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BODY:

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Conference Call Participants

* Imran Khan JP Morgan - Analyst * Brian Pitz Banc of America Securities - Analyst * James Mitchell Goldman Sachs - Analyst * Justin Post Merrill Lynch - Analyst * Christa Quarles Thomas Weisel Partners - Analyst * Doug Anmuth Lehman Brothers - Analyst * Ben Schachter UBS - Analyst * Mark Mahaney Citi - Analyst * Jeetil Patel Deutsche Bank - Analyst * David Joseph Morgan Stanley - Analyst * Jeffrey Lindsay Sanford Bernstein - Analyst

Presentation

OPERATOR: Good day and welcome, everyone, to the Google Inc. conference call. This call is being recorded. At this time I would like to turn the call over to Ms. [Krista Bessinger], Director of Investor Relations. Please go ahead, ma'am.

KRISTA BESSINGER, IR, GOOGLE: Good afternoon, everyone, and welcome to today's second-quarter 2008 earnings conference call. We have a slightly different lineup today. With us are Eric Schmidt, Chief Executive Officer; George Reyes, Chief Financial Officer; Sergey Brin, Founder and President of Technology; Jonathan Rosenberg, Senior Vice President of Product Management; Omid Kordestani, Senior Vice President of Global Sales and Operations; and Hal Varian, our Chief Economist. Eric, George, Hal and Sergey will provide us with their thoughts on the quarter, and then Jonathan and Omid will join us for Q&A.

Please note that this call is being web cast from our Investor Relations web site, and our press release issued a few minutes ago is also posted on the web site along with slides that accompany today's prepared remarks. A replay of this call will also be available on our Investor Relations web site in a few hours.

Now let me quickly cover the Safe Harbor. Some of the statements we make today may be considered forward-looking, including statements regarding investments in our core business, seasonality, traffic acquisition costs, increase in the cost of sales, international growth, statements regarding the benefits of our acquisition of DoubleClick and our expected level of capital expenditures. These statements involve a number of risks and uncertainties that could cause actual results to differ materially. Please note that these forward-looking statements reflect our opinions only as of the date of this presentation, and we undertake no obligation to revise or publicly release the results of any revision to these

136-0002

forward-looking statements in light of new information or future events. Please refer to our SEC filings, including our quarterly report on Form 10-Q for the quarter ended March 31st, 2008, as well as our earnings press release, for a more detailed description of the risk factors that may affect our results. Copies can be obtained from the SEC or by visiting the Investor Relations section of our website.

Also please note that certain financial measures we use on this call, such as EPS, net income, operating margin and operating income, are expressed on a non-GAAP basis and have been adjusted to exclude charges relating to stock-based compensation. We have also adjusted our net cash provided by operating activities to remove capital expenditures, which we refer to as free cash flow. Our GAAP results and GAAP to non-GAAP reconciliation can be found in our earnings press release.

With that, it's my pleasure to turn the call over to Eric.

ERIC SCHMIDT, CHAIRMAN OF THE BOARD, CEO, GOOGLE: Thank you very much, Krista. We're obviously very pleased with what we believe are good results in one of the weaker quarters in our normal yearly cycle. The traffic and revenue growth is strong across all regions and verticals. Traffic and revenue have held up well despite uncertain economic conditions, as everybody knows.

International, of course, a big emphasis for Google is once again contributing more than 50% of our revenue, good growth in rapidly growing markets such as Brazil and China. We continue, of course, to make critical and fundamental investments in the infrastructure of the things that are most important and, in particular, our search. We continue to scale our index, we continue to make sure that our information is the freshest possible, and we are reducing latency or delay that people experience. So, as a result, we're continuing to deliver on our fundamental mission of the most relevant and fastest results, web and other kind of information.

In ads, in addition to all of the normal ad improvements that we see, the partnership with Yahoo! was obviously the signature event. David Drummond testified two days ago during -- both to the House and Senate -- I liked it so much I wanted to read it. The Internet is a dynamic and competitive environment, and that's due to the openness that has been a hallmark since its inception. Our nonexclusive commercial agreement -- it's very important, by the way, nonexclusive -- with Yahoo! will maintain and expand that competition, create some new efficiencies that will benefit consumers, advertisers and publishers while protecting privacy and spurring innovation. Google and Yahoo! will remain fierce competitors. This continuing competition will help fuel innovation that's good for the Internet, users, good for the Internet and good for the economy. Openness, interoperability and competition are central to our culture at Google, central to the vibrancy of the Internet and central to the growth of a free market. We believe that the nonexclusive ad deal -- remember, it's not a search deal -- that was done with Yahoo! is a win for the industry primarily because it allows Yahoo! to remain independent, which we believe is very pro-competitive.

DoubleClick, of course, is the other big piece of news. Integration is now underway and going very smoothly, but display is a big opportunity. It's a big opportunity, by the way, because the strategy of offering values to advertisers and publishers is one that we can offer very much worldwide.

Putting our team together, of course, we have really now delivered on this global organization that everybody here knows about and it's beginning to bear fruit. [Angle R] for example, developed some great new ad tools that were delivered last quarter. Zurich created our new Insight feature on YouTube which lets anyone who uploads a video see traffic information. [Hypha] developed another great new YouTube feature called [Imitations]. My point here is not to highlight the hundreds and hundreds of ones that happen all the time, every quarter, but to say it really is a global company.

So we now have more than 30 products that support more than 30 languages, up from five products and 30 languages just a year ago. So people want to use Google in their own language, and we are delivering on that.

Just to finish up in my hopefully short comments, we are very, very happy to have Patrick Pichette on board as our new CFO with his 20 years of experience in financial operations and management in the telco industry. I've talked to him, he's coming up to speed. He's going to be a tremendous contributor at the Google level for many years to come. We're very, very excited about that.

And I want to make sure that we thank, once again, George Reyes, my friend and colleague for more than 20 years, George; stayed on board even more than a year after he announced his intent to retire. This shows you the kind of person that he is, to try to help Google and help all of us meet our objective. He's made a tremendous contribution to

136-0003

Google, which we've highlighted before. We are going to miss him and we're very much looking forward to working with Patrick.

In our order today we're going to have George, who I've just highlighted so I can boast about him some more, but I'll make him too embarrassed, and then we'll have him followed by Hal Varian. Larry is out this week. Hal is our chief economist, and there have been so many questions about Yahoo!/Google economics and so forth. Hal is the perfect person to talk about how does the auction really work and what does the global environment mean for Google. George, do you want to take it away?

GEORGE REYES, SVP, CFO, GOOGLE: We had another strong quarter with gross revenue increasing 39% over Q2 of 2007 to $5.4 billion. Google.com performed well, up 42% year over year to $3.5 billion, driven by strong traffic growth and, to a lesser extent, monetization. AdSense revenue grew 22% over Q2 of 2007 but was down slightly on a sequential basis, reflecting a continued focus on delivering high-quality traffic to our advertisers and typical Q2 seasonality.

Now let's take a look at aggregate paid clicks. Aggregate paid clicks include clicks related to ads served on Google properties as well as ads served on our partner sites. Aggregate paid clicks grew approximately 19% over Q2 of 2007 and were down slightly on a sequential basis, again reflecting a continued focus on delivering high-quality traffic to our advertisers and typical Q2 seasonality.

Now I'll discuss our international performance. International revenue accounted for 52% of revenue, or $2.8 billion. The UK was solid with revenues of $774 million, up 29% year over year but down 4% sequentially, reflecting typical Q2 seasonality and negligible FX impact. Revenue growth in EMEA was strong, primarily driven by strong performance in Benelux, Ireland and parts of Western continental Europe, including Germany, France, Spain and Italy, fueled by relatively strong performance in automotive and consumer packaged goods. Asia and Latin America continued to show impressive growth as well with Japan, Argentina, Australia, Brazil and China being notably strong in Q2.

Now turning to expenses, traffic acquisition costs were $1.5 billion or 28.4% of total advertising revenue, down from 29.2% in Q1. AdSense TAC was $1.3 billion, while TAC related to distribution partners and others who direct traffic to our websites totaled $154 million in the quarter. As we grow our AdSense partner network and embark on new initiatives, we may see additional pressure on TAC rates going forward.

Other costs of revenue, which include $9 million in stock-based compensation, increased $49 million over Q1 to $674 million. The largest driver of the increase was the increase in costs related to our data centers, including depreciation, equipment and operations. We continue to anticipate that other costs of sales could increase going forward. Other than cost of revenue, operating expenses totaled $1.64 billion, including approximately $264 million in stock-based compensation. Expenses related to payroll and facilities increased $1 million over Q1 to $810 million.

At the end of the quarter we had a full-time employee base of 19,604. We added 448 net new employees in Q2 with roughly half the new non-DoubleClick hires coming on board in engineering, followed by sales and marketing. We have implemented and continue to follow a disciplined hiring process in all areas of our organization. But, as we've indicated in the past, we will continue to invest in our core business both in the US and internationally. Remember also that we usually see an uptick in starts over the summer, coinciding with the end of academic year.

Turning to non-GAAP operating profit, which excludes stock-based compensation, increased to $1.9 billion in Q2 with non-GAAP operating margins of 34.5%. Note that interest income and other in Q2 was $58 million, down $109 million from Q1. To be clear, this was not a write-down, now was this due to any losses. Instead, it was primarily due to lower yields on our cash balance, lower average cash balances as a result of cash used in the first quarter to acquire DoubleClick, lower net realized gains on the sale of -- net realized gains on the sale of our marketable securities and an increase in expenses as a result of more activity under our foreign exchange hedging programs.

Finally, turning to cash, operating cash flow remained strong at $1.77 billion with CapEx for the quarter of $698 million. As in previous quarters, the majority of our CapEx was related to IT infrastructure investments including data center construction, production of servers and networking equipment. We expect to continue to make significant investments in CapEx in future quarters.

Free cash flow, a non-GAAP measure which we define as cash flow from operations less CapEx, remained strong at $1.07 billion, up 63% year over year.

136-0004

In summary, we believe our core business continues to demonstrate strength while we make key investments to pursue long-term growth opportunities.

At this point I want to take a moment to thank Eric, Larry, Sergey and the rest of the management team for having had the privilege of working with all of them, and this is an opportunity that I will never forget. So let me turn it over to Hal.

HAL VARIAN, CHIEF ECONOMIST, GOOGLE: Eric asked me to comment on the state of the economic environment and how that is impacting Google. When we look across sectors of the United States, we see that on a year-on-year basis, the query growth has been positive in every sector we track, even including those sectors that are generally economically sensitive such as automotive, real estate and travel. We also see that year-on-year revenue growth is positive in every major sector, except for real estate, and even that one is only down by a small amount.

When we look at the subsectors we see some interesting patterns. The weaker components are just the ones you would expect to see based on the macroeconomic climate -- auto financing, home financing and real estate agencies. These are the sorts of queries you would expect to see when auto or real estate transactions have already taken place. And as we all know, fewer transactions are taking place in those sectors. It's interesting to note that year-over-year automotive ad spend is up, even though the growth in auto financing is down. I interpret this as saying that auto advertisers are willing to spend on clicks, but the weakness is on the consumer side. However, I should emphasize, this behavior is not universal. Spending seems to be holding up pretty well in other consumer durable categories, such as home appliances and home furnishing.

When we turn to Europe, we see a similar pattern. In the UK we had across-the-board year-to-year growth in both revenue and queries with the sole exception being real estate. Continental Europe grew in both queries and revenue in every major vertical.

To summarize, when we look across verticals we see that consumers are being cautious in their online spending patterns, just as they are in their off-line spending. Despite the weakness in the economy, advertising revenue seems to be holding up remarkably well in most sectors. I think this illustrates the point that we've made several times. During periods of slow economic growth, the last thing an advertiser wants to cut is its spending on search-based advertising.

So with that, let me pass the mic to Sergey, who is going to talk about what we've been doing in products.

SERGEY BRIN, CO-FOUNDER & PRESIDENT, TECHNOLOGY, GOOGLE: Hello, everyone. It's really exciting for me to update you. Over the past quarter, we've had a lot of substantial improvements, new launches. Let me just start with search.

We've substantially increased the size of our index. And in particular, actually, the index of documents that we refresh every few minutes has also grown tremendously. So now our users get much fresher and faster results and across a greater range of sources.

We've, just all told, to give you a sense for this, launched over 100 search quality improvements this quarter, so roughly one a day. And some of the highlights -- again, we have increased coverage in universal search, which means you get your Web pages mixed in with video and images, news, books, all those things we're able to show more and more. And that improves our search results, and it pays us a double dividend for all of the work we've been doing (inaudible) such as Book Search.

We also just added blog results at the bottom of the page in the past quarter, and our blending of Maps results we've put into 130 more countries than we had in the past.

We've also been running more OneBox's. For example, those of you in Europe might have enjoyed our Euro 2008 OneBox in June, during the soccer tournament. Let me just take a step away from just the basic search. Many of you, I know, use iGoogle, and in fact we know that because we've had such tremendous growth, and especially internationally. More than 60% of iGoogle users are now outside of the US. We had some very important developments, in particular with themes this quarter. You might have seen our iGoogle artist campaign where 68 artists across 22 countries created new themes for the products and this encouraged hundreds of thousands of people to sign up for iGoogle. Of course, the existing users, many of them changed their themes to these artists' themes.

I have personally set my I Google page now to go do a rotation across the top theme, so that's really fun. Every day, I get a new feel aesthetically pretty exciting and varied.

136-0005

If you are listening to me right now, you probably speak English pretty well, though, of course, if you're reading a transcript that has been translated using Google Translate, then you might not. It's very important to be able to have access to information in languages that you don't speak, especially if you're a non-English speaker. The amount of information that's out there that can be useful to you that's not necessarily in your native language is huge. To this end, we have been, of course, working on Google Translate. It now covers over 20 languages. We have added 10 just in this past quarter alone, and now we let you translate from any one of those languages to any other of those languages.

We have been able to improve the performance and have tremendous growth in usage as well. We've also been working on our cross-language search. So we don't necessarily just search literally in the language that you search. We are able to produce translated results in other languages now more automatically. And you can expect us to continue to expand that work.

In ads, I should highlight a notable development. Our AdSense network now allows third parties to host and serve ads, and this has been important. It's important to many advertisers. Just as one example, Lenovo is now advertising with us because we can support this kind of third-party ad serving. We also, now that advertisers find out more about where they should be advertising because we've launched the Google Ad Planner. And that lets you see what kind of sites the particular audience that's interested in whatever the advertiser is advertising, which sites do they visit, what are the breakdowns of demographics. It lets you do very complicated statistical analyses, and I encourage you all to try it out. Even if you're not an advertiser, it's pretty fun to be able to play with that data.

Let me just jump a little bit onto YouTube. Probably most of you have had a chance to try to watch some YouTube videos, and in fact our data suggests that more and more of you are. We now have 13 hours of video uploaded every single minute. So, as you can imagine, it would take quite a many life times to watch all YouTube videos. It also gives you the opportunity, of course, to watch video in very specific topics that may be of interest to you.

We've also, on YouTube, been experimenting with a variety of advertising formats and we've had some great successes. Lion's Gate marked the opening of the film The Forbidden Kingdom, for example, and it had over 4 million video views on YouTube just from that promotion. So that was very exciting for us and for Lion's Gate.

I should mention that Mobile Search has been growing quite a bit, and of course you may have heard about our partnership that we've launched this past quarter with NTT DoCoMo in Japan. Japan is a very strong market for Mobile Search, and it's because of the devices, because of the culture, it's just a really tremendous, tremendous environment. People do many, many mobile searches. We have a robust advertising market there for Mobile Search.

And, we are certainly optimistic that many of these advances, which may initiate in Japan, will carry over in the rest of the world as the devices and culture catch up.

I want to also mention that our Mobile Search experience, which we have now rolled out to more countries and we've made substantially faster, is also causing a lot of growth in that segment [for us].

One of the things that I'm most excited to tell you about today is our progress with Apps. And I should mention, first of all, that our enterprise business with respect to Apps has been growing very rapidly. There are now more than 0.5 million businesses that are using Google Apps for their day-to-day productivity, and that's just a tremendous number. But just to give you color of what some of these businesses include, in this past quarter, Valeo, one of the world's leading automotive suppliers, now has 32,000 users using Google Apps including, of course, Gmail, Calendar, Docs, Sites and so forth. The government of Washington D.C. has 38,000 users on Google Apps. General Electric has adopted the securities side of the Apps products, which was formerly Postini, and that's running on over 300,000 users.

And just to call out a few other highlights, the Telegraph Media Group and Sanmina both also adopted Google Apps. So it has been a very exciting quarter for that. Starting from these 500,000 businesses, including some of these incredibly successful businesses, we really expect this to be an important area for growth and development.

I also just want to tell you, we don't view Google Apps and what not -- we don't want to create a closed environment or a walled garden. We really want to encourage more and more cloud computing, and want to see more and more companies out there successful in deploying cloud solutions. One of the things that we've launched in this past quarter to help out with that is the Google App engine, which basically means that developers can easily write an application and deploy it on our scaled infrastructure rather than having to try to put together all their own computers, data centers, networking, all that stuff. We handle all that for the developers. And we've had a rapidly growing base.

136-0006

Just a few fun examples -- we had a nine-year-old boy who contacted us with a bunch of questions, and then he has been able to develop his app on the Google App engine. And he said that he has been able to do it now because previously he was spending all of his allowance on hosting, and he could no longer afford that.

Other more commercial ventures include [Pick Source], a chat application that switched to Google Apps engine after they launched it, and it was subsequently purchased by the social network [Hi5]. As well as, for those of you who are into poking, BuddyPoke, a very popular open social app which is running on orkut and MySpace, has also been developed on the Google App engine.

We expect that we're going to have a lot of uptake of our various developer products and APIs, including the Google App engine. And ultimately, we think that the cloud is just a really great place to deploy apps because of the simplicity for end users to access them, the ease of updating and maintaining them. It's really a great environment. We obviously live with it every day, and we believe it really helps people be more effective and productive in their day-to-day lives.

Anyway, all told, great quarter, lots and lots of progress. And it's been a pleasure to talk to you about it.

ERIC SCHMIDT: Thank you very much, Sergey. Why don't we go straight to everybody's questions, so are we ready? Let's hear the first question.

Questions and Answers

OPERATOR: (OPERATOR INSTRUCTIONS) Imran Khan, JP Morgan.

IMRAN KHAN, ANALYST, JP MORGAN: I know, if I look at that UK growth rate, it seems like on a year-over-year basis growth rate decelerated 10 points. I was trying to understand, is it because of law of large numbers, are you seeing any specific weakness that's dragging the growth down there?

And the second question is related to the Mobile Search. I know, Sergey, you talked about the Mobile Search opportunity. Do you think that the mobile search will expand the search volume, and as well as -- what kind of impact, also, do you expect from on the revenue per queries with that? And also, if you have seen any impact from Apple iPhone yet?

ERIC SCHMIDT: Jonathan, do you want to go ahead and answer the UK question?

JONATHAN ROSENBERG, SVP, PRODUCT MANAGEMENT, GOOGLE: I think basically we are just seeing the typical Q2 seasonality. If you look back at Q1, that, of course, was very big. I think we talked in the call in Q1 about some of the verticals like travel. I think the other point would be that we have very, very high market share in the UK. So, as our market share grows, I think in past quarters when you looked at seasonality, the gains in market share may have been masking some of the seasonality. And now what we're seeing is just the typical appropriate Q2 seasonality. (multiple speakers) negligible.

ERIC SCHMIDT: Sergey?

SERGEY BRIN: Yes, on Mobile I certainly expect to see an uptick in Search volume due to Mobile because you are obviously not always at your desktop, but you pretty much always want to know something. And with respect to the revenues per query, I think that will vary from market to market. I think it will also vary as we develop more specialized monetization programs for mobile phones.

You know, in some respects you can't fit as much advertising, obviously, on a really small screen. On the other hand, the queries are very localized. You might be standing right next to that pizza place that wants to entice you to become a customer or something like that. So I think there's an opportunity for much more fine-grained targeting. And both of those things are going to balance out.

With respect to the iPhone, I don't have data off the top of my head with respect to the latest iPhone 3G launch. But certainly, the iPhone, much as I mentioned also the maturity of the Japan market, these better devices, devices with great browsers like the iPhone that make it easy for people to search and then view the results -- they definitely have much higher usage per device than other kinds of devices. And just the kind of -- on the rough order of magnitude, imagine that by 30 times as many searches per user might be done by an iPhone user as compared to a conventional cell phone.

136-0007

So I think, as you see more iPhones out there, as you see more other phones that also start to have capable browsers and input methods, I think you're going to see tremendous growth there.

OPERATOR: Brian Pitz, Banc of America Securities.

BRIAN PITZ, ANALYST, BANC OF AMERICA SECURITIES: We have a couple of questions around ad coverage. Clearly, you have intentionally reduced coverage on Google.com over the last couple of quarters to improve ad quality. Would you give us a sense for how far you are in this process? And on a related note, you expanded [auto match] to more advertisers this quarter. Do you see this as a significant driver of coverage going forward? And, any other comments on coverage would be great. Thanks.

ERIC SCHMIDT: Jonathan?

JONATHAN ROSENBERG: Sure. So basically coverage -- coverage, I think, from a quarter-to-quarter basis has been going down. It's pretty much at an all-time low relative to the last few quarters. That's basically our continued focus on quality. I don't really see that changing significantly. I think, in the limit, Larry often says that we'd be best off if we just showed one ad, the perfect ad. So I really don't think that coverage is going to change much.

The second question was?

BRIAN PITZ: Just pertaining to auto match, traction there. Do you see this potentially as a driver of coverage?

JONATHAN ROSENBERG: Yes, sure. We only just started expanding Automatch. It was in beta, so we only expanded it, I think, to a slightly bigger group of advertisers this quarter. Certainly, Automatch can help increase coverage because it helps find more keywords that a query will trigger on. But we're going to apply the same quality efforts to the output of Automatch. So overall, I think that the net result in terms of total coverage would not be significantly greater. I do think the impact on revenue would be positive.

BRIAN PITZ: Any sense on what percentage of advertisers aren't really optimizing their budgets that Automatch could help with?

JONATHAN ROSENBERG: Wow, (multiple speakers) a large number.

ERIC SCHMIDT: I think it's really too early to give you -- the answer is, it should apply to everybody. Sergey, do you want to add a little bit about coverage?

SERGEY BRIN: Yes. I just wanted to talk a little bit about that. There is some evidence that I think we've been probably a little bit more aggressive in decreasing coverage than we ought to have been. Historically, we've had this 50-50 rough notion that when we have an improvement in advertising targeting, we try to split the benefit, if you will. We try to reduce our coverage, at the same time as improving the monetization. But clearly, that's not the ideal strategy indefinitely, because we don't want to end up with no ads.

In fact, from a quality point of view, we now find our ads are a significant addition quality-wise to our page. They are just a very important source of information. So we've been, actually, re-examining some of that and there was some evidence internally that perhaps we were a little overly aggressive in decreasing coverage in this past quarter.

OPERATOR: James Mitchell, Goldman Sachs.

JAMES MITCHELL, ANALYST, GOLDMAN SACHS: Hal, I think you mentioned that queries were up year-on-year in every major sector, but erratic within subsectors, for example, in auto finance as opposed to autos. If queries are down in a particular subsector, do advertisers generally respond by bidding up the keywords that are available so they can fully spend their budgets? Or, is that not the case that budgets go unspent?

HAL VARIAN: Sometimes we see that happening, where advertisers are competing more and more aggressively for a smaller set of consumers. So we typically do see a price response to this slackening in the sector, and we've seen that even in automotive, for example, in the spring when there were a lot of deals offered to get cars off the lot and the automakers were advertising quite aggressively in all media to try to convince consumers to buy. So this is an effect that we sometimes encounter.

OPERATOR: Justin Post, Merrill Lynch.

JUSTIN POST, ANALYST, MERRILL LYNCH: Eric, on the press release, you chose to highlight that you are seeing some economic weakness. I don't think the Company was talking much about that last quarter. Are you seeing things deteriorate a little bit further than where we were a quarter ago? Can you give some color on that?

And then, on the YouTube acquisition, just wondering where you are at with some press comments out recently, where you're at on that versus your deal model at this point.

ERIC SCHMIDT: I'm going to have Hal actually talk a little bit about just sort of the nature of the environment because I think all of us have anecdotal evidence, but in fact Google has continued to do well. There is obviously evidence of a slowdown in the US and Europe; you read it in the paper every day. We continue to believe that we are very, very well-positioned in such a slowdown, and especially if it gets worse.

And the reason is that people -- there's a flight to quality and, in particular, a flight to measurability. So our economics are more driven by, for example, if people stop searching for something we might not be able to do ads against it. Maybe Hal can articulate that, a little bit better than I can.

On the YouTube side, we are enormously happy with YouTube. YouTube is a cultural and end user success that is far, far greater than we ever expected. On the revenue side, we are working on revenue scenarios and new revenue products. And I personally do not believe that the perfect ad product for YouTube has been invented yet. We've just brought out some little in-video ads, looks very good. Hal, maybe you want to talk about economics, and maybe Omid, you can talk a little bit about YouTube sales.

HAL VARIAN: Sure. On the consumer side, I already mentioned that some durables like consumer appliances and furnishings are holding up pretty well. In fact, if you look at apparel and shopping, people are still spending money online in a pretty strong way. I think part of what's happening is that, as times get a little uncertain, price-sensitive consumers are going to shop more carefully and try to make every dollar count, and that means they're going to be doing research online and they are going to be doing shopping online. So I think we have a little bit of the Wal-Mart effect going on that, as times get tough, people are going to watch their dollars. And in many cases that means doing more shopping online.

OMID KORDESTANI, SVP, GLOBAL SALES & OPERATIONS, GOOGLE: I wanted to add to Eric's comments about YouTube. I think we are spending a lot of time internally on understanding how to streamline and integrate DoubleClick, improve the sales process as well as just pure customer activity. We're having great success. Again, as usual, I'd like to highlight some of the advertising names from Lenovo, Footlocker, Lion's Gate, Oreo, Kraft Foods, IKEA, Lipton Tea -- these are the kinds of advertisers that we really did not have access or the proper types of advertising opportunities for before as much as we do now. The Footlocker example is a particularly good one as the media they use on Google was extremely broad, from YouTube search, the content network, and within the content network also access to MySpace, gadget ads, print ads and audio ads. So you can just see the way that our sales force and our product teams are working with a broader set of advertisers, broader set of offerings and a very much integrated platform approach.

And search has taken a long time for us to develop, and it still takes a lot of time for us and a lot of hard work. And we are putting a lot of energy on getting the right approach on YouTube and display advertising.

OPERATOR: Christa Quarles, Thomas Weisel Partners.

CHRISTA QUARLES, ANALYST, THOMAS WEISEL PARTNERS: Just a couple questions on DoubleClick. First, I was wondering if you could outline within licensing how much it contributed in the quarter. Second, if you could indicate if you're seeing any macroeconomic impact there. Obviously, you've made some comments about search specifically. But I was wondering if you could highlight it for DoubleClick. And then, third, just maybe some comments about how you are changing the buying process around display, I guess where you see the innovations coming in display over the next year or two.

ERIC SCHMIDT: We are not going to break out DoubleClick, and our comments are not -- basically, it's early. And so far, we are very pleased with it. It looks like it was a very, very sharp decision on our part to go ahead and get the integration. The team looks very strong. The strategy, once the acquisition was approved and so forth and so on was to develop a broad product line that went from the large customer, large advertiser, which was the traditional DoubleClick customer, all the way down to the very small advertiser through AdWords and essentially integrate all the offering. This is public information; we've said this for the previous year during the regulatory strategy, and indeed,

136-0009

that's happening now. So the theory here is that an advertiser will be able to advertise across all of the different size publishers with one mechanism.

And that's the goal. We think we can achieve that, and it will be fairly soon, some number of months, not years.

CHRISTA QUARLES: And the macro?

ERIC SCHMIDT: No particular change in the macro environment. DoubleClick is doing well. Omid, do you want to emphasize any of this?

OMID KORDESTANI: I agree with Eric. I think we have anecdotal experiences, customers, some customers that act erratically, you know, I think really affected maybe by the macro environments and stop the spending. But then we see that pick up again the following month. So it's very hard to judge this. I don't think we have any trends that we can comment on.

HAL VARIAN: I guess the one thing, some of the innovation has already started. We have an internal roadmap in terms of the innovations for the next couple of years, which I obviously can't go through here. But just this quarter we launched the AdPlanner, which basically lets advertisers designate target audiences and see exactly which sites they want to attract for an audience. We've got the Google AdManager in test, which is basically a free tool that helps publishers sell, schedule, deliver and measure their inventory. Sergey, I think, mentioned in his script the third-party serving, and we've also got some new features to let advertisers select target sites and keywords.

So all of that, I think, is really addressing the big problem in display, which is the highly fragmented market. And that's the focus of most of the innovations that you'll see coming out in the next year or so.

OPERATOR: Doug Anmuth, Lehman Brothers.

DOUG ANMUTH, ANALYST, LEHMAN BROTHERS: Question for George, we're not letting you off the hook quite yet. On the interest income, you detailed, I think, four pieces, actually, that contributed to the decrease in the interest income quarter-to-quarter. Could you provide a little bit more color there? In particular, how should we think about that going forward? Is this a one-quarter effect, or is it something that we're likely to see continue over the next couple of quarters?

GEORGE REYES: So I think what we're trying to portray here is that, in fact, we have a very healthy business and we have been investing in -- we've been investing in the business and the lower yields on our cash balances is what has really brought down what you've seen thus far, all the way through the average cash balances, as a result that cash is used first. And then DoubleClick is also a consumer of that as well.

DOUG ANMUTH: And in terms of the marketable securities and the FX hedging, are you implying that those two are less significant factors for the impact this quarter?

GEORGE REYES: No. We're actually in the process of building our internal portfolio here, so it's hard for me to say more than that.

OPERATOR: Ben Schachter, UBS.

BEN SCHACHTER, ANALYST, UBS: The headcount growth was really among its lowest levels in a long time. Is that 500 new net employees a number you are comfortable with on a quarterly basis? And where are you still looking to add, and what areas are you comfortable with headcount?

ERIC SCHMIDT: In the first place, we won't suggest a number going forward. The Company is now a reasonably large company by comparison to its peers, and we don't need massive new people in large communities that were not there before. We've largely built out a good management structure globally. So it's really dependent upon the kind of quality of people we can hire.

You'll remember a few quarters ago we actually allowed the hiring engine to get ahead of things, and we said that we would focus on that a little bit more carefully, and we have indeed done so. So I think what you'll see going forward is prudent management of headcount growth. The Company is going to continue to grow. This number may or may not be a specific number going forward, but the important point is we are paying a lot of attention to headcount. We want to make sure that we maintain the quality.

And of course also as a larger company we need to make sure that we can use the resource effectively. We never want to misuse somebody's talents as an employee.

136-0010

BEN SCHACHTER: If I could just follow up on a question on mobile, Sergey, you had discussed the evolution of the marketplace. I was wondering, at some point, can we expect to see a completely separate marketplace for mobile ads that comes with its own auction (inaudible) et cetera? Or will it continue to be an extension of the current model?

SERGEY BRIN: Yes, so currently, we do allow advertisers to place separate ads for mobile. In fact, I see them converging more in the future because, once you start to get these phones that have fully capable browsers and things like that, then there's not that much reason for disparity. Now, at the same time, as I mentioned, phones in some sense will have new capabilities that the desktop doesn't, such as location, things like that. So me may add some capability beyond the basic desktop advertising capability that we have.

But I think it will be a more fluid experience for advertisers in terms of, you know, you can select please run on mobile, too, or don't, rather than trying to have completely separate worlds.

JONATHAN ROSENBERG: Just adding to Sergey's comments, I agree with him. I'd just like to give you an example of one of the dynamics that will be different on the mobile phones. We've been talking for awhile about the fact that when you are on a mobile phone, you are much more likely to be interested in consummating a transaction if you run a search. One of the winners of the 1700 applications submitted for the Android Developer Challenge was a product that was developed called Android Scan. And basically, what it allows a user to do is take a picture of a product with a bar-code. And then they can research the product on their mobile browser. They can do price comparisons. They can figure out how far a store that can actually sell that browser might be, or they could actually figure out who to buy it from online.

Imagine the value of an ad in that kind of a scenario. So the bidding mechanisms for some of the local ads will differ in terms of the efforts that we have to scale to get them on to Mobile. But in many ways, they could be much, much more valuable.

OPERATOR: Mark Mahaney, Citi.

MARK MAHANEY, ANALYST, CITI: On the G&A line, it seemed a little bit ahead of expectations. Was there any one-time integration-related costs in that G&A line?

And then back to YouTube, Eric, you made a comment about not having yet found maybe the ideal ad solution. Could you talk about what the technical challenge is there? Or, is it finding the right format, or is it figuring out a way to best target ads against -- trying to figure out what the real content of a video is?

ERIC SCHMIDT: On the YouTube side, we basically are innovators in advertising and we've tried post-roll, pre-roll, in-the-chrome kind of ads. We're having a great deal of success now with these in-video ads, where the ads are essentially in the bottom and embedded inside of the video. That looks like a pretty good winner right there.

We've also had some significant success with gadget ads and gadget video ads are likely to be particularly effective because they allow you to tell a story.

If you look, the advertisers that we are working with and the content that we're working with are also using the format differently. There, as a typical example, is that the Lion's Gate deal, which was announced yesterday, Lion's Gate works with people who upload the segments of the Lion's Gate movies that they like and they capture them using our [claim ware] content product, and then they can run ads against them. So again, here's a community that's busy making copies that are not authorized of content, and Lion's Gate has the good judgment to say, rather than go and sue those customers, instead, let's go capture that, show an ad against them and get them even more excited about our content and our other content.

So we think those kinds of models are sustainable and scalable on the Internet and are likely to be very, very significant sources of revenue. I think it's axiomatic that a new form, and I view YouTube as a new form of video entertainment, will not ultimately use the old forms to monetize. There will be new monetization forms that will go for the new entertainment form, and that's what we're seeking.

That is the Holy Grail. When we find it or the combination of it, it's likely to be very, very large because of the scale and scope of YouTube.

On the G&A line, I want to make sure we answer that question.

GEORGE REYES: So the main increase was due to legal and professional and outsourcing services, as well as fees. So that's your answer. So, as you know, we also don't give guidance.

136-0011

MARK MAHANEY: One-time-ish, or generally sustainable?

GEORGE REYES: Generally sustainable? No. I mean -- no.

ERIC SCHMIDT: Unfortunately, the legal stuff is [bursty] because we have suits, it's welcome to the information economy.

OPERATOR: Jeetil Patel, Deutsche Bank.

JEETIL PATEL, ANALYST, DEUTSCHE BANK: First of all, you talked earlier about basically your ad coverage may have come down a little too much, and I guess Larry's idea is to be a little bit more targeting oriented, so serving the right ad. Can you talk about, in terms of that evolution or phase of the business, how far along are you in trying to better optimize the ads against the intent of the consumer across the entire network and platform today?

And then second, on the AdSense for the content side of the business, how difficult or easy would it be to convert it into a display ad network? Is this something that you would look to do? And, how does that display ad around AdSense for content -- do those two things marry up nicely or not?

SERGEY BRIN: Great questions. Let me take them in reverse order. With respect to display in AdSense for content, we actually allow for display in AdSense for content today. That's something -- it's a publisher's setting that publishers need to choose. And in those cases where they are chosen, then we will run display ads, to the extent that their yield is higher than the text ads that we can run in that space. So that's something that we are doing today and we are looking to grow and we're certainly excited about.

In general, let me just take a step back. Looking at the evolution of our overall search text ads system, from its initial starts, when we could barely feed the ad team pizza with the money that we were able to generate off the first iteration of their ads, to several iterations down the road over a number of years and through the maturation and the attraction of the advertiser base and them being able to set up really good campaigns for them, it's a multi-year process to get to where we are now. And we obviously are continuing to improve, to attract new advertisers, to improve the targeting and so forth.

So, now that we have the advertiser base, we don't necessarily need to wait quite as long to attract the advertiser base, to begin with. But for advertisers to create new types of ads for new medias, what not, these things do take time for us to go through all the experimentation of what formats and systems might work best also takes time. And just me looking back, going from '98, '99, 2000, where we were then with search ads, I feel some of these areas, YouTube ads, content ads, display and what not, are actually progressing at a faster pace.

JEETIL PATEL: You made a point earlier -- just the last question -- but that you may have gone too far on the ad coverage side, and the advertisements' ad relevance. Are you seeing basically that it's affecting the frequency of usage or search frequency because you may have dialed down ad coverage a little too much? Is that where the impact you are seeing? And if you dial it back up a bit, you may see greater usage from a consumer standpoint across in terms of frequency of searching across the entire network?

SERGEY BRIN: Yes, great question. I think that, first of all, we certainly run plenty of experiments. We're all the time running experiments. We run some people without any ads at all. And we know that our ads add value, so we know that we're happy about having them.

Now, I don't know it's the case that we're necessarily sort of decreased them past below the optimal point. But I know that we will do that in the near future if we continue with the system that we have had in place. That's what we've really had to have second thoughts about. What -- it makes more sense to me just to ask some [folks] for the optimal coverage, if you will. And that's what we're trying to figure out exactly how to do now.

OPERATOR: David Joseph, Morgan Stanley.

DAVID JOSEPH, ANALYST, MORGAN STANLEY: Just a quick question on universal search -- it seems like you have been ramping it up or you ramped it up more during the quarter. I'm just wondering what percentage of total search results universal search is today. And also, what maybe different unit user behavior is seen with universal search versus traditional text search.

And also, George, I guess one of the last questions for you is that, it looks like the incremental margin for Google improved pretty nicely sequentially and year-over-year. We do know that you had an easier comparison with the year-

136-0012

ago period, but I'm wondering if you also have been implementing or some of the programs that you have been implementing for increased financial discipline are actually starting to work now.

GEORGE REYES: Yes, we have actually made a very concerted effort to drive more accountability into the business, so that's a theme that will carry forward.

ERIC SCHMIDT: Sergey, do you want to answer the universal question?

SERGEY BRIN: Yes, universal search. So we've got -- a bit under a third of all queries now have some kind of universal search components in them. And this is just, by comparison, in the first quarter it was more like a tenth. So it's big, big improvements. And yes, our feeling is definitely that this -- and experiments, by the way, also justify this -- but this is significant improved information for our end users.

And it's amazing to me just if I look at the video, for example, video universal, which alone is at about 10%, now, of queries -- people have videos for, often, very -- for things that you wouldn't expect. I mentioned before, maybe it was on one of these calls. But I was looking to buy a RAID, like an array of disks, to store stuff on. It's not the kind of query you would expect might have good videos about it. But in fact, the particular RAID I was interested in, somebody had put together a video. This is how you take it out of the box, this is how you swap the drive on it, all those things. And in fact, that compelled me to buy that particular RAID.

So I think that you'll find increasing universal coverage in [purposes] that you wouldn't expect, and [that source] particularly would be [valuable], because the user would not have thought to click on the separate video tab in that query. We have to bring that information to the user. That's what we're doing.

DAVID JOSEPH: So are you seeing click-through rates a little bit less on universal search? And, does this actually present a little bit of a different model for search, where you're going to be able to monetize video a little bit differently, or images, for that matter?

SERGEY BRIN: Where it's less than universal search?

DAVID JOSEPH: (multiple speakers) that's a golden triangle, where people are more focused --

ERIC SCHMIDT: No, I think -- again, it's -- the system in aggregate is actually where you are seeing more (multiple speakers).

SERGEY BRIN: Oh, I see. You are saying -- how would it affect. We monitor these things pretty closely point when we launch them, and it's not that we're unwilling to launch things that might adversely affect the ad click-through rates or what not. But in sum total, the launches that we've done, I don't think that's negative. I think it's positive.

OPERATOR: Jeffrey Lindsay, Sanford Bernstein.

JEFFREY LINDSAY, ANALYST, SANFORD BERNSTEIN: Could you give us more detail about your wireless strategy and indicate just how you intend to participate in wireless in the US over the next four to five years? And then, could you give us any updates on the android alliance? When are android devices expected? And then, could you give us an indication of -- do you have to share revenues with Apple and/or AT&T to get Google onto the iPhone?

ERIC SCHMIDT: Sergey, do you want to start on wireless, overall wireless strategy, and then some of the -- (multiple speakers)?

SERGEY BRIN: Yes, overall wireless is very simple. We want our products and the Internet and Web as a whole available on as many devices in as many different markets as possible, so very easy. And we have a twofold approach for that. First, we write our apps and try to make them available on many different platforms, like the iPhone that you mentioned, or we put them on Symbian devices, on BlackBerry's, on Windows mobile devices, all those. We have Google Apps [for] -- .

And we've also, because we've had some challenge sometimes getting things out, like necessarily easily being able to get access to location data to make Maps work really well or things like that, we've developed this android platform. And we've had the same calling from carriers, from handset makers and other application makers that they just want to be able to get these things out more easily. And so we are very excited about android. We are still expecting phones before the end of the year to ship with

ERIC SCHMIDT: And, Jonathan, do you want to talk a little bit about some of the partnerships?

136-0013

JONATHAN ROSENBERG: I guess the main data point in terms of android, there are 34 companies in the open handset alliance. So we are doing pretty well there, and I already alluded to the contest that we ran and the results there with that example of the android scan barcode. There are others that we are very excited about. I think there's a Weather Channel application that will alert people and wake them up when there's a severe weather alert that they need to be aware of. There are some fantastic ones, one called [G-Walk] that helps people take city tours dynamically, and it adjusts to your location and shows points of interest. So there's already very, very significant efforts going on in the developer community in anticipation of the launches later this year.

ERIC SCHMIDT: So let's finish up. Thank you very much, Jonathan and everybody else. I want to thank everybody for spending so much time with us. We look forward to talking to you next quarter, and please have a good summer. Thank you very much.

OPERATOR: And that concludes today's conference. We thank you for your participation. You may now disconnect.

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