	930,934	(13,885)	930,934	(13,885)
Auction rate preferred securities	20,160	(840)	20,160	(840)
Total	$ 1,098,969	$ (14,996)	$ 1,098,969	$ (14,996)

As of March 31, 2008, we did not have any investments in marketable securities that were in an unrealized loss position for 12 months or greater.

Auction Rate Securities

At March 31, 2008, we held $259.6 million of auction rate securities which are included under municipal securities and auction rate preferred securities in the above table. The assets underlying these investments are primarily student loans which are

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substantially guaranteed by the U.S. government. Historically, these securities have provided liquidity through a Dutch auction at pre-determined intervals every 7 to 49 days. However, these auctions began to fail in February 2008. As a result, these securities do not have a readily determinable market value and are not liquid. To determine their estimated fair values at March 31, 2008, we used a discounted cash flow model based on estimated interest rates over the period of time we expect to hold these securities. Based on this analysis, we recorded a temporary impairment of $10.8 million to accumulated other comprehensive income on the accompanying Consolidated Balance Sheet at March 31, 2008 (see Note 5).

To the extent we determine that any impairment is other-than-temporary, we would record a charge to earnings. Also, if we ever determine that it is likely that the auctions for the auction rate securities we hold will continue to fail over the next 12 months or more, we would then reclassify those securities to long-term assets from current assets on our Consolidated Balance Sheets.

Note 4. Derivative Financial Instruments

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

In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), we recognize derivative instruments as either assets or liabilities on the balance sheet at fair value. Changes in the fair value (i.e., gains or losses) of the derivatives are recorded in the accompanying Consolidated Statement of Income as interest income and other, net, or as part of revenues, or on the accompanying Consolidated Balance Sheets as accumulated other comprehensive income.

Cash Flow Hedges

We use a combination of forward contracts and options designated as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar. The gain or loss on the effective portion of a cash flow hedge is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into revenues when the hedged exposure affects revenues or as interest income and other, net if the hedged transaction becomes probable of not occurring. Any gain or loss after a hedge is de-designated because it is no longer probable of occurring or related to an ineffective portion of a hedge, as well as any amount excluded from our assessment of hedge effectiveness, is recognized as interest income and other, net, immediately. These net gains or losses were not material in the quarter ended March 31, 2008.

The notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were 154.5 million Canadian dollars (or approximately $151.4 million) and $3.0 million at March 31, 2008. These foreign exchange forward contracts and options have maturities of 18 months or less. There were no other foreign exchange contracts designated as cash flow hedges.

Other Derivatives

Other derivatives not designated as hedging instruments under SFAS 133 consist primarily of forward contracts which we use to hedge intercompany balances and other monetary assets or liabilities denominated in currencies other than the local currency of a subsidiary. Gains and losses on these contracts are included in interest income and other, net, along with those of the related hedged items. Neither the cost nor the fair value of these foreign exchange contracts was material at March 31, 2008. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $1.5 billion and $2.3 billion at December 31, 2007 and March 31, 2008. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 296.5 million (or approximately $433.4 million) and 411.4 million (or approximately $651.1 million) at December 31, 2007 and March 31, 2008. The notional principal of foreign exchange contracts to sell Euros for Taiwanese dollars was 18.7 million (or approximately $29.6 million) at March 31, 2008.

Note 5. Fair Value Measurements

Effective January 1, 2008, we adopted SFAS 157, except as it applies to the nonfinancial assets and nonfinancial liabilities subject to FSP SFAS 157-2. SFAS 157 clarifies that 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. As a basis for considering such assumptions, SFAS 157 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

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

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

Level 3 - Unobservable inputs which are supported by little or no market activity.

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

In accordance with SFAS 157, we measure our cash equivalents, marketable securities and foreign currency derivative contracts at fair value. Our cash equivalents and marketable securities are primarily classified within Level 1 or Level 2, with the exception of our investments in auction rate securities. This is because our cash equivalents and marketable securities are valued primarily using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Our investments in auction rate securities are classified within Level 3 because they are valued using a discounted cash flow model (see Note 3). Some of the inputs to this model are unobservable in the market and are significant. Our foreign currency derivative contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments in inactive markets.

Assets and liabilities measured at fair value are summarized below (unaudited, in thousands):

		Fair value measurement at reporting date using		
Description	**March, 31 2008**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets				
Cash equivalents:				
U.S. government agencies	$ 576,870	$	$ 576,870	$
Municipal securities	87,391		87,391	
Time deposits	500,000		500,000	
Money market mutual funds	2,580,086	2,580,086		
Marketable securities:				
U.S. government notes	86,679		86,679	
U.S. government agencies	516,753		516,753	
Municipal securities	4,491,167		4,251,767	239,400
Time deposits	500,000		500,000	
Auction rate preferred securities	20,160			20,160
Foreign currency derivative contracts	10,007		10,007	
Total assets	$ 9,369,113	$ 2,580,086	$ 6,529,467	$ 259,560
Liabilities				
Foreign currency derivative contracts	$ 6,727	$	$ 6,727	$
Total liabilities	$ 6,727	$	$ 6,727	$

The following table presents our assets measured at fair value using significant unobservable inputs (Level 3) as defined in SFAS 157 at March 31, 2008 (unaudited, in thousands):

	Level 3
Balance at December 31, 2007	$
Transfers to Level 3	311,225
Unrealized loss included in other comprehensive income	(10,815)
Net settlements	(40,850)

Balance at March 31, 2008	$ 259,560

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Effective January 1, 2008, we also adopted SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an Amendment of FASB Statement No. 115*, which allows an entity to choose to measure certain financial instruments and liabilities at fair value on a contract-by-contract basis. Subsequent fair value measurement for the financial instruments and liabilities an entity chooses to measure will be recognized in earnings. As of March 31, 2008, we did not elect such option for our financial instruments and liabilities.

Note 6. Property and Equipment

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

	As of December 31, 2007	As of March 31, 2008 (unaudited)
Information technology assets	$ 2,734,916	$ 3,090,650
Construction in process	1,364,651	1,810,637
Land and buildings	951,334	1,014,044
Leasehold improvements	416,884	455,410
Furniture and fixtures	52,127	60,112
Total	5,519,912	6,430,853
Less accumulated depreciation and amortization	1,480,651	1,689,129
Property and equipment, net	$ 4,039,261	$ 4,741,724

Note 7. Acquisitions

In March 2008, we completed our acquisition of Click Holding Corp. (DoubleClick), a company that offers online ad serving and management technology to advertisers, ad agencies and web site publishers. We acquired DoubleClick primarily for their customer relationships, as well as patents and developed technology. This transaction was accounted for as a business combination. The total purchase price was $3.2 billion paid in cash, including transaction costs of $52.1 million. In addition, we issued unvested options to purchase 127,320 shares of Class A common stock valued at $50.6 million which will be recognized as stock-based compensation as the awards vest over the related vesting periods of up to 47 months. These unvested awards are earned contingent upon each individual s continued employment with us.

The preliminary allocation of the purchase price was based upon a preliminary valuation and our estimates and assumptions are subject to change. The primary areas of the purchase price allocation that are not yet finalized are related to restructuring costs, income taxes and residual goodwill. The following table summarizes the preliminary allocation of the purchase price of DoubleClick (unaudited, in thousands):

Goodwill	$ 2,312,589
Customer relationships	637,200
Patents and developed technology	143,400
Tradenames and other	28,300
Net assets acquired	78,868
Deferred tax assets	312,202
Deferred tax liabilities	(309,137)
Total	$ 3,203,422

Goodwill is not deductible for tax purposes.

Customer relationships have a weighted-average useful life of 6.7 years. Patents and developed technology have a weighted-average useful life of 5.0 years. Tradenames and other have a weighted-average useful life of 5.5 years. The majority of these assets are not deductible for tax purposes.

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Supplemental information on an unaudited pro forma basis, as if the DoubleClick acquisition had been consummated at the beginning of each of the periods presented, is as follows (in millions, except per share amounts):

	Three Months Ended March 31, 2007	2008
	(unaudited)	
Revenues	$ 3,739.4	$ 5,255.3
Net income	$ 983.3	$ 1,269.5
Net income per share of Class A and Class B common stock - diluted	$ 3.12	$ 4.00

The unaudited pro forma supplemental information is based on estimates and assumptions, which we believe are reasonable. It is not necessarily indicative of our consolidated financial position or results of income in future periods or the results that actually would have been realized had we been a combined company as of the beginning of the periods presented. The unaudited pro forma supplemental information includes incremental intangible asset amortization and other charges as a result of the acquisition, net of the related tax effects.

In connection with certain acquisitions in the prior periods, we are obligated to make additional cash payments if certain criteria are met. As of March 31, 2008, our remaining contingent obligations related to these acquisitions was approximately $591 million. Since these contingent payments are based on the achievement of performance targets, actual payments may be substantially lower.

Note 8. Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the three months ended March 31, 2008, are as follows (in thousands):

Balance as of December 31, 2007	$ 2,299,368
Goodwill acquired	2,313,623
Goodwill adjustment	178,408
Balance as of March 31, 2008	$ 4,791,399

The goodwill adjustment of $178.4 million was primarily a result of contingent payments earned upon the achievement of certain performance targets.

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

	As of December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Patents and developed technology	$ 364,937	$ 179,102	$ 185,835
Customer relationships	171,876	37,738	134,138
Tradenames and other	196,392	69,769	126,623
Total	$ 733,205	$ 286,609	$ 446,596

	As of March 31, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value

		(unaudited)	
Patents and developed technology	$ 511,494	$ 205,359	$ 306,135
Customer relationships	809,076	55,169	753,907
Tradenames and other	225,148	81,218	143,930
Total	$ 1,545,718	$ 341,746	$ 1,203,972

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Amortization expense of acquisition-related intangible assets for the three months ended March 31, 2007 and 2008 was $36.3 million and $55.0 million. Expected amortization expense for acquisition-related intangible assets on our March 31, 2008 Consolidated Balance Sheet for the remainder of 2008 and each of the next five years and thereafter is as follows (unaudited, in thousands):

Remainder of 2008	$ 222,220
2009	246,775
2010	215,871
2011	167,016
2012	129,730
2013	103,671
Thereafter	110,589
	$ 1,195,872

Note 9. Interest Income and Other, Net

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

	Three Months Ended March 31,	
	2007	2008
	(unaudited)	
Interest income	$ 130,475	$ 122,003
Interest expense	(342)	(387)
Realized gains on marketable securities, net	8,053	46,571
Other	(7,458)	(844)
Interest income and other, net	$ 130,728	$ 167,343

Note 10. Comprehensive Income

The changes in the components of other comprehensive income, net of taxes, were as follows (in thousands):

	Three Months Ended March 31,	
	2007	2008
	(unaudited)	
Net income	$ 1,002,162	$ 1,307,086
Change in unrealized gains (losses) on marketable securities, net	881	(9,809)
Change in cumulative translation adjustment and other	12,749	29,851
Comprehensive income	$ 1,015,792	$ 1,327,128

The components of accumulated other comprehensive income, net of taxes, were as follows (in thousands):

		As of December 31, 2007		As of March 31, 2008 (unaudited)
Unrealized gains on marketable securities, net	$	90,872	$	12,692
Cumulative translation adjustment and other		22,501		120,723
Accumulated other comprehensive income	$	113,373	$	133,415

Note 11. Contingencies

Legal Matters

Companies have filed trademark infringement and related claims against us over the display of ads in response to user queries that include trademark terms. The outcomes of these lawsuits have differed from jurisdiction to jurisdiction. Courts in France have held us liable for allowing advertisers to select certain trademarked terms as keywords. We are appealing those decisions. We were also subject to two lawsuits in Germany on similar matters where the courts held that we are not liable for the actions of our advertisers prior to notification of trademark rights. We are litigating or have recently litigated similar issues in other cases in the U.S., Australia, Austria, Brazil, China, France, Germany, Israel and Italy.

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We have also had copyright claims filed against us alleging that features of certain of our products and services, including Google Web Search, Google News, Google Video, Google Image Search, Google Book Search and YouTube, infringe their rights. Adverse results in these lawsuits may include awards of substantial monetary damages, costly royalty or licensing agreements or orders preventing us from offering certain functionalities, and may also result in a change in our business practices, which could result in a loss of revenue for us or otherwise harm our business. In addition, any time one of our products or services links to or hosts material in which others allegedly own copyrights, we face the risk of being sued for copyright infringement or related claims. Because these products and services comprise the majority of our products and services, our business could be harmed in the event of an adverse result in any of these claims.

We have also experienced an increase in patent lawsuits filed against us alleging that certain of our products and services, including Google Web Search, Google AdWords, and Google AdSense, infringe another party s patents. Adverse results in these lawsuits may include awards of substantial monetary damages, obligations to pay licensing fees and/or orders preventing us from offering certain features, functionalities, products or services, which could result in a loss of revenue for us or otherwise harm our business.

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

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

Income Taxes

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

Note 12. Stockholders Equity

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

	Three Months Ended March 31, 2007	2008
	(unaudited)	
Risk-free interest rate	4.6%	2.7%
Expected volatility	30%	35%
Expected life (in years)	3.4	5.3
Dividend yield		
Weighted-average estimated fair value of options granted during the period	$ 130.77	$ 269.79

The following table summarizes the activity for our options for the three months ended March 31, 2008:

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions) (1)
		(unaudited)		
Balance at December 31, 2007	12,892,886	$ 333.62		
Options granted	338,339	$ 346.11		
Exercised(2)	(624,514)	$ 28.04		
Canceled/forfeited	(142,999)	$ 388.38		

Balance at March 31, 2008	12,463,712	$	345.49	7.3	$	1,162.0
Vested and exercisable as of March 31, 2008	4,902,442	$	235.53	7.0	$	1,004.7
Vested and exercisable as of March 31, 2008 and expected to vest thereafter (3)	11,761,690	$	342.54	7.3	$	1,151.8

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $440.47 of our Class A common stock on March 31, 2008.

(2) Includes options vested during the period that were early exercised.

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

The following table summarizes additional information regarding outstanding, exercisable and exercisable and vested stock options at March 31, 2008:

	Options Outstanding					Options Exercisable		Options Exercisable and Vested	
Range of Exercise Prices	**Total Number of Shares**	**Unvested Options Granted and Exercised Subsequent to March 21, 2002**	**Number of Shares**	**Weighted-Average Remaining Life (Years)**	**Weighted Average Exercise Price**	**Number of Shares**	**Weighted Average Exercise Price**	**Number of Shares**	**Weighted Average Exercise Price**
$ 0.30 94.80	2,147,822	228,029	1,919,793	5.6	$ 21.12	1,757,476	$ 19.01	1,185,220	$ 18.46
$117.84 $198.41	1,655,976		1,655,976	5.5	$ 176.43	1,100,627	$ 175.12	1,100,514	$ 175.12
$205.96 $298.91	1,380,939		1,380,939	6.2	$ 274.48	808,224	$ 274.09	808,170	$ 274.09
$300.97 $399.00	1,763,894		1,763,894	6.7	$ 329.63	930,789	$ 326.92	930,506	$ 326.90
$401.78 $499.07	1,543,774		1,543,774	8.3	$ 450.09	468,924	$ 440.47	468,783	$ 440.48
$500.00 594.05	3,710,417		3,710,417	9.1	$ 556.54	409,112	$ 507.95	409,112	$ 507.95
$615.95 $699.35	208,207		208,207	9.7	$ 655.41	95	$ 664.72	95	$ 664.72
$707.00 $732.94	52,683		52,683	9.6	$ 718.17	42	$ 707.00	42	$ 707.00
$ 0.30 $732.94	12,463,712	228,029	12,235,683	7.3	$ 345.49	5,475,289	$ 213.03	4,902,442	$ 235.53

Options outstanding at March 31, 2008 in the above tables include 228,029 options granted and exercised subsequent to March 21, 2002 that are unvested at March 31, 2008, in accordance with EITF Issue No. 00-23, *Issues Related to Accounting for Stock Compensation Under APB Opinion No. 25 and FASB Interpretation No. 44*. However, the computations of the weighted-average exercise prices, weighted-average remaining contractual term and aggregate intrinsic value do not consider these unvested shares. Further, the above tables include 990,799 warrants held by financial institutions that were options purchased from employees under our TSO program.

The total grant date fair value of stock options vested during the three months ended March 31, 2008 was $161.0 million. The aggregate intrinsic value of all options exercised during the period was $228.3 million. These amounts do not include the aggregate sales price of options sold under the TSO program.

During the three months ended March 31, 2008, the number of shares underlying TSOs sold to selected financial institutions under the TSO program was 66,400 at a total value of $16.0 million, or an average of $241.26 per share, and an average premium of $41.52 per share. The premium is calculated as the difference between (a) the sale price of the TSO and (b) the intrinsic value of the TSO, which we define as the excess, if any, of the price of our Class A common stock at the time of the sale over the exercise price of the TSO. At March 31, 2008, the number of options eligible for participation under the TSO program was 8.7 million.

As of March 31, 2008, there was $1,078.5 million of unrecognized compensation cost related to outstanding employee stock options, net of forecasted forfeitures. This amount is expected to be recognized over a weighted average period of 2.8 years. To the extent the forfeiture rate is different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

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The following table summarizes the activity for our unvested restricted stock units and restricted shares for the three months ended March 31, 2008:

	Unvested Restricted Stock Units and Restricted Shares		
	Number of Shares		Weighted-Average Grant-Date Fair Value
	(unaudited)		
Unvested at December 31, 2007	2,990,222	$	526.92
Granted	981,483	$	467.42
Vested	(187,113)	$	417.49
Forfeited	(125,709)	$	508.93
Unvested at March 31, 2008	3,658,883	$	516.34
Expected to vest after March 31, 2008 (1)	3,421,056	$	516.34

(1) Restricted stock units and restricted shares expected to vest reflect an estimated forfeiture rate.

As of March 31, 2008, there was $1,586.3 million of unrecognized compensation cost related to employee unvested restricted stock units and restricted shares, net of forecasted forfeitures. This amount is expected to be recognized over a weighted average period of 3.4 years. To the extent the actual forfeiture rate is different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

Note 13. Income Taxes

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Financial Standards Accounting Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes,* and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination. Our total unrecognized tax benefits as of December 31, 2007 and March 31, 2008 were $387.2 million and $524.5 million. Also, our total unrecognized tax benefits that, if recognized, would affect our effective tax rate were $283.5 million and $387.2 million as of December 31, 2007 and March 31, 2008, respectively. The increase in our unrecognized tax benefits during the three months ended March 31, 2008 was primarily related to uncertain tax positions on our international structure.

Note 14. Information about Geographic Areas

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

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

	Three Months Ended		
	March 31, 2007	December 31, 2007	March 31, 2008
		(Unaudited)	

Revenues:			
United States	$ 1,958,382	$ 2,505,888	$ 2,535,474
United Kingdom	578,359	692,027	802,973
Rest of the world	1,127,230	1,628,764	1,847,596
Total revenues	$ 3,663,971	$ 4,826,679	$ 5,186,043

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	As of December 31, 2007	As of March 31, 2008 (unaudited)
Long-lived assets:		
United States	$ 7,334,877	$ 11,231,085
International	711,791	908,966
Total long-lived assets	$ 8,046,668	$ 12,140,051

Note 15. Subsequent Event

In May 2008, Clearwire Corporation and Sprint Nextel Corporation agreed to combine certain businesses to form a wireless communication company, the new Clearwire. In addition, certain other companies have collectively agreed to contribute $3.2 billion in cash to the new Clearwire or its subsidiary, including $500 million from us. The completion of this transaction is subject to customary closing conditions. We expect the transaction to close during the second half of 2008.

This investment will be a marketable equity security and will be classified and accounted for as available for sale. As a result, it will be carried at fair value, with unrealized gains and losses, net of taxes, reported as a component of stockholders equity, except for unrealized losses determined to be other than temporary which will be recorded as interest income and other, net, in accordance with our policy and FSP Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*.

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

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

regarding the growth and growth rate of our operations, business, revenues, operating margins, costs and expenses;

that seasonal fluctuations in internet usage and traditional advertising seasonality are likely to affect our business;

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

regarding our future stock-based compensation charges including charges related to our TSO program;

regarding our dilution related to all equity grants to employees;

regarding the steps we take to improve the relevance of the ads we deliver;

regarding our actions to reduce the number of accidental clicks;

that we will continue to make significant capital expenditure investments;

that the growth rate of our costs and expenses may exceed the growth rate of our revenues;

that our cost of revenues and traffic acquisition costs may increase in dollars and as a percentage of revenues;

regarding the increase of research and development, sales and marketing and general and administrative expenses in the future;

regarding quarterly fluctuations in paid clicks;

that we will continue to make investments and acquisitions;

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

regarding quarterly fluctuations in our effective tax rate;

regarding continued investments in international markets;

regarding the expected closing date of our proposed investment in Clearwire;

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

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

Overview

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

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

Advertisers. We provide advertisers with cost-effective ways to deliver online ads, as well as ads on offline media such as TV, print and radio, to customers across Google sites and through the Google Network, which is the network of online and offline third parties that use our advertising programs to deliver relevant ads with their search results and content. These advertising programs provide advertisers with a cost-effective way to deliver ads to customers across Google sites and through the Google Network, which is the network of online and offline third parties that use our advertising programs to deliver relevant ads with the search results and content they provide.

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

How We Generate Revenue

Advertising revenues made up 98% of our revenues for the three months ended March 31, 2008 and 99% for the three months ended March 31, 2007. We derive the balance of our revenues from the license of our web search technology, the license of our search solutions to enterprises and the sale and license of other products and services.

Google AdWords is our automated online program that enables advertisers to place targeted text-based and display ads on our web sites and the web sites of our Google Network members. Most of our AdWords customers pay us on a cost-per-click basis, which means that an advertiser pays us only when a user clicks on one of its ads. We also offer AdWords on a cost-per-impression basis that enables advertisers to pay us based on the number of times their ads appear on Google Network members sites specified by the advertiser. For advertisers using our AdWords cost-per-click pricing, we recognize as revenue the fees charged advertisers each time a user clicks on one of the ads that appears next to the search results on our web sites or next to the search results or content on Google Network members sites. For advertisers using our AdWords cost-per-impression pricing, we recognize as revenue the fees charged advertisers each time their ads are displayed on the Google Network members sites. Our AdWords agreements are generally terminable at any time by our advertisers.

Google AdSense refers to the online and offline programs through which we distribute our advertisers AdWords ads for display on the web sites of our Google Network members as well as programs to deliver audio ads on radio broadcasts, print ads for display in newspapers and magazines, and ads on television broadcasts. Our AdSense programs include AdSense for search and AdSense for content.

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

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

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

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

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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 web sites and our Google Network members web sites from which the content is viewed and share most of the fees these ads generate with the content providers and Google Network members. We recognize these advertiser fees as revenue and the portion of the advertiser fee we pay to our content providers as content acquisition costs under cost of revenues. In some cases, we guarantee our content providers minimum revenue share or other payments.

Our agreements with content providers are typically standard agreements with no stated term and are terminable at will. Agreements with our larger members are individually negotiated. Both the standard agreements and the negotiated agreements contain provisions requiring us to pay the content providers for the content we license or share, and the content providers receive most of the advertiser fees generated by ads displayed on our web sites and our Google Network members web sites.

We also distribute our advertisers ads for publication in print media through our Google Print Ads program, and we recognize as revenue the fees charged advertisers when their ads are published in print media. Additionally, we distribute advertisers audio ads for broadcast in radio programs through our Google Audio Ads program, and we recognize as revenue the fees charged advertisers each time an ad is broadcasted or a listener responds to that ad.

In the fourth quarter of 2006, we acquired YouTube, a consumer media company for people to watch and share videos worldwide through the web. We recognize as revenue the fees charged advertisers each time an ad or a promoted video is displayed on the YouTube site.

In the second quarter of 2007, we began delivering Google TV ads to viewers and helping advertisers, operators and programmers buy, schedule, deliver and measure ads on television. We recognize as revenue the fees charged advertisers each time an ad is displayed on TV in accordance with the terms of the related agreements.

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

- The relevance, objectivity and quality of our search results.
- The number and type of searches initiated at our web sites.
- The number and type of searches initiated at, as well as the number of visits to and the content of, our Google Network members web sites.
- The advertisers return on investment (ad cost per sale or cost per conversion) from advertising campaigns on our web sites or our Google Network members web sites or other media compared to other forms of advertising.
- The number of advertisers and the breadth of items advertised.
- The total and per click or per impression advertising spending budgets of each advertiser.
- The amount we ultimately pay our Google Network members and our content providers for traffic and content compared to the amount of revenue we generate.
- The monetization of (or generation of revenue from) traffic on our web sites and our Google Network members web sites.

We believe that the monetization of traffic on our web sites, and our Google Network members web sites is affected by the following factors:

The relevance and quality of ads displayed with each search results page on our web sites and our Google Network members web sites, as well as with each content page on our Google Network members web sites, including the relevance and quality of an ad s landing page or page a user views after an ad is clicked.

The number and prominence of ads displayed, if any, with each search results page on our web sites and our Google Network members web sites, as well as with each content page on our Google Network members web sites.

The rate at which our users and users of our Google Network members web sites click on advertisements.

Our minimum fee per click.

Trends in Our Business

Our business has grown rapidly 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 we expect it will continue to do so as a result of increasing competition and the difficulty of maintaining growth rates as our revenues increase to higher levels. In addition, the main focus of our advertising programs is to provide relevant and useful advertising to our users, reflecting our commitment to constantly improve their overall web experience. As a result, we may continue to take steps to improve the relevance of the ads displayed on our web sites and our Google Network members web sites. These steps include removing ads that generate low click-

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through rates or that send users to irrelevant or otherwise low quality sites and terminating Google Network members whose web sites do not meet our quality requirements. In addition, we may continue to take steps to reduce the number of accidental clicks. These steps could negatively affect our near-term advertising 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 revenue and paid click growth rates.

From the inception of the Google Network in 2002 through the first quarter of 2004, the growth in advertising revenues from our Google Network members web sites exceeded that from our web sites, which had a negative impact on our operating margins. The operating margin we realize on revenues generated from ads placed on our Google Network members web sites through our AdSense program is significantly lower than the operating margin we realize from revenues generated from ads placed on our web sites because most of the advertiser fees from ads served on Google Network member web sites are shared with our Google Network members. However, beginning in the second quarter of 2004, growth in advertising revenues from our web sites has exceeded that from our Google Network members web sites. 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 web sites compared to the rate of growth in revenues from our Google Network members web sites may vary over time.

We are heavily investing in building the necessary employee and systems infrastructures required to manage our growth and develop and promote our products and services, and this may cause our operating margins to decrease. We have experienced and expect to continue to experience substantial growth in our operations as we build our research and development programs, expand our base of users, advertisers, Google Network members and content providers and increase our presence in international markets. Also, we have acquired and expect to continue to acquire businesses and other assets from time to time. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other functional areas, our technologies and our product offerings. In addition, we are incurring significant costs and expenses to support our Google Checkout product and promote its adoption by merchants and consumers, as well as promote the distribution of certain other products, including the Google Toolbar. Our full-time employee headcount has significantly increased over the last 12 months, growing from 12,238 at March 31, 2007 to 19,156 at March 31, 2008, including approximately 1,500 new employees as a result of our acquisition of DoubleClick. We also utilize a significant number of temporary employees. We also expect to continue to make significant capital expenditure investments in, among other things, information and technology infrastructure and corporate facilities. In April 2007, we launched our TSO program. We modified employee options at that time to allow them to participate in this program, and as a result we incurred a modification charge of approximately $104 million through March 31, 2008 related to vested options, and we expect to incur an additional modification charge of approximately $125 million related to unvested options over their remaining vesting periods through the second quarter of 2011. In addition, the fair value of each option granted under the TSO program will be greater than it would have been otherwise because of a longer expected life, resulting in more stock-based compensation per option. As a result of all of the above, the growth rate of our costs and expenses may exceed the growth rate of our revenues.

We expect our cost of revenues to continue to increase in dollars and may increase as a percentage of revenues in 2008 and in future periods, primarily as a result of forecasted increases in traffic acquisition costs, data center costs and credit card and other transaction fees, including transaction processing fees related to Google Checkout, as well as content acquisition 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 of traffic on our web sites and our Google Network members web sites, particularly with those members to whom we have guaranteed minimum revenue share payments.

Our international revenues grew as a percentage of our total revenues to 51% in the three months ended March 31, 2008 from 48% in the three months ended December 31, 2007 and from 47% in the three months ended March 31, 2007. This increase in the portion of our revenues derived from international markets results largely from increased acceptance of our advertising programs, increases in our direct sales resources and customer support operations and our continued progress in developing localized versions of our products in these international markets, as well as an increase in the value of the Euro, the British pound and other foreign currencies compared to the U.S. dollar over these periods. The increase in the proportion of international revenues derived from international markets increases our exposure to fluctuations in foreign currency to U.S. dollar exchange rates.

Results of Operations

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

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	Three Months Ended		
	March 31, 2007	December 31, 2007	March 31, 2008
Consolidated Statements of Income Data:			
Revenues	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of revenues	40.1	40.5	40.7
Research and development	11.1	13.1	13.0
Sales and marketing	8.3	8.8	8.6
General and administrative	7.2	7.8	7.9
Total costs and expenses	66.7	70.2	70.2
Income from operations	33.3	29.8	29.8
Interest income and other, net	3.6	3.5	3.2
Income before income taxes	36.9	33.3	33.0
Provision for income taxes	9.5	8.3	7.8
Net income	27.4%	25.0%	25.2%

Revenues

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

	Three Months Ended		
	March 31, 2007	December 31, 2007	March 31, 2008
Advertising revenues:			
Google web sites	$ 2,282.1	$ 3,121.6	$ 3,400.4
Google Network web sites	1,345.4	1,635.8	1,686.1
Total advertising revenues	3,627.5	4,757.4	5,086.5
Licensing and other revenues	36.5	69.3	99.5
Revenues	$ 3,664.0	$ 4,826.7	$ 5,186.0

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

	Three Months Ended		
	March 31, 2007	**December, 31, 2007**	**March 31, 2008**
Advertising revenues:			
Google web sites	62%	65%	66%
Google Network web sites	37	34	32
Total advertising revenues	99	99	98
Google web sites as % of advertising revenues	63	66	67
Google Network web sites as % of advertising revenues	37	34	33
Licensing and other revenues	1%	1%	2%

Growth in our revenues in the three months ended March 31, 2008 compared to the three months ended December 31, 2007 resulted primarily from growth in advertising revenues for Google web sites, and to a lesser extent, Google Network web sites. Our advertising revenue growth for Google web sites and Google Network web sites resulted primarily from an increase in the total number of paid clicks and ads displayed through our programs, rather than from changes in the average fees paid by our advertisers. The increase in the number of paid clicks and ads displayed through our programs was due to an increase in aggregate traffic on our web sites, certain monetization improvements and the continued global expansion of our products, our advertiser base and our user base, as well as an increase in the number of Google Network members and distribution partners.

Growth in our revenues in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 resulted primarily from growth in advertising revenues for Google web sites and Google Network web sites. Our advertising revenue growth for Google web sites and Google Network web sites resulted primarily from increases in the total number of paid clicks and ads displayed through our programs, rather than from changes in the average fees paid by our advertisers. The increase in the number of paid clicks and ads displayed through our programs was due to an increase in aggregate traffic on both our web sites and those of our Google Network members, certain improvements in the monetization of increased traffic on our web sites and our Google Network member sites, the continued global expansion of our products, our advertiser base and our user base, and an increase in the number of Google Network members and distribution partners.

Improvements in our ability to ultimately monetize this 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 sites they visit. These improvements have included, for instance, a change to the formula used to determine which ads appear at the top of our search results pages, a change to consider not only a user s current search query, but also their immediately preceding query, to determine the ads displayed on our search results pages, and a change to the clickable area around our AdSense for content text-based ads to only the title and URL to reduce the number of accidental clicks.

Our sequential quarterly revenue growth rate decreased from 14.1% for the three months ended December 31, 2007, to 7.5% for the three months ended March 31, 2008.

The sequential quarterly revenue growth rate from Google web sites decreased from 14.1% for the three months ended December 31, 2007, to 8.9% for the three months ended March 31, 2008. The sequential quarterly revenue growth rate from our Google Network members web sites decreased from 12.5% for the three months ended December 31, 2007, to 3.1% for the three months ended March 31, 2008. These decreases in the sequential quarterly revenue growth rates are primarily the result of our higher revenue levels and seasonal slowdowns in internet usage and commercial queries. In addition, during the three months ended March 31, 2008, we terminated relationships with certain Google Network members who did not comply with our AdSense policies, which adversely affected our revenues. The sequential quarterly revenue growth from our web sites has been greater than that from our Google Network members web sites primarily as a result of a greater increase in the total number of paid clicks on our web sites, which was largely due to higher traffic growth and monetization improvements. We expect that our revenue growth rates will generally decline in the future as a result of increasing competition and the difficulty of maintaining growth rates as our revenues increase to higher levels.

Aggregate paid clicks on our web sites and our Google Network members web sites increased approximately 4% from the three months ended December 31, 2007 to the three months ended March 31, 2008, and increased approximately 20% from the three months ended March 31, 2007 to the three months ended March 31, 2008. In general, the increase in paid clicks has historically correlated with increases in our revenues. However, the rate of increase in paid clicks, and its correlation with the rate of increase in revenues, may fluctuate from quarter to quarter based on various factors including seasonality, advertiser competition for keywords

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and the revenue growth rates on our web sites compared to those of our Google Network members. In addition, traffic growth in emerging markets compared to more mature markets and across various advertising verticals also contributes to these fluctuations.

We believe that the increase in the number of paid clicks and ads displayed through our programs is substantially the result of our commitment to improving the relevance and quality of both our search results and the advertisements displayed, which we believe results in a better user experience, which in turn results in more searches, advertisers, and Google Network members and other partners. Revenues realized through the Google Print Ads Program, Google Audio Ads, Google TV Ads, Google Checkout, YouTube, Postini and DoubleClick were not material in any of the periods presented.

Revenues by Geography

Domestic and international revenues as a percentage of consolidated revenues, determined based on the billing addresses of our advertisers, are set forth below (unaudited):

	Three Months Ended		
	March 31, 2007	December 31, 2007 (unaudited)	March 31, 2008
United States	53%	52%	49%
United Kingdom	16%	14%	15%
Rest of the world	31%	34%	36%

The growth in international revenues in the three months ended March 31, 2008 compared to the three months ended December 31, 2007 and the three months ended March 31, 2007 resulted largely from increased acceptance of our advertising programs, increases in our direct sales resources and customer support operations in international markets and our continued progress in developing localized versions of our products for these international markets. Furthermore, the growth in international revenues from the three months ended December 31, 2007 to the three months ended March 31, 2008 resulted from seasonally stronger traffic and monetization in certain advertising verticals, such as travel and finance in the United Kingdom and certain other countries compared to the U.S.

In addition, the weakening of the U.S. dollar relative to other foreign currencies (primarily the Euro and the British pound) in the three months ended March 31, 2008 compared to the three months ended December 31, 2007 had a favorable impact on our international revenues, which increased $329.8 million. Had foreign exchange rates remained constant in these periods, our total revenues would have been approximately $18.1 million, or 0.3%, lower. The weakening of the U.S. dollar relative to other foreign currencies (primarily the Euro and the British pound) in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 had a favorable impact on our international revenues, which increased $945.0 million. Had foreign exchange rates remained constant in these periods, our total revenues would have been approximately $202.0 million, or 3.9%, lower.

Although we expect to continue to make investments in international markets, they may not result in an increase in our international revenues as a percentage of total revenues in 2008 or thereafter. See Note 14 of Notes to Consolidated Financial Statements included as part of this Form 10-Q for additional information about geographic areas.

Costs and Expenses

Cost of Revenues.

Cost of revenues consists primarily of traffic acquisition costs. Traffic acquisition costs consist of amounts ultimately paid to our Google Network members under AdSense arrangements and to certain other partners (our distribution partners) who distribute our toolbar and other products (collectively referred to as access points) or otherwise direct search queries to our web site (collectively referred to as distribution arrangements). These amounts are primarily based on the revenue share 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. The fees are paid when the access points are delivered or based on revenue share and are non-refundable. Further, the 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 (two years) to the extent we can reasonably estimate those lives and they are longer than one year, or based on any contractual revenue share, if greater. Otherwise, the fees are charged to expense as incurred. The estimated useful life of the access points is based on the historical average period of time they generate traffic and revenue.

In addition, certain AdSense agreements obligate us to make guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. These fees may be paid in advance or in arrears and are non-refundable but are subject to adjustment based on the achievement of the

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defined performance terms. In addition, the arrangements are terminable at will, although under the terms of certain contracts we or our Google Network members may be subject to penalties in the event of early termination. To the extent we expect revenues generated under an arrangement to exceed the guaranteed minimum revenue share payments, we recognize traffic acquisition costs on a contractual revenue share basis or on a basis proportionate to forecasted revenues, whichever is greater. Otherwise, we recognize the guaranteed revenue share payments as traffic acquisition costs on a straight-line basis over the term of the related agreements. In addition, concurrent with the commencement of a small number of AdSense and other agreements, we have purchased certain items from, or provided other consideration to, our Google Network members and partners. We have determined that certain of these amounts are prepaid traffic acquisition costs and are amortized on a straight-line basis over the terms of the related agreements.

Cost of revenues also includes the expenses associated with the operation of our data centers, including depreciation, labor, energy and bandwidth costs, credit card and other transaction fees related to processing customer transactions as well as content acquisition costs. We have entered into arrangements with certain content providers under which we distribute or license their video and other content. In a number of these arrangements we display ads on the pages of our web sites and our Google Network members web sites from which the content is viewed and share most of the fees these ads generate with the content providers and the Google Network members. To the extent we are obligated to make guaranteed minimum revenue share or other payments to our content providers, we recognize content acquisition costs equal to the greater of the following three amounts: the contractual revenue share amount, if any, based on the number of times the content is displayed, or on a straight-line basis over the terms 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, unaudited):

	Three Months Ended		
	March 31, 2007	**December 31, 2007 (unaudited)**	**March 31, 2008**
Cost of revenues	$ 1,470.4	$ 1,955.8	$ 2,110.5
Cost of revenues as a percentage of revenues	40.7%	40.5%	40.7%

	Three Months Ended		
	March 31, 2007	**December 31, 2007**	**March 31, 2008**
Traffic acquisition costs	$ 1,125.0	$ 1,439.8	$ 1,486.4
Traffic acquisition costs as a percentage of advertising revenues	31.0%	30.3%	29.2%

Cost of revenues increased $154.7 million from the three months ended December 31, 2007 to the three months ended March 31, 2008. There was an increase in data center costs of $66.0 million primarily as a result of the depreciation of additional information technology assets and data center buildings as well as additional personnel required to manage the data centers. Over this same period there was an increase in traffic acquisition costs of $46.6 million, which includes an increase of $17.9 million in fees related to distribution arrangements. In addition, there was an increase in content acquisition costs of $27.0 million and an increase in amortization of intangible assets of $10.0 million primarily as a result of our acquisition of DoubleClick. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to an increase in the proportion of advertising revenues coming from our web sites rather than from our Google Network members web sites. The traffic acquisition costs associated with revenues generated from ads placed on our web sites is considerably lower than the traffic acquisition costs associated with revenues generated from ads placed on our Google Network members web sites.

Cost of revenues increased $640.1 million from the three months ended March 31, 2007 to the three months ended March 31, 2008. Over the same period there was an increase in traffic acquisition costs of $361.4 million primarily resulting from more advertiser fees generated through our AdSense program, and to a lesser extent, an increase of $70.0 million in fees related to distribution arrangements, and an increase in data center costs of $196.8 million primarily resulting from the depreciation of additional information technology assets as well as additional labor required to manage the data centers. In addition, there was an increase in content acquisition costs of $31.7 million and an increase in the amortization of intangible assets of $24.3 million primarily resulting from acquisitions in the current and prior periods, and an increase in credit card and other transaction processing fees of $13.4 million resulting from more advertiser fees being generated through AdWords. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily due to an increase in the proportion of advertising revenues coming from our web sites rather than from our Google Network members web sites.

We expect cost of revenues to continue to increase in dollars and may increase as a percentage of revenues in 2008 and in future periods, primarily as a result of forecasted increases in traffic acquisition costs, data center costs, credit card and other transaction fees,

including transaction processing fees related to Google Checkout, content acquisition and other costs. Traffic acquisition costs as a percentage of advertising revenues may fluctuate in the future based on a number of factors, including:

- the relative growth rates of revenues from our web sites and from our Google Network members web sites.

- 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, including arrangements with guaranteed minimum payments.

- whether we are able to continue to improve the monetization of traffic on our web sites and our Google Network members web sites, particularly with those members to whom we have guaranteed minimum revenue share payments.

- whether we share with existing and new partners proportionately more of the aggregate advertising fees that we earn from paid clicks derived from search queries these partners direct to our web sites.

- the relative growth rates of expenses associated with distribution arrangements and the related revenues generated.

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, unaudited):

	Three Months Ended		
	March 31, 2007	**December 31, 2007 (unaudited)**	**March 31, 2008**
Research and development expenses	$ 408.4	$ 630.8	$ 673.1
Research and development expenses as a percentage of revenues	11.1%	13.1%	13.0%

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

Research and development expenses increased $42.3 million from the three months ended December 31, 2007 to the three months ended March 31, 2008. This increase was primarily due to an increase in stock-based compensation of $32.4 million. In addition, labor and facilities related costs increased $20.7 million as a result of a 13% increase in research and development headcount which also includes the increased headcount resulting from our acquisition of DoubleClick.

Research and development expenses increased $264.7 million from the three months ended March 31, 2007 to the three months ended March 31, 2008. This increase was primarily due to an increase in labor and facilities related costs of $149.2 million as a result of a 60% increase in research and development headcount. In addition, there was an increase in stock-based compensation expense of $73.0 million, an increase in fees for professional services of $22.7 million and an increase in depreciation and related expenses of $11.4 million due to our increased capital expenditures.

We anticipate that research and development expenses will increase in dollar amount and may increase as a percentage of revenues in 2008 and future periods because we expect to hire more research and development personnel and build the infrastructure required to support the development of new, and improve existing, products and services.

Sales and Marketing.

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

	Three Months Ended		
	March 31, 2007	December 31, 2007 (unaudited)	March 31, 2008
Sales and marketing expenses	$ 302.6	$ 422.3	$ 446.9
Sales and marketing expenses as a percentage of revenues	8.3%	8.8%	8.6%

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

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Sales and marketing expenses increased $24.6 million from the three months ended December 31, 2007 to the three months ended March 31, 2008. This increase was primarily due to an increase in labor and facilities related costs of $29.4 million mostly as a result of a 16% increase in sales and marketing headcount which also includes the increased headcount resulting from our acquisition of DoubleClick. This increase was partially offset by a decrease in advertising and promotional activities.

Sales and marketing expenses increased $144.3 million from the three months ended March 31, 2007 to the three months ended March 31, 2008. This increase was primarily due to an increase in labor and facilities related costs of $106.3 million mostly as a result of a 54% increase in sales and marketing headcount, as well as an increase in stock-based compensation expense of $15.3 million.

We anticipate sales and marketing expenses will continue to increase in dollar amount and may increase as a percentage of revenues in 2008 and future periods as we continue to expand our business on a worldwide basis. A significant portion of these increases relate to our plan to hire additional personnel and increase advertising and promotional expenditures to increase the level of service we provide to our advertisers and Google Network members. We also plan to add more international sales personnel to support our worldwide expansion.

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, unaudited):

	Three Months Ended		
	March 31, 2007	December 31, 2007 (unaudited)	March 31, 2008
General and administrative expenses	$ 261.4	$ 377.0	$ 409.3
General and administrative expenses as a percentage of revenues	7.2%	7.8%	7.9%

General and administrative expenses consist primarily of compensation and related costs for personnel and facilities related to our finance, human resources, facilities, information technology and legal organizations, and fees for professional services. Professional services are principally comprised of outside legal, audit, information technology consulting and outsourcing services.

General and administrative expenses increased $32.3 million from the three months ended December 31, 2007 to the three months ended March 31, 2008, primarily due to an increase in bad debt expense of $21.2 million as a result of increased risk in this area. In addition, there was an increase in fees for professional services of $14.7 million.

General and administrative expenses increased $147.9 million from the three months ended March 31, 2007 to the three months ended March 31, 2008. This increase was primarily due to an increase in labor and facilities related costs of $47.2 million primarily as a result of a 59% increase in headcount. In addition, there was an increase in fees for professional services of $40.3 million and an increase in depreciation related expense of $10.5 million.

As we expand our business and incur additional expenses, we believe general and administrative expenses will increase in dollar amount and may increase as a percentage of revenues in 2008 and future periods.

Stock-Based Compensation.

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

	Three Months Ended		
	March 31, 2007	December 31, 2007 (unaudited)	March 31, 2008
Stock-based compensation	$ 183.9	$ 245.3	$ 280.8

Stock-based compensation as a percentage of revenues	5.0%	5.1%	5.4%

Stock-based compensation increased $35.5 million from the three months ended December 31, 2007 to the three months ended March 31, 2008, and $96.9 million from the three months ended March 31, 2007 to the three months ended March 31, 2008. These increases were primarily due to additional stock awards issued to existing and new employees.

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We expect stock-based compensation to be approximately $1.1 billion in 2008 and $1.9 billion thereafter. These amounts do not include stock-based compensation related to stock awards that have been and may be granted to employees and directors subsequent to March 31, 2008 and stock awards that have been or may be granted to non-employees. 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. We currently anticipate that dilution related to all equity grants to employees will be at or below 2% this year.

Interest Income and Other, Net

Interest income and other of $167.3 million in the three months ended March 31, 2008 primarily consisted of $122.0 million of interest income earned on our cash, cash equivalents and marketable securities balances. In addition, we recognized $46.6 million of realized gains on sales of marketable securities.

Interest income and other of $130.7 million in the three months ended March 31, 2007 primarily consisted of $130.5 million of interest income earned on our cash, cash equivalents and marketable securities balances.

Provision for Income Taxes

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

	Three Months Ended		
	March 31, 2007	December 31, 2007 (unaudited)	March 31, 2008
Provision for income taxes	$ 349.8	$ 401.6	$ 406.5
Effective tax rate	25.9%	25.0%	23.7%

Our effective tax rate decreased from the three months ended December 31, 2007 to the three months ended March 31, 2008, primarily as a result of proportionately more of our annual earnings expected to be realized in countries where we have lower statutory tax rates in 2008 compared to 2007.

Our provision for income taxes increased from the three months ended March 31, 2007 to the three months ended March 31, 2008, primarily as a result of increases in federal and state income taxes, driven by higher taxable income period over period. Our effective tax rate decreased from the three months ended March 31, 2007 to the three months ended March 31, 2008, primarily as a result of proportionately more of our annual earnings expected to be realized in countries where we have lower statutory tax rates in 2008 compared to 2007.

Our effective tax rate could fluctuate significantly on a quarterly basis and could be adversely affected to the extent earnings are lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Liquidity and Capital Resources

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

	Three Months Ended March 31,	
	2007	2008
	(unaudited)	
Net cash provided by operating activities	$ 1,219.6	$ 1,779.4
Net cash used in investing activities	(777.1)	(1,407.0)

Net cash provided by financing activities	88.5	28.7

At March 31, 2008, we had $12.1 billion of cash, cash equivalents and marketable securities. Cash equivalents and marketable securities are comprised of debt instruments of the U.S. government and its agencies, municipalities in the U.S., time deposits as well as U.S. corporate securities. Marketable securities also include auction rate securities (ARS) of $259.6 million. The related auctions began to fail in February 2008. As a result, these securities are currently illiquid. Note 3 of Notes to Consolidated Financial Statements included as part of this report provides further discussion on ARS and the composition of our cash, cash equivalents and marketable securities.

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Our principal sources of liquidity are our cash, cash equivalents and marketable securities, as well as the cash flow that we generate from our operations. At December 31, 2007 and March 31, 2008, we had unused letters of credit for approximately $20.4 million and $54.8 million. We believe that our existing cash, cash equivalents, marketable securities and cash generated from operations 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.

Cash provided by operating activities consisted of net income adjusted for certain non-cash items including depreciation, amortization, in-process research and development, stock-based compensation, excess tax benefits from stock-based award activity, and the effect of changes in working capital and other activities. Cash provided by operating activities in the three months ended March 31, 2008 was $1,779.4 million and consisted of net income of $1,307.1 million, adjustments for non-cash items of $483.1 million and cash used in working capital and other activities of $10.8 million. Adjustments for non-cash items primarily consisted of $280.8 million of stock-based compensation, $280.6 million of depreciation and amortization expense on property and equipment and $56.0 million of amortization of intangibles and other, partially offset by $51.1 million of excess tax benefits from stock-based award activity. In addition, changes in working capital activities primarily consisted of a decrease of $234.3 million in accrued expenses and other liabilities primarily as a result of employee bonuses for the year ended December 31, 2007 paid in the first quarter of 2008, and an increase of $223.5 million in accounts receivable due to the growth in fees billed to our advertisers and an increase of $41.6 million in prepaid revenue share, expenses and other assets, partially offset by a net increase in income taxes payable and deferred income taxes of $438.2 million (which includes the same $51.1 million of excess tax benefits from stock-based awards included under adjustments for non-cash items) and to a lesser extent by an increase in accounts payable of $53.8 million. The increase in income taxes payable and deferred income taxes was primarily a result of additional tax obligations accrued, as well as less estimated income taxes paid, in the first quarter of 2008 compared to the fourth quarter of 2007.

Cash provided by operating activities in the three months ended March 31, 2007 was $1,219.6 million and consisted of net income of $1,002.2 million, adjustments for non-cash items of $247.0 million and cash used in working capital and other activities of $29.6 million. Adjustments for non-cash items primarily consisted of $183.9 million of stock-based compensation and $170.3 million of depreciation expense on property and equipment, partially offset by $74.1 million of excess tax benefits from stock-based award activity. In addition, working capital activities primarily consisted of an increase of $185.5 million in prepaid revenue share, expenses and other assets, an increase of $153.6 million in accounts receivable due to the growth in fees billed to our advertisers, a decrease of $169.1 million in accrued expenses and other liabilities and accounts payable primarily as a result of employee bonuses for the year ended December 31, 2006 paid in the first quarter of 2007, partially offset by a net increase in income taxes payable and deferred income taxes of $399.1 million which includes the same $74.1 million of excess tax benefits from stock-based award included under adjustments for non-cash items. The increase in income taxes payable and deferred income taxes was primarily a result of additional tax obligations accrued, as well as less estimated income taxes paid, in the first quarter of 2007 compared to the fourth quarter of 2006.

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. In addition, since we have become a public company our cash-based compensation per employee has increased and will likely continue to increase in order to attract and retain employees.

Cash used in investing activities in the three months ended March 31, 2008 of $1,407.0 million was attributable to cash consideration used in acquisitions of $3,125.1 million, primarily related to the DoubleClick acquisition and capital expenditures of $841.6 million, partially offset by net proceeds received from the sales and maturities of marketable securities of $2,559.7 million. Cash used in investing activities in the three months ended March 31, 2007 of $777.1 million was attributable to net purchases of marketable securities of $145.8 million, capital expenditures of $596.9 million and cash consideration used in acquisitions and other investments of $34.4 million. Capital expenditures are mainly for the purchase of information technology assets. 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 will continue to invest heavily in data center operations, technology, corporate facilities and information technology infrastructure in 2008 and thereafter.

In addition, we expect to spend a significant amount of cash on acquisitions and other investments from time to time. These acquisitions generally enhance the breadth and depth of our expertise in engineering and other functional areas, our technologies and our product offerings. In connection with certain acquisitions, we are obligated to make additional cash payments if certain criteria are met. As of March 31, 2008, our remaining contingent obligations related to these acquisitions was approximately $591 million. Since these contingent payments are based on the achievement of performance targets, actual payments may be substantially lower. In May 2008, Clearwire Corporation and Sprint Nextel Corporation agreed to combine certain businesses to form a wireless communication company,

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the new Clearwire. In addition, certain other companies have collectively agreed to contribute $3.2 billion in cash to the new Clearwire or its subsidiary, including $500 million from us. The completion of this transaction is subject to customary closing conditions. We expect the transaction to close during the second half of 2008.

Also, as part of our philanthropic program, we expect to make donations as well as investments in for-profit enterprises that aim to alleviate poverty, improve the environment or achieve other socially or economically progressive objectives. We expect these payments to be made primarily in cash. We have authorized up to $175 million of such payments over the three years ending December 31, 2008, with any unallocated amounts to be rolled over into the following year. The majority of this authorized amount has not been spent or committed.

Cash provided by financing activities in the three months ended March 31, 2008 of $28.7 million was primarily due to excess tax benefits of $51.1 million from stock-based award activities during the period which represents a portion of the $70.3 million reduction to income taxes payable that we recorded in the first quarter of 2008 related to the total direct tax benefit realized from the exercise, sale or vesting of these awards, as well as net payments related to stock-based award activity of $22.4 million. Net payments result when the tax withholding payments we make on behalf of our employees upon the net settlement of their vested restricted stock units exceeds the cash we receive upon the exercise of stock options. Cash provided by financing activities in the three months ended March 31, 2007 of $88.5 million was primarily due to excess tax benefits of $74.1 million from stock-based award activity during the period which represents a portion of the $107.1 million reduction to income taxes payable that we recorded in the first quarter of 2007 related to the total direct tax benefit realized from the exercise, sale or vesting of these awards. In addition, we received net proceeds from the issuance of common stock pursuant to stock-based award activity of $14.4 million.

Contractual Obligations

We are obligated under certain agreements to make non-cancelable guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. At March 31, 2008, our aggregate outstanding non-cancelable guaranteed minimum revenue share commitments totaled $1,598.7 million through 2012 compared to $1,746.4 million at December 31, 2007.

In addition, as of a result of having adopted FIN 48 (discussed below under Income Taxes) in January 2007, we increased long-term taxes payable by $400.4 million in the year ended December 31, 2007 as FIN 48 specifies that tax positions for which the timing of the ultimate resolution is uncertain should be recognized as long-term liabilities. We also recognized additional long-term taxes payable of $140.3 million in the quarter ended March 31, 2008. 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 accounting principles generally accepted in the U.S. 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. Effective January 1, 2007, we adopted Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

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

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closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

Our effective tax rates have differed from the statutory rate primarily due to the tax impact of foreign operations, research and experimentation tax credits, state taxes, and certain benefits realized related to stock option activity. The effective tax rate was 25.0% and 23.7% for the three months ended December 31, 2007 and March 31, 2008, respectively. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets or liabilities, or by changes in tax laws, regulations, accounting principles, or interpretations thereof. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service 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.

Stock-Based Compensation

We account for stock-based compensation in accordance with SFAS 123R. Under the provisions of SFAS 123R, stock-based compensation cost is estimated at the grant date based on the award s fair value as calculated by the Black-Scholes-Merton (BSM) option-pricing model and is recognized as expense over the requisite service period. The BSM model requires various highly judgmental assumptions including volatility, forfeiture rates and expected option life. If any of the assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

Traffic Acquisition Costs

We are obligated under certain agreements to make non-cancelable guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. To the extent we expect revenues generated under such an arrangement to exceed the guaranteed minimum revenue share payments, we recognize traffic acquisition costs on a contractual revenue share basis or on a basis proportionate to forecasted revenues, whichever is greater; if our estimate of revenues under such an arrangement is subsequently revised downward, then the amount of traffic acquisition costs we would recognize thereafter would be proportionately greater. Otherwise, we recognize the guaranteed revenue share payments as traffic acquisition costs on a straight-line basis over the term of the related agreements.

Effect of Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. This statement is effective for us beginning January 1, 2009. We are currently evaluating the potential impact of the adoption of SFAS 141R on our consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51* (SFAS 160). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. This statement is effective for us beginning January 1, 2009. We are currently evaluating the potential impact of the adoption of SFAS 160 on our consolidated financial position, results of operations and cash flows.

In February 2008, the FASB issued Financial Staff Positions (FSP) FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS 157-2), which delays the effective date of SFAS No. 157, *Fair Value Measurement* (SFAS 157), for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). SFAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. FSP FAS 157-2 partially defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. FSP FAS 157-2 is effective for us beginning January 1,

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2009. We are currently evaluating the potential impact of the adoption of those provisions of SFAS 157, for which effectiveness was delayed by FSP SFAS 157-2, on our consolidated financial position and results of operations.

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 Exchange Risk

Economic Exposure

We transact business in various foreign currencies and have significant international revenues as well as costs denominated in foreign currencies, subjecting us to foreign currency risk. We purchase foreign exchange forward and option contracts to reduce the volatility of cash flows primarily related to forecasted revenue denominated in certain foreign currencies. The objective of the foreign exchange contracts is to better ensure that the U.S. dollar-equivalent cash flows are not adversely affected by changes in the U.S. dollar/foreign currency exchange rate. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedge Activities* (SFAS 133), these contracts are designated as cash flow hedges. The gain or loss on the effective portion of a cash flow hedge is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into earnings when the hedged exposure affects earnings or when the hedged transaction is no longer probable of occurring. The gain or loss on the ineffective portion, if any, of a hedge is recognized in earnings immediately. At March 31, 2008, the notional principal and fair value of foreign exchange contracts to purchase U.S. dollars with Canadian dollars were 154.5 million Canadian dollars (or approximately $151.4 million) and $3.0 million. These foreign exchange forward contracts and options have maturities of 18 months or less. There are no other foreign exchange contracts designated as cash flow hedges, however, we may enter into similar contracts in other foreign currencies in the future. The net gains or losses on the effective and ineffective portions of these cash flow hedges were not material at March 31, 2008 and in the quarter ended March 31, 2008.

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that adverse changes in exchange rates of 10% for our foreign currencies instruments could be experienced in the near term. These changes would have resulted in a decrease of $4.0 million in the fair values of our foreign currency instruments designated as cash flow hedges.

Transaction Exposure

Our exposure to foreign currency transaction gains and losses is the result of certain net receivables due from our foreign subsidiaries and customers being denominated in currencies other than the U.S. dollar, primarily the British pound, the Euro, the Canadian dollar and the Japanese yen. Our foreign subsidiaries conduct their businesses in local currency. We have entered into foreign exchange contracts to offset the foreign exchange risk on certain monetary assets and liabilities denominated in currencies other than the local currency of the subsidiary. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $1.5 billion and $2.3 billion at December 31, 2007 and March 31, 2008. The notional principal of foreign exchange contracts to purchase Euros with other currencies was 296.5 million (or approximately $433.4 million) and 411.4 million (or approximately $651.1 million) at December 31, 2007 and March 31, 2008. The notional principal of foreign exchange contracts to sell Euros for Taiwanese dollars was 18.7 million (or approximately $29.6 million) at March 31, 2008.

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that adverse changes in exchange rates of 10% 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 $39.7 million and $14.7 million at December 31, 2007 and March 31, 2008. The adverse impact at December 31, 2007 and March 31, 2008 is after consideration of the offsetting effect of approximately $163.7 million and $244.2 million from forward exchange contracts in place for the months of December 2007 and March 2008. These reasonably possible adverse changes in exchange rates of 10% were applied to total monetary assets 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 taxes in the near term.

Interest Rate Risk

We invest in a variety of securities, consisting primarily of investments in interest-bearing demand deposit accounts with financial institutions, tax-exempt money market funds and debt securities of corporations and municipalities. By policy, we limit the amount of credit exposure to any one issuer.

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

We considered the historical volatility of short term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term. A hypothetical 1.00% (100 basis-point) increase in interest rates would have resulted in a decrease in the fair values of our marketable securities of approximately $86.7 million and $74.2 million at December 31, 2007 and March 31, 2008.

ITEM 4. CONTROLS AND PROCEDURES

(a) 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 of the end of the period covered by this Quarterly Report on Form 10-Q. 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.

Based on our evaluation, our chief executive officer and chief financial officer concluded that 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 Securities and Exchange Commission 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.

(b) Changes in internal control over financial reporting.

We regularly review our system of internal control over financial reporting to ensure we maintain an effective internal control environment. As we grow geographically and with new product offerings, we continue to create new processes and controls as well as improve our existing environment to increase efficiencies. Improvements may include such activities as implementing new, more efficient systems, consolidating activities, and migrating processes.

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in a variety of claims, suits, investigations and proceedings arising from the ordinary course of our business, including actions with respect to intellectual property claims, breach of contract claims, labor and employment claims, tax and other matters. Although claims, suits, investigations and proceedings are inherently uncertain and their results cannot be predicted with certainty, we believe that the resolution of our current pending matters will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flow. Regardless of the outcome, litigation can have an adverse impact on us because of defense costs, diversion of management resources and other factors. In addition, it is possible that an unfavorable resolution of one or more such proceedings could in the future materially and adversely affect our financial position, results of operations or cash flows in a particular period. See the risk factors *We are, and may in the future be, subject to intellectual property rights claims, which are costly to defend, could require us to pay damages and could limit our ability to use certain technologies in the future* and *Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our products, services and brand* in the Risks Related to Our Business and Industry section of Item 1A of this Quarterly Report on Form 10-Q.

ITEM 1A. RISK FACTORS

Risks Related to Our Business and Industry

We face significant competition from Microsoft and Yahoo.

We face formidable competition in every aspect of our business, and particularly from other companies that seek to connect people with information on the web and provide them with relevant advertising. Currently, we consider our primary competitors to be Microsoft Corporation and Yahoo! Inc. Microsoft has developed features that make web search a more integrated part of its Windows operating system and other desktop software products. We expect that Microsoft will increasingly use its financial and engineering resources to compete with us. Microsoft has more employees and cash resources than we do. Also, both Microsoft and Yahoo have longer operating histories and more established relationships with customers and end users. They can use their experience and resources against us in a variety of competitive ways, including by making acquisitions, investing more aggressively in research and development and competing more aggressively for advertisers and web sites. Microsoft and Yahoo also may have a greater ability to attract and retain users than we do because they operate internet portals with a broad range of content products and services. If Microsoft or Yahoo are successful in providing similar or better web search results or more relevant advertisements, or in leveraging their platforms or products to make their web search or advertising services easier to access, we could experience a significant decline in user traffic or the size of the Google Network. Any such decline could negatively affect our revenues.

We face competition from other internet companies, including web search providers, internet access providers, internet advertising companies and destination web sites.

In addition to Microsoft and Yahoo, we face competition from other web search providers, including start-ups as well as developed companies that are enhancing or developing search technologies. We compete with internet advertising companies, particularly in the areas of pay-for-performance and keyword-targeted internet advertising. Also, we may compete with companies that sell products and services online because these companies, like us, are trying to attract users to their web sites to search for information about products and services. We also provide a number of online products and services, including Google Checkout, YouTube and our communications tools such as Google Docs, that compete directly with new and established companies that offer communication, information and entertainment services integrated into their products or media properties.

We also compete with web sites that provide their own or user-generated content and provide advertising to their users. These destination web sites include those operated by internet access providers, such as cable and DSL service providers. Because our users need to access our services through internet access providers, they have direct relationships with these providers. If an access provider or a computer or computing device manufacturer offers online services that compete with ours, the user may find it more convenient to use the services of the access provider or manufacturer. In addition, the access provider or manufacturer may make it hard to access our services by not listing them in the access provider s or manufacturer s own menu of offerings, or may charge users to access our web sites or the web sites of our Google Network members. Also, because the access provider gathers information from the user in connection with the establishment of a billing relationship, the access provider may be more effective than we are in tailoring services and advertisements to the specific tastes of the user.

There has been a trend toward industry consolidation among our competitors, and so smaller competitors today may become larger competitors in the future. If our competitors are more successful than we are at generating traffic, our revenues may decline.

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We face competition from traditional media companies, and we may not be included in the advertising budgets of large advertisers, which could harm our operating results.

In addition to internet companies, we face competition from companies that offer traditional media advertising opportunities. Most large advertisers have fixed advertising budgets, a small portion of which is allocated to internet advertising. We expect that large advertisers will continue to focus most of their advertising efforts on traditional media. If we fail to convince these companies to spend a portion of their advertising budgets with us, or if our existing advertisers reduce the amount they spend on our programs, our operating results would be harmed.

We expect our revenue growth rate to decline and anticipate downward pressure on our operating margin in the future.

We expect that our revenue growth rate will decline over time and anticipate that there will be downward pressure on our operating margin. We believe our revenue growth rate will generally decline as a result of increasing competition and the inevitable decline in growth rates as our revenues increase to higher levels. We believe our operating margin will experience downward pressure as a result of increasing competition and increased expenditures for many aspects of our business. Our operating margin will also experience downward pressure if a greater percentage of our revenues comes from ads placed on our Google Network members sites compared to revenues generated through ads placed on our own sites or if we spend a proportionately larger amount to promote the distribution of certain products, including Google Toolbar. The margin on revenue we generate from our Google Network members is significantly less than the margin on revenue we generate from advertising on our web sites. Additionally, the margin we earn on revenue 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.

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 Item 1A and the following factors may affect our operating results:

- Our ability to continue to attract users to our web sites.
- Our ability to monetize (or generate revenue from) traffic on our web sites and our Google Network members web sites.
- Our ability to attract advertisers to our AdWords program.
- Our ability to attract web sites to our AdSense program.
- The mix in our revenues between those generated on our web sites and those generated through our Google Network.
- The amount and timing of operating costs 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.

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

Our ability to achieve revenue goals for partners to whom we guarantee minimum payments or pay distribution fees.

Our ability to generate revenue from services in which we have invested considerable time and resources, such as YouTube, Gmail, orkut and Google Checkout.

Because our business is changing and evolving, our historical operating results may not be useful to you in predicting our future operating results. In addition, advertising spending has historically been cyclical in nature, reflecting overall economic conditions as well as budgeting and buying patterns. For example, in 1999, advertisers spent heavily on internet advertising. This was followed by a lengthy downturn in ad spending on the web. Also, user traffic tends to be seasonal. Our rapid growth has tended to mask the cyclicality and seasonality of our business. As our growth rate has slowed, the cyclicality and seasonality in our business has become more pronounced and caused our operating results to fluctuate.

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

Our success depends on providing products and services that make using the internet a more useful and enjoyable experience for our users. Our competitors are constantly developing innovations in web search, online advertising and web based products and services. As a result, we must continue to invest significant resources in research and development in order to enhance our web search

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technology and our existing products and services and introduce new products and services that people can easily and effectively use. If we are unable to provide quality products and services, then our users may become dissatisfied and move to a competitor s products and services. Our operating results would also suffer if our innovations are not responsive to the needs of our users, advertisers and Google Network members, are not appropriately timed with market opportunities or are not effectively brought to market. As search technology continues to develop, our competitors may be able to offer search results that are, or that are seen to be, substantially similar to or better than ours. This may force us to compete in different ways and expend significant resources in order to remain competitive.

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

We generated 99% of our revenues in 2007 and 98% of our revenues for the first three months of 2008 from our advertisers. Our advertisers can generally terminate their contracts with us at any time. Advertisers will not continue to do business with us if their investment in advertising with us does not generate sales leads, and ultimately customers, or if we do not deliver their advertisements in an appropriate and effective manner. If we are unable to remain competitive and provide value to our advertisers, they may stop placing ads with us, which would negatively harm our revenues and business. In addition, expenditures by advertisers tend to be cyclical, reflecting overall economic conditions and budgeting and buying patterns. Any decreases in or delays in advertising spending due to general economic conditions could reduce our revenues or negatively impact our ability to grow our revenues.

We rely on our Google Network members for a significant portion of our revenues, and we benefit from our association with them. The loss of these members could adversely affect our business.

We provide advertising, web search and other services to members of our Google Network, which accounted for 35% of our revenues in 2007 and 32% of our revenues in the three months ended March 31, 2008. Some of the participants in this network may compete with us in one or more areas. They may decide in the future to terminate their agreements with us. If our Google Network members decide to use a competitor s or their own web search or advertising services, our revenues would decline. Our agreements with a few of the largest Google Network members account for a significant portion of revenues derived from our AdSense program. If our relationship with one or more large Google Network members were terminated or renegotiated on terms less favorable to us, our business could be adversely affected.

Also, certain of our key network members operate high-profile web sites, and we derive tangible and intangible benefits from this affiliation. If one or more of these key relationships is terminated or not renewed, and is not replaced with a comparable relationship, our business would be adversely affected.

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

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

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 and Google Network members.

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. If we fail to maintain and enhance the Google brand, or if we incur excessive expenses in this effort, our business, operating results and financial condition will be materially and adversely affected. Maintaining and enhancing our brand will depend largely on our ability to be a technology leader and continue to provide high-quality products and services, which we may not do successfully.

Acquisitions could result in operating difficulties, dilution and other harmful consequences.

We do not have a great deal of experience acquiring companies, and the companies we have acquired have typically been small. However, recently, we have closed a number of larger acquisitions, including our acquisitions of DoubleClick, Postini and YouTube, and are in the process of integrating these businesses into our own. We also expect to continue to evaluate and enter into discussions

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regarding a wide array of potential strategic transactions. These transactions could be material to our financial condition and results of operations. The process of integrating an acquired company, business or technology has created, and will continue to create unforeseen operating difficulties and expenditures. The areas where we face risks include:

- Implementation or remediation of controls, procedures and policies at the acquired company.
- Diversion of management time and focus from operating our business to acquisition integration challenges.
- Coordination of product, engineering and sales and marketing functions.
- Cultural challenges associated with integrating employees from the acquired company into our organization.
- Retention of employees from the businesses we acquire.
- Integration of the acquired company s accounting, management information, human resource and other administrative systems.
- Liability for activities of the acquired company before the acquisition, including violations of laws, commercial disputes, tax liabilities and other known and unknown liabilities.

In addition, foreign acquisitions involve unique risks in addition to those mentioned above, including those related to integration of operations across different cultures and languages, currency risks and the particular economic, political and regulatory risks associated with specific countries.

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

Future acquisitions or dispositions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses, or write-offs of goodwill, any of which could harm our financial condition. Future acquisitions may require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all. Also, the anticipated benefit of many of our acquisitions may not materialize. For example, we have yet to realize significant revenue benefits from our acquisitions of dMarc Broadcasting (Audio Ads), YouTube or Postini.

Our international operations are subject to increased risks which could harm our business, operating results and financial condition.

International revenues accounted for approximately 51% of our total revenues in the first three months of 2008, and more than half of our user traffic came from outside the U.S. during this period. We have limited experience with operations outside the U.S. and our ability to manage our business and conduct our operations internationally requires considerable management attention and resources and is subject to a number of risks, including the following:

- Challenges caused by distance, language and cultural differences and by doing business with foreign agencies and governments.
- Difficulties in developing products and services in different languages and for different cultures.

Longer payment cycles in some countries.

Credit risk and higher levels of payment fraud.

Currency exchange rate fluctuations.

Foreign exchange controls that might prevent us from repatriating cash earned in countries outside the U.S.

Import and export requirements that may prevent us from shipping products or providing services to a particular market and may increase our operating costs.

Political and economic instability.

Potentially adverse tax consequences.

Higher costs associated with doing business internationally.

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

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity and teamwork fostered by our culture, and our business may be harmed.

We believe that a critical contributor to our success has been our corporate culture, which we believe 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 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 and services. 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. Any significant impairment of our intellectual property rights could harm our business or 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.

Although we seek to obtain patent protection for our innovations, it is possible we may not be able to protect some of these innovations. In addition, given the costs of obtaining patent protection, we may choose not to protect 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 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.

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

We are, and may in the future be, subject to intellectual property rights claims, which are costly to defend, could require us to pay damages and could limit our ability to use certain technologies in the future.

Companies in the internet, technology and media industries 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. As we have grown, the intellectual property rights claims against us have increased. Our products, services and technologies may not be able to withstand any third-party claims and regardless of the merits of the claim, intellectual property claims are often time-consuming and expensive to litigate or settle. In addition, to the extent claims against us are successful, we may have to pay substantial monetary damages or discontinue any of our services or practices that are found to be in violation of another party s rights. We also may have to seek a license to continue such practices, which may significantly increase our operating expenses. In addition, many of our agreements with members of our Google Network and other partners require us to indemnify these members for certain third-party intellectual property infringement claims, which would increase our costs as a result of defending such claims and may require that we pay damages if there were an adverse ruling in any such claims.

Companies have filed trademark infringement and related claims against us over the display of ads in response to user queries that include trademark terms. The outcomes of these lawsuits have differed from jurisdiction to jurisdiction. Courts in France have held us liable for allowing advertisers to select certain trademarked terms as keywords. We are appealing those decisions. We were also subject to two lawsuits in Germany on similar matters where the courts held that we are not liable for the actions of our advertisers prior to notification of trademark rights. We are litigating or have recently litigated similar issues in other cases in the U.S., Australia, Austria, Brazil, China, France, Germany, Israel and Italy.

We have also had copyright claims filed against us alleging that features of certain of our products and services, including Google Web Search, Google News, Google Video, Google Image Search, Google Book Search and YouTube, infringe another party s rights. Adverse results in these lawsuits may include awards of substantial monetary damages, costly royalty or licensing agreements or orders preventing us from offering certain functionalities, and may also result in a change in our business practices, which could

result in a loss of revenue for us or otherwise harm our business. In addition, any time one of our products or services links to or hosts material in which others allegedly own copyrights, we face the risk of being sued for copyright infringement or related claims. Because these products and services comprise the majority of our products and services, the risk of harm from such lawsuits could be substantial.

We have also experienced an increase in patent lawsuits filed against us alleging that certain of our products and services, including Google Web Search, Google AdWords, and Google AdSense, infringe another party s patents. Adverse results in these lawsuits may include awards of substantial monetary damages, obligations to pay licensing fees and/or orders preventing us from offering certain features, functionalities, products or services, which could result in a loss of revenue for us or otherwise harm our business.

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

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

In addition, as nearly all of our products and services are web based, the amount of data we store for our users on our servers (including personal information) has been increasing. Any systems failure or compromise of our security that results in the release of our users data could seriously limit the adoption of our products and services as well as harm our reputation and brand and, therefore, our business. We may also need 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 as well as increase the number of countries where we operate.

A number of legislative proposals pending before the U.S. Congress, various state legislative bodies and foreign governments concern data protection. In addition, the interpretation and application of data protection laws in Europe and elsewhere are still uncertain and in flux. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could have an adverse effect on our business. 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.

Our business is subject to a variety of U.S. and foreign laws that could subject us to claims or otherwise harm our business.

We are subject to a variety of laws in the U.S. and abroad that are costly to comply with, can result in negative publicity and diversion of management time and effort, and can subject us to claims or other remedies. 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 been threatened and filed under both U.S. and foreign law for defamation, libel, slander, invasion of privacy and other tort claims, unlawful activity, 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.

In addition, the Digital Millennium Copyright Act has provisions that limit, but do not necessarily eliminate, our liability for listing or linking to third-party web sites that include materials that infringe copyrights or other rights, so long as we comply with the statutory requirements of this act. The Child Online Protection Act and the Children s Online Privacy Protection Act 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.

Any failure on our part to comply with these laws and regulations may subject us to additional liabilities.

We compete internationally with local information providers and with U.S. competitors who are currently more successful than we are in various markets, and if we fail to compete effectively in international markets, our business will be harmed.

We face different market characteristics and competition outside the U.S. In certain markets, other web search, advertising services and internet companies have greater brand recognition, more users and more search traffic than we have. Even in countries where we have a significant user following, we may not be as successful in generating advertising revenue due to slower market development, our inability to provide attractive local advertising services or other factors. In order to compete, we need to improve our brand recognition and our selling efforts internationally and build stronger relationships with advertisers. We also need to better

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understand our international users and their preferences. If we fail to do so, our global expansion efforts may be more costly and less profitable than we expect.

Our business may be adversely affected by malicious applications that interfere with, or exploit security flaws in, our products and services.

Our business may be adversely affected by malicious applications that make changes to our users computers and interfere with the Google experience. These applications have in the past attempted, and may in the future attempt, to change our users internet experience, including hijacking queries to Google.com, altering or replacing Google search results, or otherwise interfering with our ability to connect with our users. The interference often occurs without disclosure to or consent from users, resulting in a negative experience that users may associate with Google. These applications may be difficult or impossible to uninstall or disable, may reinstall themselves and may circumvent other applications efforts to block or remove them. In addition, we offer a number of products and services that our users download to their computers or that they rely on to store information and transmit information to others over the internet. These products and services are subject to attack by viruses, worms and other malicious software programs, which could jeopardize the security of information stored in a user s computer or in our computer systems and networks. The ability to reach users and provide them with a superior experience is critical to our success. If our efforts to combat these malicious applications are unsuccessful, or if our products and services have actual or perceived vulnerabilities, our reputation may be harmed and our user traffic could decline, which would damage our business.

Proprietary document formats may limit the effectiveness of our search technology by preventing our technology from accessing the content of documents in such formats, which could limit the effectiveness of our products and services.

A large amount of information on the internet is provided in proprietary document formats such as Microsoft Word. The providers of the software application used to create these documents could engineer the document format to prevent or interfere with our ability to access the document contents with our search technology. This would mean that the document contents would not be included in our search results even if the contents were directly relevant to a search. The software providers may also seek to require us to pay them royalties in exchange for giving us the ability to search documents in their format. If the software provider also competes with us in the search business, they may give their search technology a preferential ability to search documents in their proprietary format. Any of these results could harm our brand and our operating results.

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

Technologies may be developed that can block the display of our ads. Most of our revenues are derived from fees paid to us by advertisers in connection with the display of ads on web pages. As a result, ad-blocking technology could, in the future, adversely affect our operating results.

If we fail to detect click fraud or other invalid clicks, we could face additional litigation as well as lose the confidence of our advertisers, which would cause our business to suffer.

We are exposed to the risk of fraudulent clicks and other invalid clicks on our ads from a variety of potential sources. We have regularly refunded fees that our advertisers have paid to us that were later attributed to click fraud and other invalid clicks, and we expect to do so in the future. Invalid clicks are clicks that we have determined are not intended by the user to link to the underlying content, such as inadvertent clicks on the same ad twice and clicks resulting from click fraud. Click fraud occurs when a user intentionally clicks on a Google AdWords ad displayed on a web site for a reason other than to view the underlying content. If we are unable to stop these invalid clicks, these refunds may increase. If we find new evidence of past invalid clicks we may issue refunds retroactively of amounts previously paid to our Google Network members. This would negatively affect our profitability, and these invalid clicks could hurt our brand. If invalid clicks are not detected, the affected advertisers may experience a reduced return on their investment in our advertising programs because the invalid clicks will not lead to potential revenue for the advertisers. This could lead the advertisers to become dissatisfied with our advertising programs, which has led to litigation alleging click fraud and could lead to further litigation, as well as to a loss of advertisers and revenues.

Index spammers could harm the integrity of our web search results, which could damage our reputation and cause our users to be dissatisfied with our products and services.

There is an ongoing and increasing effort by index spammers to develop ways to manipulate our web search results. For example, because our web search technology ranks a web page s relevance based in part on the importance of the web sites that link to it, people have attempted to link a group of web sites together to manipulate web search results. We take this problem very seriously because providing relevant information to users is critical to our success. If our efforts to combat these and other types of index spamming are unsuccessful, our reputation for delivering relevant information could be diminished. This could result in a decline in user traffic, which would damage our business.

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If we were to lose the services of Eric, Larry, Sergey or other members of our senior management team, 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, our CEO, Eric Schmidt, and our founders, Larry Page and Sergey Brin, are critical to the overall management of Google as well as the development of our technology, our culture and 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 any of our management or key personnel could seriously harm our business.

We rely on highly skilled personnel and, if we are unable to retain or motivate key personnel or hire qualified personnel, 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. Our continued ability to compete effectively depends on our ability to attract new employees and to retain and motivate our existing employees.

We have in the past maintained a rigorous, highly selective and time-consuming hiring process. We believe that our approach to hiring has significantly contributed to our success to date. As we grow, our hiring process may prevent us from hiring the personnel we need in a timely manner. In addition, as we become a more mature company, we may find our recruiting efforts more challenging. The incentives to attract, retain and motivate employees provided by our equity award grants may not be as effective as in the past. In addition, our other current and future compensation arrangements, which include cash bonuses and our TSO program, may not be successful in attracting new employees and retaining and motivating our existing employees. If we do not succeed in attracting excellent personnel or retaining or motivating existing personnel, we may be unable to grow effectively.

We have a short operating history and a relatively new business model in an emerging and rapidly evolving market. This makes it difficult to evaluate our future prospects and may increase the risk that we will not continue to be successful.

We first derived revenue from our online search business in 1999 and from our advertising services in 2000, and we have only a short operating history with our cost-per-click advertising model, which we launched in 2002 and our cost-per-impression advertising model which we launched in the second quarter of 2005. As a result, we have little operating history to aid in assessing our future prospects. Also, we derive nearly all of our revenues from online advertising, which is an immature industry that has undergone rapid and dramatic changes in its short history. We will encounter risks and difficulties as a company operating in a new and rapidly evolving market. We may not be able to successfully address these risks and difficulties, which could materially harm our business and operating results.

More individuals are using non-PC devices to access the internet. If users of these devices do not widely adopt versions of our web search technology developed for these devices, our business could be adversely affected.

The number of people who access the internet through devices other than personal computers, including mobile telephones, personal digital assistants (PDAs), smart phones and handheld computers and video game consoles, as well as television set-top devices, has increased dramatically in the past few years. The lower resolution, functionality and memory associated with alternative devices make the use of our products and services through such devices more difficult. If we are unable to attract and retain a substantial number of alternative device users to our web search services or if we are slow to develop products and technologies that are more compatible with non-PC communications devices, we will fail to capture a significant share of an increasingly important portion of the market for online services, which could adversely affect our business.

We may have difficulty scaling and adapting our existing architecture to accommodate increased traffic and technology advances or changing business requirements, which could lead to the loss of users, advertisers and Google Network members, and cause us to incur expenses to make architectural changes.

To be successful, our network infrastructure has to perform well and be reliable. The greater the user traffic and the greater the complexity of our products and services, the more computing power we will need. We have spent and expect to continue to spend substantial amounts on the purchase and lease of data centers and equipment and the upgrade of our technology and network infrastructure to handle increased traffic on our web sites and to roll out new products and services. This expansion is expensive and complex and could result in inefficiencies or operational failures. If we do not expand successfully, or if we experience inefficiencies and operational failures, the quality of our products and services and our users experience could decline. This could damage our reputation and lead us to lose current and potential users, advertisers and Google Network members. Cost increases, loss of traffic or failure to accommodate new technologies or changing business requirements could harm our operating results and financial condition.

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We rely on bandwidth providers, data centers and others in providing products and services to our users, and any failure or interruption in the services and products provided by these third parties could damage our reputation and harm our ability to operate our business.

We rely on vendors, including data center and bandwidth providers in providing products and services to our users. Any disruption in the network access or colocation services provided by these providers or any failure of these providers to handle current or higher volumes of use could significantly harm our business. Any financial or other difficulties our providers face may have negative effects on our business. We exercise little control over these vendors, which increases our vulnerability to problems with the services they provide. We license technology and related databases to facilitate aspects of our data center and connectivity operations including internet traffic management services. We have experienced and expect to continue to experience interruptions and delays in service and availability for such elements. Any errors, failures, interruptions or delays in connection with these technologies and information services could harm our relationship with users, adversely affect our brand and expose us to liabilities.

Our systems are also heavily reliant on the availability of electricity. If we were to experience a major power outage, we would have to rely on back-up generators. These back-up generators may not operate properly and their fuel supply could be inadequate during a major power outage. This could result in a disruption of our business.

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 and increasing market power in the broadband and internet access marketplace, including incumbent telephone companies, cable companies and mobile communications companies. Some of these providers have stated that they may take measures that could degrade, disrupt or increase the cost of user access to certain of our products by restricting or prohibiting the use of their infrastructure to support or facilitate our offerings, or by charging increased fees to us or our users to provide our offerings. These activities may be permitted in the U.S. after recent regulatory changes, including recent decisions by the U.S. Supreme Court and Federal Communications Commission. While interference with access to our popular products and services seems unlikely, such carrier 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 revenue and growth.

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

Our business depends on increasing use of the internet by users searching for information, advertisers marketing products and services and web sites seeking to earn revenue to support their web content. If the internet infrastructure does not grow and is not maintained to support these activities, our business will be harmed.

Our success will depend on the continued growth and maintenance of the internet infrastructure. This includes maintenance of a reliable network backbone with the necessary speed, data capacity and security for providing reliable internet services. Internet infrastructure may be unable to support the demands placed on it if the number of internet users continues to increase, or if existing or future internet users access the internet more often or increase their bandwidth requirements. In addition, viruses, worms and similar programs may harm the performance of the internet. The internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure, and could face outages and delays in the future. These outages and delays could reduce the level of internet usage as well as our ability to provide our solutions.

Payments to certain of our Google Network members have exceeded the related fees we receive from our advertisers.

We are obligated under certain agreements to make non-cancelable guaranteed minimum revenue share payments to Google Network members based on their achieving defined performance terms, such as number of search queries or advertisements displayed. In these agreements, we promise to make these minimum payments to the Google Network member for a pre-negotiated period of

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time. At March 31, 2008, our aggregate outstanding non-cancelable guaranteed minimum revenue share commitments totaled $1.60 billion through 2012 compared to $1.75 billion at December 31, 2007. It is difficult to forecast with certainty the fees that we will earn under agreements with guarantees, and sometimes the fees we earn fall short of the guaranteed minimum payment amounts.

We rely on outside providers for our worldwide billing, collection, payment processing and payroll. If these outside service providers are not able to fulfill their service obligations, our business and operations could be disrupted, and our operating results could be harmed.

Outside providers perform various functions for us, such as worldwide billing, collection, payment processing and payroll. These functions are critical to our operations and involve sensitive interactions between us and our advertisers, partners (e.g., Google Network members) and employees. Although we have implemented service level agreements and have established monitoring controls, if we do not successfully manage our service providers or if the service providers do not perform satisfactorily to agreed-upon service levels, our operations could be disrupted resulting in advertiser, partner or employee dissatisfaction. In addition, our business, reputation and operating results could be adversely affected.

To the extent our revenues are paid in foreign currencies, and currency exchange rates become unfavorable, we may lose some of the economic value of the revenues in U.S. dollar terms.

As we expand our international operations, more of our customers may pay us in foreign currencies. Conducting business in currencies other than U.S. dollars subjects us to fluctuations in currency exchange rates. If the currency exchange rates were to change unfavorably, the value of net receivables we receive in foreign currencies and later convert to U.S. dollars after the unfavorable change would be diminished. This could have a negative impact on our reported operating results. Hedging strategies, such as forward contracts, options and foreign exchange swaps related to transaction exposures, that we have implemented or may implement to mitigate this risk may not eliminate our exposure to foreign exchange fluctuations. Additionally, hedging programs expose us to risks that could adversely affect our operating results, including the following:

- We have limited experience in implementing or operating hedging programs. Hedging programs are inherently risky and we could lose money as a result of poor trades.

- We may be unable to hedge currency risk for some transactions or match the accounting for the hedge with the exposure because of a high level of uncertainty or the inability to reasonably estimate our foreign exchange exposures.

- We may be unable to acquire foreign exchange hedging instruments in some of the geographic areas where we do business, or, where these derivatives are available, we may not be able to acquire enough of them to fully offset our exposure.

- We may determine that the cost of acquiring a foreign exchange hedging instrument outweighs the benefit we expect to derive from the derivative, in which case we would not purchase the derivative and be exposed to unfavorable changes in currency exchange rates.

We may have exposure to greater than anticipated tax liabilities.

Our future income taxes could be adversely affected by earnings being lower than anticipated in jurisdictions where we have lower statutory rates and higher than anticipated in jurisdictions where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities or by changes in tax laws, regulations, accounting principles or interpretations thereof. Our determination of our tax liability is always subject to review by applicable tax authorities. Any adverse outcome of such a review could have a negative effect on our operating results and financial condition. In addition, the determination of our worldwide provision for income taxes and other tax liabilities requires significant judgment, and there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

Risks Related to Ownership of our Common Stock

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

The trading price of our Class A common stock has been volatile since our initial public offering and will likely continue to be volatile. The trading price of our Class A common stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include:

- Quarterly variations in our results of operations or those of our competitors.
- Announcements by us or our competitors of acquisitions, new products, significant contracts, commercial relationships or capital commitments.

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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.

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

Sales of stock by us or by our stockholders.

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

In addition, the stock market in general, and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our Class A common stock, regardless of our actual operating performance. In the past, following periods of volatility in the overall market and the market price of a company s securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management s attention and resources.

We do not intend to pay dividends on our common stock.

We have never declared or paid any cash dividend on our capital stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future.

The concentration of our capital stock ownership with our founders, executive officers and our directors and their affiliates will limit our stockholders ability to influence corporate matters.

Our Class B common stock has 10 votes per share and our Class A common stock has one vote per share. As of March 31, 2008, our founders, executive officers and directors (and their affiliates) together owned shares of Class A common stock, Class B common stock and other equity interests representing approximately 71% of the voting power of our outstanding capital stock. In particular, as of March 31, 2008, our two founders and our CEO, Larry, Sergey and Eric, owned approximately 89% of our outstanding Class B common stock, representing approximately 68% 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 its assets, for the foreseeable future. This concentrated control limits our stockholders ability to influence corporate matters and, as a result, we may take actions that our stockholders do not view as beneficial. As a result, the market price of our Class A common stock could be adversely affected.

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

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

Our certificate of incorporation provides for a dual class common stock structure. As a result of this structure our founders, executives and employees 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 its assets. This concentrated control could discourage others from initiating any potential merger, takeover or other change of control transaction that other stockholders may view as beneficial.

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

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

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

Stockholders must provide advance notice to nominate individuals for election to the board of directors or to propose matters that can be acted upon at a stockholders meeting. These provisions may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror s own slate of directors or otherwise attempting to obtain control of our company.

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

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

Results of Google s Transferable Stock Option Program

Under our TSO program, which we launched in April 2007, eligible employees are able to sell vested stock options to participating financial institutions in an online auction as an alternative to exercising options in the traditional method and selling the underlying shares. The following table provides information with respect to sales by our employees of TSOs during the three month period ended March 31, 2008:

	Aggregate Amounts			Weighted-Average Per Share Amounts		
Period (1)	**Number of Shares Underlying TSOs Sold**	**Sale Price of TSOs Sold (in thousands)**	**TSO Premium (2) (in thousands)**	**Exercise Price of TSOs Sold**	**Sale Price of TSOs Sold**	**TSO Premium (2)**
January 1-31						
February 1-29	66,400	$ 19,789	$ 2,756	$ 298.10	$ 241.26	$ 41.52
March 1-31						
Total (except weighted-average amounts)	66,400	$ 19,789	$ 2,756	$ 298.10	$ 241.26	$ 41.52

(1) The TSO program is generally active during regular NASDAQ trading hours when Google s trading window is open. However, we have the right to suspend the TSO program at any time for any reason, including for maintenance and other technical reasons.

(2) TSO premium is calculated as the difference between (a) the sale price of the TSO and (b) the intrinsic value of the TSO, which we define as the excess, if any, of the price of our Class A common stock at the time of the sale over the exercise price of the TSO.

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ITEM 6. EXHIBITS

Exhibit Number		Description
31.01	*	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14 (a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
31.02	*	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14 (a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2003
32.01		Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2003

* Filed herewith.

Furnished herewith.

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SIGNATURES

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

	GOOGLE INC.
Date: May 12, 2008	By: /s/ GEORGE REYES
	George Reyes
	Senior Vice President and Chief Financial Officer
	(Principal Financial Officer and duly authorized signatory)

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EXHIBIT INDEX

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