Google Inc.
Form 10-Q
May 06, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from __________ to __________

Commission file number: 000-50726

Google Inc.

(Exact name of registrant as specified in its charter)

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

1600 Amphitheatre Parkway

Mountain View, CA 94043

(Address of principal executive offices)

(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 x 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. (Check one):

Large accelerated filer x 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 x

At April 30, 2009, there were 241,087,476 shares of Google s Class A common stock outstanding and 74,851,783 shares of Google s Class B common stock outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GOOGLE INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except par value per share)

	As of December 31, 2008	As of March 31, 2009 (unaudited)
Assets		
Current assets:		
Cash and cash equivalents	$ 8,656,672	$ 10,426,291
Marketable securities	7,189,099	7,358,642
Accounts receivable, net of allowance of $80,086 and $112,511	2,642,192	2,543,105
Deferred income taxes, net	286,105	434,903
Prepaid revenue share, expenses and other assets	1,404,114	1,317,861
Total current assets	20,178,182	22,080,802
Prepaid revenue share, expenses and other assets, non-current	433,846	416,168
Deferred income taxes, net, non-current		52,296
Non-marketable equity securities	85,160	100,999
Property and equipment, net	5,233,843	5,122,105
Intangible assets, net	996,690	910,344
Goodwill	4,839,854	4,830,315
Total assets	$ 31,767,575	$ 33,513,029
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 178,004	$ 196,220
Accrued compensation and benefits	811,643	464,899
Accrued expenses and other current liabilities	480,263	465,164
Accrued revenue share	532,547	522,835
Deferred revenue	218,084	216,937
Income taxes payable, net	81,549	317,799
Total current liabilities	2,302,090	2,183,854
Deferred revenue, non-current	29,818	30,146
Income taxes payable, net, non-current	890,115	1,160,158
Deferred income taxes, net, non-current	12,515	
Other long-term liabilities	294,175	290,776
Stockholders equity:		
Convertible preferred stock, $0.001 par value, 100,000 shares authorized; no shares issued and outstanding		
Class A and Class B common stock, $0.001 par value: 9,000,000 shares authorized; 315,114 (Class A 240,073, Class B 75,041) and par value of $315 (Class A $240, Class B $75) and 315,761 (Class A 240,872, Class B 74,889) and par value of $316 (Class A $241, Class B $75) shares issued and outstanding, excluding 26 and 10 Class A shares subject to repurchase at	315	316

December 31, 2008 and March 31, 2009		
Additional paid-in capital	14,450,338	14,694,501
Accumulated other comprehensive income	226,579	168,820
Retained earnings	13,561,630	14,984,458
Total stockholders equity	28,238,862	29,848,095
Total liabilities and stockholders equity	$ 31,767,575	$ 33,513,029

See accompanying notes.

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GOOGLE INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

	Three Months Ended March 31,	
	2008	**2009**
	(unaudited)	
Revenues	$ 5,186,043	$ 5,508,990
Costs and expenses:		
Cost of revenues (including stock-based compensation expense of $9,148 and $12,537)	2,110,536	2,101,504
Research and development (including stock-based compensation expense of $193,800 and $168,561)	673,069	641,643
Sales and marketing (including stock-based compensation expense of $42,576 and $59,026)	446,898	433,941
General and administrative (including stock-based compensation expense of $35,255 and $37,359)	409,305	448,311
Total costs and expenses	3,639,808	3,625,399
Income from operations	1,546,235	1,883,591
Interest income and other, net	167,343	6,210
Income before income taxes	1,713,578	1,889,801
Provision for income taxes	406,492	466,973
Net income	$ 1,307,086	$ 1,422,828
Net income per share of Class A and Class B common stock:		
Basic	$ 4.17	$ 4.51
Diluted	$ 4.12	$ 4.49

See accompanying notes.

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GOOGLE INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2009
	(unaudited)	
Operating activities		
Net income	$ 1,307,086	$ 1,422,828
Adjustments:		
Depreciation and amortization of property and equipment	280,564	321,129
Amortization of intangibles and other	55,960	82,093
Stock-based compensation expense	280,779	277,483
Excess tax benefits from stock-based award activities	(51,101)	(31,844)
Deferred income taxes	(38,214)	(12,847)
Other, net	(44,903)	(21,409)
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(223,493)	97,390
Income taxes, net	438,175	324,753
Prepaid revenue share, expenses and other assets	(41,584)	77,457
Accounts payable	53,784	21,879
Accrued expenses and other liabilities	(234,277)	(322,339)
Accrued revenue share	(10,124)	4,264
Deferred revenue	6,794	8,675
Net cash provided by operating activities	1,779,446	2,249,512
Investing activities		
Purchases of property and equipment	(841,597)	(262,755)
Purchases of marketable securities	(2,819,512)	(5,244,845)
Maturities and sales of marketable securities	5,379,228	5,109,590
Investments in non-marketable equity securities		(18,750)
Acquisitions, net of cash acquired, and purchases of intangible and other assets	(3,125,113)	(2,072)
Net cash used in investing activities	(1,406,994)	(418,832)
Financing activities		
Net payments related to stock-based award activities	(22,445)	(36,736)
Excess tax benefits from stock-based award activities	51,101	31,844
Net cash provided by (used in) financing activities	28,656	(4,892)
Effect of exchange rate changes on cash and cash equivalents	37,048	(56,169)
Net increase in cash and cash equivalents	438,156	1,769,619
Cash and cash equivalents at beginning of year	6,081,593	8,656,672
Cash and cash equivalents at end of period	$ 6,519,749	$ 10,426,291
Supplemental disclosures of cash flow information		
Cash paid for interest	$ 387	$ 162

Cash paid for income taxes	$ 12,091	$ 158,439

See accompanying notes.

GOOGLE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

Nature of Operations

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

Basis of Consolidation

The Consolidated Financial Statements include the accounts of Google and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

Unaudited Interim Financial Information

The accompanying Consolidated Balance Sheet as of March 31, 2009, the Consolidated Statements of Income for the three months ended March 31, 2008 and 2009, and the Consolidated Statements of Cash Flows for the three months ended March 31, 2008 and 2009 are unaudited. These unaudited interim Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles. 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 March 31, 2009, our results of operations for the three months ended March 31, 2008 and 2009, and our cash flows for the three months ended March 31, 2008 and 2009. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the year ending December 31, 2009.

These unaudited interim Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and related notes included in our 2008 Annual Report on Form 10-K filed on February 13, 2009.

Use of Estimates

The preparation of interim Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the amounts reported and disclosed in the financial statements and the accompanying notes. Actual results could differ materially from these estimates. On an ongoing basis, we evaluate our estimates, including those related to accounts receivable and sales allowances, fair values of financial instruments, fair values of prepaid revenue share, intangible assets and goodwill, useful lives of intangible assets and property and equipment, fair values of options to purchase our common stock, and income taxes, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Effect of Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*, which amends and clarifies the initial recognition and measurement, subsequent measurement and accounting, and related disclosures of assets and liabilities arising from contingencies in a business combination under Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), *Business Combinations* (SFAS 141R). This FSP is effective for assets and liabilities arising from contingencies in business combinations for which the acquisition date is on or after December 15, 2008. We adopted this FSP in the first quarter of 2009 and the impact of the adoption on our consolidated financial statements largely depends on the size and nature of the business combinations.

In April 2009, the FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly,* which provides additional guidance for estimating fair value in accordance with SFAS No. 157, *Fair Value Measurements* (SFAS 157). This FSP states that a significant decrease in the volume and level of activity for the asset or liability when compared with normal market activity is an indication that transactions or quoted prices may not be determinative of fair value because there may be increased instances of transactions that are not orderly in

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such market conditions. Accordingly, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value. This FSP is effective for us beginning April 1, 2009. We do not expect the impact of the adoption of this FSP to be material on our consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, which requires disclosures about the fair value of our financial instruments for which it is practicable to estimate that value, whether recognized or not recognized in the balance sheets, in the interim reporting periods as well as in the annual reporting periods. In addition, the FSP requires disclosures of the methods and significant assumptions used to estimate the fair value of those financial instruments. This FSP is effective for us beginning April 1, 2009. We do not expect the impact of the adoption of this FSP to be material on our consolidated financial statements.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments,* which establishes a new method of recognizing and reporting other-than-temporary impairments of debt securities and requires additional disclosures related to debt and equity securities. This FSP does not change existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This FSP is effective for us beginning April 1, 2009. We do not expect the impact of the adoption of this FSP to be material on our consolidated financial statements.

Note 2. Net Income Per Share of Class A and Class B Common Stock

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

	For the Three Months Ended March 31,			
	2008		2009	
	(unaudited)			
	Class A	Class B	Class A	Class B
Basic net income per share:				
Numerator:				
Allocation of undistributed earnings	$ 989,006	$ 318,080	$ 1,084,488	$ 338,340
Denominator:				
Weighted average common shares outstanding	237,185	76,219	240,303	74,965
Less: Weighted average unvested common shares subject to repurchase or cancellation	(256)	(19)	(16)	
Number of shares used in per share computation	236,929	76,200	240,287	74,965
Basic net income per share	$ 4.17	$ 4.17	$ 4.51	$ 4.51
Diluted net income per share:				
Numerator:				
Allocation of undistributed earnings for basic computation	$ 989,006	$ 318,080	$ 1,084,488	$ 338,340
Reallocation of undistributed earnings as a result of conversion of Class B to Class A shares	318,080		338,340	
Reallocation of undistributed earnings to Class B shares		(2,868)		(1,715)
Allocation of undistributed earnings	$ 1,307,086	$ 315,212	$ 1,422,828	$ 336,625
Denominator:				
Number of shares used in basic computation	236,929	76,200	240,287	74,965
Weighted average effect of dilutive securities				
Add:				
Conversion of Class B to Class A common shares outstanding	76,200		74,965	
Unvested common shares subject to repurchase or cancellation	275	19	16	
Employee stock options and warrants under Transferable Stock Option program	3,244	322	1,767	86

Restricted shares and restricted stock units	744		186	
Number of shares used in per share computation	317,392	76,541	317,221	75,051
Diluted net income per share	$ 4.12	$ 4.12	$ 4.49	$ 4.49

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

Note 3. Cash and Investments

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

	As of December 31, 2008	As of March 31, 2009 (unaudited)
Cash and cash equivalents:		
Cash	$ 3,330,658	$ 4,070,597
Cash equivalents:		
U.S. government agencies		214,998
Municipal securities	14,250	
Time deposits	3,015,557	3,027,156
Money market mutual funds	2,296,207	3,113,540
Total cash and cash equivalents	8,656,672	10,426,291
Marketable securities:		
U.S. government notes		410,233
U.S. government agencies	3,342,406	3,943,242
Municipal securities	2,721,603	2,000,677
Money market mutual funds	73,034	50,132
Corporate debt securities	907,056	694,692
Agency residential mortgage-backed securities		60,312
Commercial mortgage-backed securities		47,883
Marketable equity security	145,000	151,471
Total marketable securities	7,189,099	7,358,642
Total cash, cash equivalents and marketable securities	$ 15,845,771	$ 17,784,933

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, 2008			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies	$ 3,324,750	$ 17,747	$ (91)	$ 3,342,406
Municipal securities	2,690,270	34,685	(3,352)	2,721,603
Money market mutual funds	73,034			73,034
Corporate debt securities	903,963	3,265	(172)	907,056
Marketable equity security	145,000			145,000
Total	$ 7,137,017	$ 55,697	$ (3,615)	$ 7,189,099

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	As of March 31, 2009			
	Adjusted Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(unaudited)		
U.S. government notes	$ 410,153	$ 80	$	$ 410,233
U.S. government agencies	3,932,108	11,253	(119)	3,943,242
Municipal securities	1,964,823	36,151	(297)	2,000,677
Money market mutual funds	50,132			50,132
Corporate debt securities	695,000	499	(807)	694,692
Agency residential mortgage-backed securities	59,939	373		60,312
Commercial mortgage-backed securities	47,906	69	(92)	47,883
Marketable equity security	145,000	6,471		151,471
Total	$ 7,305,061	$ 54,896	$ (1,315)	$ 7,358,642

Time deposits were held by institutions outside the U.S. at December 31, 2008 and March 31, 2009. Gross unrealized gains and losses on cash equivalents were not material at December 31, 2008 and March 31, 2009.

Our corporate debt securities are guaranteed by the full faith and credit of the United States government under the Federal Deposit Insurance Corporation s Temporary Liquidity Guarantee Program (TLGP) or the sovereign guarantee of foreign governments under similar programs to the TLGP.

Our agency residential mortgage-backed securities are specified pools of mortgage pass-through securities that are guaranteed by government-sponsored enterprises. Our commercial mortgage-backed securities are fully defeased securities with underlying collateral loans replaced by U.S. Treasury notes.

We recognized gross realized gains of $50.8 million and $34.3 million on the sale of our marketable securities for the three months ended March 31, 2008 and 2009. Gross realized losses were not material in either period. 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 securities, excluding the marketable equity security, designated as available-for-sale classified by the contractual maturity date of the security (in thousands):

	As of March 31, 2009 (unaudited)
Due within 1 year	$ 3,108,150
Due within 1 year through 5 years	2,158,027
Due within 5 years through 10 years	674,778
Due after 10 years	1,266,216
Total	$ 7,207,171

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In accordance with Emerging Issues Task Force (EITF) Issue No. 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, 2008 and March 31, 2009, 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, 2008			
	Less than 12 Months		Total	
Security Description	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
U.S. government agencies	$ 183,054	$ (91)	$ 183,054	$ (91)
Municipal securities	274,042	(3,352)	274,042	(3,352)
Corporate debt securities	199,828	(172)	199,828	(172)
Total	$ 656,924	$ (3,615)	$ 656,924	$ (3,615)

	As of March 31, 2009			
	Less than 12 Months		Total	
Security Description	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**
	(unaudited)			
U.S. government agencies	$ 158,374	$ (119)	$ 158,374	$ (119)
Municipal securities	112,408	(297)	112,408	(297)
Corporate debt securities	444,193	(807)	444,193	(807)
Commercial mortgage-backed securities	27,288	(92)	27,288	(92)
Total	$ 742,263	$ (1,315)	$ 742,263	$ (1,315)

As of December 31, 2008 and March 31, 2009, 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, 2009, we held $189.8 million of auction rate securities (ARS). The assets underlying these 35 individual investments are primarily student loans which are mostly AAA rated and substantially guaranteed by the U.S. government under the Federal Family Education Loan Program. Historically, these securities have provided liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined intervals every 7 to 49 days. However, these auctions began to fail in the first quarter of 2008. Since these auctions have failed, we have realized higher interest rates for many of these ARS than we would have otherwise. Although we have been receiving interest payments at these generally higher rates, the related principal amounts will not be accessible until a successful auction occurs, a buyer is found outside of the auction process, the issuer calls the security, or the security matures according to contractual terms. Maturity dates for these ARS investments range from 2025 to 2047. Since these auctions have failed, $47.8 million of the related securities were called at par by their issuers.

As a result of the auction failures, these ARS do not have a readily determinable market value. To estimate their fair values at March 31, 2009, we used a discounted cash flow model based on estimated interest rates, timing and amount of cash flows, the credit quality of the underlying securities and illiquidity considerations. Specifically, we estimated the future cash flows of our ARS over the expected workout periods using a projected weighted average interest rate of 4.0% per annum, which is based on the forward swap curve at the end of March 2009 plus any additional basis points currently paid by the issuers assuming these auctions continue to fail. A discount factor was applied over these estimated cash flows of our ARS, which is calculated based on the interpolated forward swap curve adjusted by up to 2,000 basis points to reflect the current market conditions for instruments with similar credit quality at the date of the valuation and additionally adjusted for a liquidity discount of up to 400 basis points to reflect the risk in the marketplace for these investments that has arisen due to the lack of an active market.

At March 31, 2009, the estimated fair values of these ARS were $32.8 million ($19.5 million, net of tax effect) less than their costs. Based primarily on our ability and intent to hold these securities until recovery and the extent of impairment, we concluded the decline in fair values was temporary and recorded the unrealized loss to accumulated other comprehensive income on the accompanying Consolidated Balance Sheet at March 31, 2009.

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To the extent we determine that any impairment is other-than-temporary, we would record a charge to earnings. In addition, we have concluded that the auctions for these securities may continue to fail for at least the next 12 months and as a result, they have been classified as non-current assets on the accompanying Consolidated Balance Sheet at March 31, 2009.

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 Statements of Income as interest income and other, net, as part of revenues, or to accumulated other comprehensive income (AOCI) on the accompanying Consolidated Balance Sheets.

Cash Flow Hedges

We use options designated as cash flow hedges to hedge certain forecasted revenue transactions denominated in currencies other than the U.S. dollar. Any gain on the effective portion of a cash flow hedge is initially reported as a component of AOCI and subsequently reclassified to revenues when the hedged revenues are recorded or as interest income and other, net, if the hedged transaction becomes probable of not occurring.

At March 31, 2009, the effective portion of our cash flow hedges before tax effect was $338.1 million, of which $316.7 million is expected to be reclassified from AOCI to revenues within the next 12 months.

Any gain after a hedge is de-designated because the hedged transaction is no longer probable of occurring or related to an ineffective portion of a hedge is recognized as interest income and other, net, immediately. Further, the change in the time value of the options is excluded from our assessment of hedge effectiveness. The premium paid or time value of an option whose strike price is equal to or greater than the market price on the date of purchase is recorded as an asset. Thereafter, any change to this time value is included in interest income and other, net.

The notional principal of foreign exchange contracts to purchase U.S. dollars with Euros was €1.9 billion (or approximately $2.6 billion) and €2.1 billion (or approximately $2.8 billion) at December 31, 2008 and March 31, 2009; the notional principal of foreign exchange contracts to purchase U.S. dollars with British pounds was £1.1 billion (or approximately $1.8 billion) and £1.1 billion (or approximately $1.7 billion) at December 31, 2008 and March 31, 2009 ; and the notional principal of foreign exchange contracts to purchase U.S. dollars with Canadian dollars was C$229.7 million (or approximately $202.2 million) and C$261.8 million (or approximately $216.7 million) at December 31, 2008 and March 31, 2009 . These foreign exchange 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 of forward contracts that 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 as well as the related costs are included in interest income and other, net, along with the gains and losses of the related hedged items. Costs incurred related to these contracts during the three months ended March 31, 2008 and 2009 were not material. The notional principal of foreign exchange contracts to purchase U.S. dollars with foreign currencies was $2.6 billion and $2.1 billion at December 31, 2008 and March 31, 2009. The notional principal of foreign exchange contracts to sell U.S. dollars for foreign currencies was $54.2 million and $97.4 million at December 31, 2008 and March 31, 2009. The notional principal of foreign exchange contracts to purchase Euros with other currencies was €630.5 million (or approximately $897.6 million) and €476.7 million (or approximately $634.3 million) at December 31, 2008 and March 31, 2009. The notional principal of foreign exchange contracts to sell Euros for other currencies was €4.0 million (or approximately $5.3 million) at March 31, 2009.

Effective January 1, 2009, we adopted the disclosure requirements of SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133* (SFAS 161). At December 31, 2008 and March 31, 2009, the fair values of our outstanding derivative instruments are summarized below (in thousands):

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	Balance Sheet Location	Fair Value of Derivative Instruments As of December 31, 2008	Fair Value of Derivative Instruments As of March 31, 2009 (unaudited)
Derivative Assets			
Derivatives designated as hedging instruments under SFAS 133:			
Foreign exchange option contracts	Prepaid revenue share, expenses and other assets, current and non-current	$ 451,722	$ 391,700
Derivatives not designated as hedging instruments under SFAS 133:			
Foreign exchange forward contracts	Prepaid revenue share, expenses and other assets, current	13,270	151
Total		$ 464,992	$ 391,851
Derivative Liabilities			
Derivatives not designated as hedging instruments under SFAS 133:			
Foreign exchange forward contracts	Accrued expenses and other current liabilities	877	1,005
Total		$ 877	$ 1,005

The effect of derivative instruments in cash flow hedging relationship on income and other comprehensive income for the three months ended March 31, 2008 and 2009 is summarized below (in thousands):

Derivatives in SFAS 133 Cash Flow Hedging Relationships	Gains Recognized in AOCI on Derivative Before Tax Effect (Effective Portion)		Gains Reclassified from AOCI into Income (Effective Portion)			Gains or (Losses) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)[1]		
	2008	2009	Location	2008	2009	Location	2008	2009
					(unaudited)			
Foreign exchange option contracts	$ 152	$ 137,950	Revenue	$ 95	$ 154,085	Interest income and other, net	$ (1,628)	$ (99,979)
Total	$ 152	$ 137,950		$ 95	$ 154,085		$ (1,628)	$ (99,979)

[1] Amount of gains (losses) recognized in income on derivatives includes losses of $1.6 million and $100.6 million related to the amount excluded from the assessment of hedge effectiveness in the three months ended March 31, 2008 and 2009. Gains (losses) related to the ineffectiveness portion of the hedges were not material in the three months ended March 31, 2008 and 2009.

The effect of derivative instruments not designated as hedging instruments on the Consolidated Statements of Income for the three months ended March 31, 2008 and 2009 is summarized below (in thousands):

Derivatives Not Designated as Hedging Instruments under SFAS 133	Gains or (Losses) Recognized in Income on Derivative Location	2008	2009
		(unaudited)	
Foreign exchange forward contracts	Interest income and other, net	$ (99,600)	$ 112,617
Total		$ (99,600)	$ 112,617

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Note 5. Fair Value Measurements

In accordance with SFAS 157, we measure our cash equivalents, marketable securities, auction rate securities and foreign currency derivative contracts at fair value. 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:

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.

Our cash equivalents and marketable securities are classified within Level 1 or Level 2. This is because our cash equivalents and marketable securities are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Our investments in ARS is classified within Level 3 because they are valued using valuation techniques (see Note 3). Some of the inputs to these models 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.

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

		Fair value measurement at reporting date using		
Description	**December 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:				
Municipal securities	$ 14,250	$	$ 14,250	$
Time deposits	3,015,557		3,015,557	
Money market mutual funds	2,296,207	2,296,207		
Marketable securities:				
U.S. government agencies	3,342,406		3,342,406	
Municipal securities	2,721,603		2,721,603	
Money market mutual funds	73,034		73,034	
Corporate debt securities	907,056		907,056	
Marketable equity securities	145,000	145,000		
Foreign currency derivative contracts	464,993		464,993	
Auction rate securities	197,361			197,361
Total	$ 13,177,467	$ 2,441,207	$ 10,538,899	$ 197,361
Liabilities				
Foreign currency derivative contracts	$ 877	$	$ 877	$
Total	$ 877	$	$ 877	$

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Description	March 31, 2009	Fair value measurement at reporting date using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(unaudited)		
Assets				
Cash equivalents:				
U.S. government agencies	$ 214,998	$		