

GOOGLE INC.
 Form 10-Q
 July 23, 2015
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UNITED STATES
 SECURITIES AND EXCHANGE COMMISSION
 Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from _____ to _____

Commission file number: 001-36380

Google Inc.

(Exact name of registrant as specified in its charter)

Delaware

77-0493581

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

1600 Amphitheatre Parkway

Mountain View, CA 94043

(Address of principal executive offices, including zip code)

(650) 253-0000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer

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

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

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As of July 17, 2015, there were 289,886,273 shares of Google's Class A common stock outstanding, 51,720,104 shares of Google's Class B common stock outstanding, and 343,928,872 Google's Class C capital stock outstanding.

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

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

the growth of our business and revenues and our expectations about the factors that influence our success and trends in our business;

our plans to continue to invest in new businesses, products and technologies, systems, facilities, and infrastructure, to continue to hire aggressively and provide competitive compensation programs, as well as to continue to invest in acquisitions;

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

the potential for declines in our revenue growth rate;

our expectation that growth in advertising revenues from our websites will continue to exceed that from our Google Network Members' websites, which will have a positive impact on our operating margins;

our expectation that we will continue to take steps to improve the relevance of the ads we deliver and to reduce the number of accidental clicks;

fluctuations in aggregate paid clicks and average cost-per-click;

our belief that our foreign exchange risk management program will not fully offset our net exposure to fluctuations in foreign currency exchange rates;

the expected increase of costs related to hedging activities under our foreign exchange risk management program;

our expectation that our cost of revenues, research and development expenses, sales and marketing expenses, and general and administrative expenses will increase in dollars and may increase as a percentage of revenues;

our potential exposure in connection with pending investigations, proceedings, and other contingencies;

our expectation that our traffic acquisition costs will fluctuate in the future;

our continued investments in international markets;

- estimates of our future compensation expenses;

fluctuations in our effective tax rate;

the sufficiency of our sources of funding;

our payment terms to certain advertisers, which may increase our working capital requirements;

fluctuations in our capital expenditures;

as well as other statements regarding our future operations, financial condition and prospects, and business strategies.

Forward-looking statements may appear throughout this report and other documents we file with the Securities and Exchange Commission (SEC), including without limitation, Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report on Form 10-Q and Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014, as may be updated in our subsequent Quarterly Reports on Form 10-Q. Forward-looking statements generally can be identified by words such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "projects," "will be," "will continue," "will" and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q, and in particular, the risks discussed in Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014, and those discussed in other documents we file with the SEC. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

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

"Google" and other trademarks of ours appearing in this report are our property. This report contains additional trade names and trademarks of other companies. We do not intend our use or display of other companies' trade names or

trademarks to imply an endorsement or sponsorship of us by such companies, or any relationship with any of these companies.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Google Inc.

CONSOLIDATED BALANCE SHEETS

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

	As of December 31, 2014	As of June 30, 2015 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 18,347	\$ 18,453
Marketable securities	46,048	51,327
Total cash, cash equivalents, and marketable securities (including securities loaned of \$4,058 and \$4,448)	64,395	69,780
Accounts receivable, net of allowance of \$225 and \$235	9,383	9,394
Receivable under reverse repurchase agreements	875	625
Deferred income taxes, net	1,322	1,316
Income taxes receivable, net	591	0
Prepaid revenue share, expenses and other assets	3,412	3,049
Total current assets	79,978	84,164
Prepaid revenue share, expenses and other assets, non-current	3,280	3,403
Non-marketable investments	3,079	4,409
Property and equipment, net	23,883	27,008
Intangible assets, net	4,607	4,213
Goodwill	15,599	15,610
Total assets	\$ 130,426	\$ 138,807
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 1,715	\$ 1,315
Short-term debt	2,009	3,008
Accrued compensation and benefits	3,069	2,466
Accrued expenses and other current liabilities	4,434	4,396
Accrued revenue share	1,952	1,823
Securities lending payable	2,778	2,694
Deferred revenue	752	712
Income taxes payable, net	96	948
Total current liabilities	16,805	17,362
Long-term debt	3,228	2,225
Deferred revenue, non-current	104	108
Income taxes payable, non-current	3,340	3,615
Deferred income taxes, net, non-current	1,971	1,754
Other long-term liabilities	1,118	1,960
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, \$0.001 par value per share, 100,000 shares authorized; no shares issued and outstanding	0	0
	28,767	30,722

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Class A and Class B common stock, and Class C capital stock and additional paid-in capital, \$0.001 par value per share: 15,000,000 shares authorized (Class A 9,000,000, Class B 3,000,000, Class C 3,000,000); 680,172 (Class A 286,560, Class B 53,213, Class C 340,399) and par value of \$680 (Class A \$287, Class B \$53, Class C \$340) and 685,490 (Class A 289,834, Class B 51,748, Class C 343,908) and par value of \$686 (Class A \$290, Class B \$52, Class C \$344) shares issued and outstanding

Accumulated other comprehensive income (loss)	27	(929)
Retained earnings	75,066	81,990	
Total stockholders' equity	103,860	111,783	
Total liabilities and stockholders' equity	\$ 130,426	\$ 138,807	
See accompanying notes.			

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Google Inc.

CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2015	2014	2015
	(unaudited)			
Revenues	\$15,955	\$17,727	\$31,375	\$34,985
Costs and expenses:				
Cost of revenues	6,114	6,583	12,075	12,939
Research and development	2,238	2,789	4,364	5,542
Sales and marketing	1,941	2,080	3,670	4,145
General and administrative	1,404	1,450	2,893	3,087
Total costs and expenses	11,697	12,902	23,002	25,713
Income from operations	4,258	4,825	8,373	9,272
Interest and other income, net	145	131	502	288
Income from continuing operations before income taxes	4,403	4,956	8,875	9,560
Provision for income taxes	984	1,025	1,887	2,114
Net income from continuing operations	3,419	3,931	6,988	7,446
Net loss from discontinued operations	(68	) 0	(266	) 0
Net income	\$3,351	\$3,931	\$6,722	\$7,446
Less: Adjustment Payment to Class C capital stockholders	0	522	0	522
Net income available to all stockholders	\$3,351	\$3,409	\$6,722	\$6,924
Basic net income (loss) per share of Class A and B common stock:				
Continuing operations	\$5.06	\$4.99	\$10.37	\$10.15
Discontinued operations	(0.10	) 0.00	(0.39	) 0.00
Basic net income per share of Class A and B common stock	\$4.96	\$4.99	\$9.98	\$10.15
Basic net income (loss) per share of Class C capital stock:				
Continuing operations	\$5.06	\$6.51	\$10.37	\$11.68
Discontinued operations	(0.10	) 0.00	(0.39	) 0.00
Basic net income per share of Class C capital stock	\$4.96	\$6.51	\$9.98	\$11.68
Diluted net income (loss) per share of Class A and B common stock:				
Continuing operations	\$4.98	\$4.93	\$10.19	\$10.03
Discontinued operations	(0.10	) 0.00	(0.39	) 0.00
Diluted net income per share of Class A and B common stock	\$4.88	\$4.93	\$9.80	\$10.03
Diluted net income (loss) per share of Class C capital stock:				
Continuing operations	\$4.98	\$6.43	\$10.19	\$11.53
Discontinued operations	(0.10	) 0.00	(0.39	) 0.00
Diluted net income per share of Class C capital stock	\$4.88	\$6.43	\$9.80	\$11.53

See accompanying notes.

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Google Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

	Three Months Ended		Six Months Ended	
	June 30, 2014	2015	June 30, 2014	2015
	(unaudited)			
Net income	\$3,351	\$3,931	\$6,722	\$7,446
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(11	) 218	54	(705)
Available-for-sale investments:				
Change in net unrealized gains (losses)	228	(336)	445	(115)
Less: reclassification adjustment for net gains included in net income	(40	) (50	) (107	) (77)
Net change (net of tax effect of \$62, \$92, \$104, and \$31)	188	(386	) 338	(192)
Cash flow hedges:				
Change in net unrealized gains	(16	) (61	) (6	) 501
Less: reclassification adjustment for net gains included in net income	(4	) (329	) (9	) (560)
Net change (net of tax effect of \$21, \$202, \$9, and \$10)	(20	) (390	) (15	) (59)
Other comprehensive income (loss)	157	(558) 377	(956)
Comprehensive income	\$3,508	\$3,373	\$7,099	\$6,490
See accompanying notes.				

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Google Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

	Six Months Ended	
	June 30,	
	2014	2015
	(unaudited)	
Operating activities		
Net income	\$6,722	\$7,446
Adjustments:		
Depreciation expense and impairment of property and equipment	1,629	1,949
Amortization and impairment of intangible and other assets	536	462
Stock-based compensation expense	1,802	2,335
Excess tax benefits from stock-based award activities	(292)	(216)
Deferred income taxes	(138)	(150)
Gain on equity interest	(126)	0
(Gain) loss on marketable and non-marketable investments, net	(239)	33
Other	91	116
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(454)	(69)
Income taxes, net	90	1,950
Prepaid revenue share, expenses and other assets	519	62
Accounts payable	14	(398)
Accrued expenses and other liabilities	(68)	237
Accrued revenue share	(68)	(121)
Deferred revenue	0	(34)
Net cash provided by operating activities	10,018	13,602
Investing activities		
Purchases of property and equipment	(4,991)	(5,442)
Purchases of marketable securities	(24,857)	(33,126)
Maturities and sales of marketable securities	23,605	27,586
Purchases of non-marketable investments	(467)	(1,449)
Cash collateral related to securities lending	1,713	(84)
Investments in reverse repurchase agreements	0	250
Acquisitions, net of cash acquired, and purchases of intangibles and other assets	(3,490)	(142)
Net cash used in investing activities	(8,487)	(12,407)
Financing activities		
Net payments related to stock-based award activities	(921)	(1,004)
Excess tax benefits from stock-based award activities	292	216
Adjustment Payment to Class C capital stockholders	0	(47)
Proceeds from issuance of debt, net of costs	6,293	6,698
Repayments of debt	(6,304)	(6,704)
Net cash used in financing activities	(640)	(841)
Effect of exchange rate changes on cash and cash equivalents	(9)	(248)
Net increase in cash and cash equivalents	882	106
Cash and cash equivalents at beginning of period	18,898	18,347
Reclassification of assets previously held for sale	(160)	0
Cash and cash equivalents at end of period	\$ 19,620	\$ 18,453

Supplemental disclosures of cash flow information

Cash paid for taxes	\$1,666	\$234
Cash paid for interest	\$38	\$48
Non-cash financing activity:		
Shares issued in connection with the Class C Adjustment Payment	\$0	\$475
See accompanying notes.		

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Google Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

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

On October 29, 2014, we sold the Motorola Mobile business (Motorola Mobile) to Lenovo Group Limited (Lenovo). The financial results of Motorola Mobile are presented as net loss from discontinued operations on the Consolidated Statements of Income for the three and six months ended June 30, 2014. See Note 8 for further discussion of the sale.

Basis of Consolidation

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

Unaudited Interim Financial Information

The accompanying Consolidated Balance Sheet as of June 30, 2015, the Consolidated Statements of Income for the three and six months ended June 30, 2014 and 2015, the Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2014 and 2015, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2015 are unaudited. These unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP). In our opinion, the unaudited interim consolidated financial statements include all adjustments of a normal recurring nature necessary for the fair presentation of our financial position as of June 30, 2015, our results of operations for the three and six months ended June 30, 2014 and 2015, and our cash flows for the six months ended June 30, 2014 and 2015. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, filed with the SEC on February 6, 2015.

Use of Estimates

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

Recent Accounting Pronouncements

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

In June 2014, the FASB issued Accounting Standards Update No. 2014-10 (ASU 2014-10) "Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation". ASU 2014-10 removes the definition of a development stage entity from the Master Glossary of the ASC thereby removing the financial reporting distinction between development stage entities and other reporting entities. The amendment eliminating the exception to the

sufficiency-of-equity-at-risk criterion for development stage entities will be applied retrospectively for annual reporting periods beginning after December 15, 2015, and interim periods therein. Early application of these amendments is permitted. We are

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currently in the process of evaluating the impact of the adoption of ASU 2014-10 on our consolidated financial statements.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02 (ASU 2015-02) "Consolidation (Topic 810): Amendments to the Consolidation Analysis." ASU 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. We are currently in the process of evaluating the impact of the adoption of ASU 2015-02 on our consolidated financial statements.

Revision of Previously Issued Financial Statements

In the second quarter of 2015, we identified an incorrect classification of certain revenues between legal entities, and as a consequence, we revised our income tax expense for periods beginning in 2008 through the first quarter of 2015 in the cumulative amount of \$711 million. We have evaluated the materiality of the income tax expense impact quantitatively and qualitatively and concluded it was not material to any of the prior periods impacted and that correction of income tax expense as an out of period adjustment in the quarter ended June 30, 2015 would not be material to our consolidated financial statements for the year ending December 31, 2015. Consolidated revenues are not impacted. We have elected to revise previously issued financial statements for periods contained on this Form 10-Q to correct the effect of this immaterial income tax expense underaccrual for the corresponding periods. Periods not presented herein will be revised, as applicable, as they are included in future filings. Refer to Note 15 for additional information.

Note 2. Financial Instruments

Fair Value Measurements

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

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

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

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

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

We classify our cash equivalents and marketable securities within Level 1 or Level 2 because we use quoted market prices or alternative pricing sources and models utilizing market observable inputs to determine their fair value. We classify our foreign currency and interest rate derivative contracts primarily within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments. We classify our non-marketable investments within Level 3 as the valuation inputs are not observable in an active market.

Cash, Cash Equivalents and Marketable Securities

The following tables summarize our cash, cash equivalents and marketable securities by significant investment categories as of December 31, 2014 and June 30, 2015 (in millions):

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	As of December 31, 2014					
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities
Cash	\$9,863	\$0	\$0	\$9,863	\$9,863	\$0
Level 1:						
Money market and other funds	2,532	0	0	2,532	2,532	0
U.S. government notes	15,320	37	(4	) 15,353	1,128	14,225
Marketable equity securities	988	428	(64	) 1,352	0	1,352
	18,840	465	(68	) 19,237	3,660	15,577
Level 2:						
Time deposits ⁽¹⁾	2,409	0	0	2,409	2,309	100
Money market and other funds ⁽²⁾	1,762	0	0	1,762	1,762	0
Fixed-income bond funds ⁽³⁾	385	0	(38	) 347	0	347
U.S. government agencies	2,327	8	(1	) 2,334	750	1,584
Foreign government bonds	1,828	22	(10	) 1,840	0	1,840
Municipal securities	3,370	33	(6	) 3,397	3	