10-K Filing Data

Section: Item1

>ITEM 1.

BUSINESS

Overview

As our founders Larry and Sergey wrote in the original founders letter, "Google is not a conventional company. We do not intend to become one." As part of that, they also explained that you could expect us to make "smaller bets in areas that might seem very speculative or even strange when compared to our current businesses." From the start, the company has always strived to do more, and to do important and meaningful things with the resources we have.

To help accelerate this, we announced plans in August 2015 to create a new public holding company, called Alphabet. Alphabet is a collection of businesses -- the largest of which, of course, is Google. It also includes businesses that we combine as Other Bets and generally are pretty far afield of our main Internet products such as Verily, Calico, X, Nest, GV, Google Capital and Access/Google Fiber. Our Alphabet structure is about helping businesses within Alphabet prosper through strong leaders and independence.

At Google, our innovations in search and advertising have made our website widely used and our brand one of the most recognized in the world. We generate revenues primarily by delivering online advertising that consumers find relevant and that advertisers find cost-effective. Google's core products such as Search, Android, Maps, Chrome, YouTube, Google Play and Gmail each have over one billion monthly active users. And we believe we are just beginning to scratch the surface. Google's vision is to remain a place of incredible creativity and innovation that uses our technical expertise to tackle big problems. Our Other Bets are also making important strides in their industries, and our goal is for them to become thriving, successful businesses in the long term.

Serving Our Users

In many ways Google search -- and the clean white page with the blinking cursor -- is a metaphor for how we think about innovation. Imagining the ways things could be -- without constraint -- is the process we use to look for better answers to some of life's everyday problems. It's about starting with the "What if?" and then working relentlessly to see if we can find the answer.

It's been that way from the beginning; providing ways to access knowledge and information has been core to Google and our products have come a long way in the last decade. We used to show just ten blue links in our results. You had to click through to different websites to get your answers, which took time. Now we are increasingly able to provide direct answers -- even if you're speaking your question using Voice Search -- which makes it quicker, easier and more natural to find what you're looking for.

Over time, we have added other services that let you access information quickly and easily. What if we could develop a smarter email service with plenty of storage? That's Gmail. What if we could make a simpler, speedier, safer browser? That's Chrome. What if we could provide easy access to movies, books, music and apps, no matter which device you're on? That's Google Play. What if developers could use Google's infrastructure to easily build and scale applications? And what if people could collaborate and get work done from anywhere on any device? That's cloud and apps.

As devices proliferate, it's more and more important to ensure that you can navigate effortlessly across them -- that the technology gets out of the way, so you can move through this multi-screen world as easily as possible. It's why we're investing so much in platforms like our Chrome browser, Chrome OS and our Android mobile operating system. Ultimately, we want you to have speedy, secure access to whatever you need, wherever you happen to be, and on whatever device you may be using at the time.

Ads as Answers

We asked, what if ads weren't intrusive and annoying? What if we could deliver a relevant ad at just the right time and give people useful commercial information? What if we could provide products that allow for better attribution and measurement across screens so that we show great ads for the right people?

Our advertising solutions help millions of companies grow their businesses, and we offer a wide range of products across screens and devices. We generate revenues primarily by delivering both performance advertising and brand advertising.

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Performance advertising

creates and delivers relevant ads that users will click, leading to direct engagement with advertisers. Most of our performance advertisers pay us when a user engages in their ads. Performance advertising lets our advertisers connect with users while driving measurable results.

For performance advertisers, AdWords, our primary auction-based advertising program, helps create simple text-based ads that appear on Google websites and the websites of Google Network Members, who use our advertising programs to deliver relevant ads alongside their search results and content. In addition, our partners that comprise the Google Network use our AdSense program to deliver relevant ads that generate revenues and enhance the user experience. These programs let both small and large businesses connect with users looking for a specific item, say a pair of shoes or a plane ticket back home. To that end, we continue to invest in our advertising programs and to make significant upgrades, including Estimated Total Conversions, which help advertisers measure the effectiveness of their campaigns in a multi-screen world.

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Brand advertising

helps enhance users' awareness of and affinity with advertisers' products and services, through videos, text, images, and other interactive ads that run across various devices. We help brand advertisers deliver digital videos and other types of ads to specific audiences for their brand-building marketing campaigns and in turn, generate revenue by distributing their ads such as the TrueView ads displayed on our YouTube videos.

We have built a world-class ad technology platform for brand advertisers, agencies, and publishers to power their digital marketing businesses. We aim to ensure great user experiences by serving the right ads at the right time and by building deep partnerships with brands and agencies. We also seek to improve the measurability of the effectiveness of brand advertising.

Furthermore, we have invested significantly in programmatic advertising to help advertisers reach users when and where it matters, giving them access to top-tier inventory across screens and formats, as well as the real-time insights that advertisers need to make their buys count.

We have allocated substantial resources to stopping bad advertising practices and protecting users on the web. We focus on creating

the best advertising experiences for our users and advertisers in many ways,

ranging from removing hundreds of millions of bad ads from our systems every year to closely monitoring the sites and apps that show our ads and blacklisting them when necessary to ensure that our ads do not fund bad content.

Bringing the Next 5 Billion Online

Fast search and high-quality ads matter only if you have access to the Internet. Right now, only a fraction of the seven billion people in the world are fortunate enough to be able to get online. That leaves out billions of people. With so much useful and life-changing information available today, it is unfortunate that such a significant portion of the world's population lacks even the most basic Internet connection.

Those people will be able to learn and start businesses, to grow and prosper in ways they simply could not without an Internet connection. Creating platforms for other people's success is a huge part of who we are. We want the world to join us online and to be greeted with the best possible experience once they get there. Connection is powerful; and we are working hard to make it a reality for everyone. The opportunities to improve lives on a grand scale are endless.

And there are people around the world whose lives we can improve every day by bringing information into their homes, into their schools, and into their pockets -- showing them just how powerful the simple idea of "getting online" can be.

At Google, we are helping people get online by tailoring hardware and software experiences that suit the needs of emerging markets, primarily through Android and Chrome. We're also making sure our core Google apps are fast and useful, especially for users in areas where speed, size and connectivity are central concerns.

Other Alphabet companies are pursuing initiatives with similar goals too. That's why we're investing in new projects, like Project Loon. We asked, what if we could use a network of balloons that could fly at the edge of space and provide connectivity in rural and remote areas? Loon has helped students in Brazil and farmers in New Zealand experience the power of an internet connection for the first time. And as the program expands, we hope to bring this to more and more people -- creating opportunities that simply did not exist before for millions of people, all around the world.

Moonshots

The idea of trying new things is reflected in some of our new, ambitious projects both within Google and Other Bets. Everything might not fit into a neat little box. We believe that is exactly how to stay relevant. Many companies get comfortable doing what they have always done, making only incremental changes. This incrementalism leads to irrelevance over time, especially in technology, where change tends to be revolutionary, not evolutionary. People thought we were crazy when we acquired YouTube and Android, and when we launched Chrome. But as those efforts have matured into major platforms for digital video and mobile devices, and a safer, popular browser, respectively, we continue to look towards the future and continue to invest for the long-term.

We won't become complacent, relying solely on small tweaks as the years wear on. As we said in the 2004 Founders' IPO Letter, we will not shy away from high-risk, high-reward projects that we believe in because they are the key to our long-term success. We won't stop asking "What if?" and then working hard to find the answer.

As explained in the letter from our CEO in August 2015, our Alphabet reorganization was implemented to better allow us to structure teams in ways that we believe will produce the fastest, most focused innovation possible for moonshot projects.

Research

We continue to invest in our existing products and services, including search and advertising, as well as developing new products and services through research and product development. We often release early-stage products. We then use data and user feedback to decide if and how to invest further in those products.

Our research and development expenses, which includes the vast majority of engineering and technical headcount responsible for research and development, as well as their associated costs, were

$7.1 billion

,

$9.8 billion

, and

$12.3 billion

in 2013, 2014 and 2015, respectively, which included stock-based compensation expense of

$1.6 billion

,

$2.2 billion

, and

$2.7 billion

, respectively. We expect to continue investing in hiring talented employees and building systems to develop new products and services and improve existing ones.

Competition

Our business is characterized by rapid change as well as new and disruptive technologies. We face formidable competition in every aspect of our business, particularly from companies that seek to connect people with online information and provide them with relevant advertising. We face competition from:

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General purpose search engines and information services, such as Yahoo, Microsoft's Bing, Yandex, Baidu, Naver, WebCrawler, and MyWebSearch.

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Vertical search engines and e-commerce websites, such as Kayak (travel queries), LinkedIn (job queries), WebMD (health queries), and Amazon and eBay (e-commerce). Some users will navigate directly to such content, websites, and apps rather than go through Google.

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Social networks, such as Facebook and Twitter. Some users are increasingly relying on social networks for product or service referrals, rather than seeking information through traditional search engines.

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Other forms of advertising, such as television, radio, newspapers, magazines, billboards, and yellow pages. Our advertisers typically advertise in multiple media, both online and offline.

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Other online advertising platforms and networks, including Criteo, AppNexus, and Facebook, that compete for advertisers with AdWords, our primary auction-based advertising program.

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Other operating systems and mobile device companies.

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Providers of online products and services that provide answers, information, and services. A number of our online products and services, including Gmail, YouTube, and Google Docs, compete directly with new and established companies, which offer communication, information, storage and entertainment services, either on a stand-alone basis or integrated into other offerings.

Competing successfully depends heavily on our ability to rapidly deliver innovative products and technologies to the marketplace so that we can attract and retain:

- Users, for whom other products and services are literally one click away, primarily on the basis of the relevance and usefulness of our search results and the features, availability, and ease of use of our products and services.

- Advertisers, primarily based on our ability to generate sales leads, and ultimately customers, and to deliver their advertisements in an efficient and effective manner across a variety of distribution channels.

- Content providers (Google Network Members, the parties who use our advertising programs to deliver relevant ads alongside their search results and content, as well as other content providers for whom we distribute or license content), primarily based on the quality of our advertiser base, our ability to help these partners generate revenues from advertising, and the terms of our agreements with them.

Intellectual Property

We rely on various intellectual property laws, confidentiality procedures and contractual provisions to protect our proprietary technology and our brand. We have registered, and applied for the registration of, U.S. and international trademarks service marks, domain names and copyrights. We have also filed patent applications in the U.S. and foreign

countries covering certain of our technology, and acquired patent assets to supplement our portfolio. We have licensed in the past, and expect that we may license in the future, certain of our rights to other parties.

Culture and Employees

We take great pride in our culture. We embrace collaboration and creativity, and encourage the iteration of ideas to address complex technical challenges. Transparency and open dialogue are central to how we work, and we like to ensure that company news reaches our employees first through internal channels.

Despite our rapid growth, we still cherish our roots as a startup and wherever possible empower employees to act on great ideas regardless of their role or function within the company. We strive to hire great employees, with backgrounds and perspectives as diverse as those of our global users. We work to provide an environment where these talented people can have fulfilling careers addressing some of the biggest challenges in technology and society.

Our employees are among our best assets and are critical for our continued success. We expect to continue investing in hiring talented employees and to provide competitive compensation programs to our employees. As of

December 31, 2015

, we had

61,814

 full-time employees: 23,336 in research and development, 19,082 in sales and marketing, 10,944 in operations, and 8,452 in general and administrative functions. Although we have work councils and statutory employee representation obligations in certain countries, our U.S. employees are not represented by a labor union. Competition for qualified personnel in our industry is intense, particularly for software engineers, computer scientists, and other technical staff.

Seasonality

Our business is affected by both seasonal fluctuations in Internet usage and traditional retail seasonality. Internet usage generally slows during the summer months, and commercial queries typically increase significantly in the fourth quarter of each year.

Information about Segments and Geographic Areas

Please refer to Note 16 of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

Other Matters

As part of the Alphabet reorganization, we expect to convert Google Inc. into a limited liability company.

Available Information

Our websites are located at www.google.com and www.abc.xyz, and our investor relations website is located at www.abc.xyz/investor. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and our Proxy Statements are available through our investor relations website, free of charge, after we file them with the SEC. We also provide a link to the section of the SEC's website at www.sec.gov that has all of the reports that we file or furnish with the SEC. You may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You can get information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

We webcast via our investor relations website our earnings calls and certain events we participate in or host with members of the investment community. Our investor relations website also provides notifications of news or announcements regarding our financial performance, including SEC filings, investor events, press and earnings releases, and blogs. Further corporate governance information, including our certificate of incorporation, bylaws, governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website under the heading "Other." The content of our websites are not incorporated by reference into this Annual Report on Form 10-K or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

Section: Item1a

>ITEM 1A.

RISK FACTORS

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

Risks Related to Our Businesses and Industries

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

Our businesses are rapidly evolving, intensely competitive, and subject to changing technologies, shifting user needs, and frequent introductions of new products and services. Competing successfully depends heavily on our ability to deliver innovative products and technologies to the marketplace rapidly and, for Google, provide products and services that make our search results and ads relevant and useful for our users. As our businesses evolve, the competitive pressure to innovate will encompass a wider range of products and services, including products and services that may be outside of our historical core business.

We have many competitors in different industries, including general purpose search engines and information services, vertical search engines and e-commerce websites, social networks, providers of online products and services, other forms of advertising and online advertising platforms and networks, other operating systems, and wireless mobile device companies. Our current and potential domestic and international competitors range from large and established companies to emerging start-ups. Established companies have longer operating histories and more established relationships with customers and users, and they can use their experiences and resources in ways that could affect our competitive position, including by making acquisitions, continuing to invest heavily in research and development, aggressively initiating intellectual property claims (whether or not meritorious), and continuing to compete aggressively for advertisers and websites. Emerging start-ups may be able to innovate and provide products and services faster than we can or may foresee the consumer need for products and services before us.

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

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

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

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

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

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

We generated

90%

of total Google segment revenues from advertising in 2015. Many of our advertisers, companies that distribute our products and services, digital publishers, and content partners can terminate their contracts with us at any time. Those partners may not continue to do business with us if we do not create more value (such as increased numbers of users or customers, new sales leads, increased brand awareness, or more effective monetization) than their available alternatives. If we do not provide superior value or deliver advertisements efficiently and competitively, we could see a decrease in revenue and other adverse impacts to our business. Adverse macroeconomic conditions can also have a material negative impact on advertising revenues, which could adversely affect our revenues and business.

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

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

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

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increasing competition,

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changes in property mix, platform mix, and geographical mix

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the challenges in maintaining our growth rate as our revenues increase to higher levels,

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the evolution of the online advertising market, including the increasing variety of online platforms for advertising, and the other markets in which we participate, and

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the rate of user adoption of our products, services, and technologies.

We believe our margins could experience downward pressure as a result of increasing competition and increased costs for many aspects of our business. For instance, the margin on revenues we generate from our Google Network Members is significantly less than the margin on revenues we generate from advertising on Google websites. Consequently, our margins will experience downward pressure if a greater percentage of our revenues comes from ads placed on our Google Network Members' websites compared to revenues generated through ads placed on Google websites. Additionally, the margin we earn on revenues generated from our Google Network Members could decrease in the future if we pay an even larger percentage of advertising fees to our Google Network Members.

Additionally, our margins could experience downward pressure because the margin on the sale of digital content and apps, advertising revenues from mobile devices and newer advertising formats are generally less than the margin on revenues we generate from advertising on our websites or traditional formats. Further, our margins could be impacted

adversely if we spend a proportionately larger amount to promote or distribute certain products or if we invest more heavily in our R&D efforts across the Company (such as our Other Bets businesses) than we have historically.

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

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

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

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

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

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

Acquisitions are an important element of our overall corporate strategy and use of capital, and these transactions could be material to our financial condition and results of operations. We expect to continue to evaluate and enter into discussions regarding a wide array of potential strategic transactions. The process of integrating an acquired company, business, or technology has created, and will continue to create, unforeseen operating difficulties and expenditures. The areas where we face risks include:

- Diversion of management time and focus from operating our business to acquisition integration challenges.
- Failure to successfully further develop the acquired business or technology.
- Implementation or remediation of controls, procedures, and policies at the acquired company.
- Integration of the acquired company's accounting, human resource, and other administrative systems, and coordination of product, engineering, and sales and marketing functions.
- Transition of operations, users, and customers onto our existing platforms.
- Failure to obtain required approvals on a timely basis, if at all, from governmental authorities, or conditions placed upon approval, under competition laws which could, among other things, delay or

prevent us from completing a transaction, or otherwise restrict our ability to realize the expected financial or strategic goals of an acquisition or investment.

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

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

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

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

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

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

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

Our strong Google brand has significantly contributed to the success of our business. Maintaining and enhancing the brands of both Google and Other Bets increases our ability to enter new categories and launch new and innovative products that better serve the needs of our users. Our brands may be negatively impacted by a number of factors, including, among others, reputational issues and product/technical performance failures. Further, if we fail to maintain and enhance equity in the Google brand, our business, operating results, and financial condition may be materially and adversely affected. Maintaining and enhancing our brand will depend largely on our ability to remain a technology leader and continue to provide high-quality, innovative products and services that are truly useful and play a meaningful role in people's everyday lives.

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

We are subject to numerous U.S. and foreign laws and regulations covering a wide variety of subject matters. New laws and regulations (or new interpretations of existing laws and regulations) may also impact our business. For example, current and new patent laws such as U.S. patent laws and European patent laws may affect the ability of companies, including us, to protect their innovations and defend against claims of patent infringement. The costs of compliance with these laws and regulations are high and are likely to increase in the future.

Claims have been, or may be, threatened and filed against us under both U.S. and foreign laws for defamation, invasion of privacy and other tort claims, unlawful activity, patent, copyright and trademark infringement, product liability, or other theories based on the nature and content of the materials searched and the ads posted by our users, our products and services, or content generated by our users. Furthermore, many of these laws do not contemplate or address the unique issues raised by a number of our new businesses, products, services and technologies. In addition, the applicability and scope of these laws, as interpreted by the courts, remain uncertain. For example, the laws relating to the liability of providers of online services are currently unsettled both within the U.S. and abroad.

In addition, other laws that could subject us to claims or otherwise harm our business include, among others:

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The Digital Millennium Copyright Act, which has provisions that limit in the U.S., but do not necessarily eliminate, our liability for caching or hosting, or for listing or linking to, third-party websites that include materials that infringe copyrights or other rights, so long as we comply with the statutory requirements of this act. Any future legislation impacting these safe harbors may adversely impact us.

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Court decisions such as the 'right to be forgotten' ruling issued by the European court, which allows individuals to demand that Google remove search results about them in certain instances, may limit the content we can show to our users.

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Various U.S. and international laws that restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from minors.

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Data protection laws passed by many states that require notification to users when there is a security breach for personal data, such as California's Information Practices Act.

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Data localization laws, which generally mandate that certain types of data collected in a particular country be stored and/or processed within that country.

We face risks and costs overseas as our products and services are offered in international markets and may be subject to additional regulations. Any failure on our part to comply with these laws and regulations can result in negative publicity and diversion of management time and effort and may subject us to significant liabilities and other penalties.

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

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

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

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

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

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

Our patents, trademarks, trade secrets, copyrights, and other intellectual property rights are important assets for us. Various events outside of our control pose a threat to our intellectual property rights, as well as to our products, services and technologies. For example, effective intellectual property protection may not be available in every country in which our products and services are distributed or made available through the Internet. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective.

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

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

We also face risks associated with our trademarks. For example, there is a risk that the word

"Google" could become so commonly used that it becomes synonymous with the word "search." If this happens, we could lose protection for this trademark, which could result in other people using the word "Google" to refer to their own products, thus diminishing our brand.

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

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

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

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

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

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

In addition, as nearly all of our products and services are web-based, the amount of data we store for our users on our servers (including personal information) has been increasing. Any systems failure or compromise of our security that results in the release of our users' data could seriously limit the adoption of our products and services, as well as harm our reputation and brand and, therefore, our business. We expect to continue to expend significant resources to protect against security breaches. The risk that these types of events could seriously harm our business is likely to increase as we expand the number of web-based products and services we offer, and operate in more countries.

Regulatory authorities around the world are considering a number of legislative and regulatory proposals concerning data protection, including measures to ensure that our encryption of users' data does not hinder law enforcement agencies' access to that data. In addition, the interpretation and application of consumer and data protection laws in the U.S., Europe and elsewhere are often uncertain and in flux. It is possible that these laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could have an adverse effect on our business and results of operations. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business.

Recent legal developments in Europe have created compliance uncertainty regarding certain transfers of information from Europe to the U.S. A preliminary agreement has been reached between the U.S. and European governments to allow for legal certainty regarding transfers of data. However, given the preliminary nature of the agreement, some uncertainty remains, and compliance obligations could cause us to incur costs or require us to change our business practices in a manner adverse to our business.

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

Our products and services involve the storage and transmission of users' and customers' proprietary information, and security breaches expose us to a risk of loss of this information, litigation, and potential liability. We experience cyber attacks of varying degrees on a regular basis. Our security measures may also be breached due to employee error, malfeasance, system errors or vulnerabilities, or otherwise. Additionally, outside parties may attempt to fraudulently induce employees, users, or customers to disclose sensitive information in order to gain access to our

data or our users' or customers' data. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and a loss of confidence in the security of our products and services that could potentially have an adverse effect on our business. Because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and often are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose users and customers.

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

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

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

We have in the past, and may experience in the future, supply shortages and price increases driven by raw material availability, manufacturing capacity, labor shortages, industry allocations, natural disasters and significant changes in the financial or business condition of our suppliers. Workaround plans to address shortages could entail increased freight costs for expedited shipments. We may experience shortages or other supply chain disruptions in the future that could negatively impact our operations. In addition, some of the components we use in our products are available only from a single source or limited sources, and we may not be able to find replacement vendors on favorable terms or at all in the event of a supply chain disruption.

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

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

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

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

"Web spam" refers to websites that attempt to violate a search engine's quality guidelines or that otherwise seek to rank higher in search results than a search engine's assessment of their relevance and utility would rank them.

Although English-language web spam in our search results has been significantly reduced, and web spam in most other languages is limited, we expect web spammers will continue to seek ways to improve their rankings inappropriately. We continuously combat web spam, including through indexing technology that makes it harder for spam-like, less useful web content to rank highly. We face challenges from low-quality and irrelevant content websites, including "content farms", which are websites that generate large quantities of low-quality content to help them improve

their search rankings. We are continually launching algorithmic changes focused on low-quality websites. If our search results display an increasing number of web spam and content farms, this could hurt our reputation for delivering relevant information or reduce user traffic to our websites. In addition, as we continue to take actions to improve our search quality and reduce low-quality content, this may in the short run reduce our AdSense revenues, since some of these websites are AdSense partners.

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

The availability of our products and services depends on the continuing operation of our information technology and communications systems. Our systems are vulnerable to damage or interruption from earthquakes, terrorist attacks, natural disasters, the effects of climate change (such as sea level rise, drought, flooding, wildfires, and increased storm severity), power loss, telecommunications failures, computer viruses, computer denial of service attacks, or other attempts to harm our systems. Some of our data centers are located in areas with a high risk of major earthquakes. Our data centers are also subject to break-ins, sabotage, and intentional acts of vandalism, and to potential disruptions if the operators of certain of these facilities have financial difficulties. Some of our systems are not fully redundant, and our disaster recovery planning cannot account for all eventualities. The occurrence of a natural disaster, a decision to close a facility we are using, or other unanticipated problems at our data centers could result in lengthy interruptions in our service. In addition, our products and services are highly technical and complex and may contain errors or vulnerabilities, which could result in interruptions in our services or the failure of our systems.

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

Our international operations are significant to our revenues and net income, and we plan to continue to grow internationally. International revenues accounted for approximately 54% of our consolidated revenues in 2015. In certain international markets, we have limited operating experience and may not benefit from any first-to-market advantages or otherwise succeed.

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

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Changes in local political, economic, regulatory, tax, social, and labor conditions, which may adversely harm our business.

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Restrictions on foreign ownership and investments, and stringent foreign exchange controls that might prevent us from repatriating cash earned in countries outside the U.S.

-

Import and export requirements, tariffs, trade disputes and barriers, and customs classifications that may prevent us from offering products or providing services to a particular market and may increase our operating costs.

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Longer payment cycles in some countries, increased credit risk, and higher levels of payment fraud.

-

Still developing foreign laws and legal systems.

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Uncertainty regarding liability for services and content, including uncertainty as a result of local laws and lack of legal precedent.

-

Different employee/employer relationships, existence of workers' councils and labor unions, and other challenges caused by distance, language, and cultural differences, making it harder to do business in certain jurisdictions.

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

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

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

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

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

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

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

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

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

-

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

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

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

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

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

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

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

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

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

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

Our business depends on continued and unimpeded access to the Internet by us and our users. Internet access providers may be able to restrict, block, degrade, or charge for access to certain of our products and services, which could lead to additional expenses and the loss of users and advertisers.

Our products and services depend on the ability of our users to access the Internet, and certain of our products require significant bandwidth to work effectively. Currently, this access is provided by companies that have significant market power in the broadband and internet access marketplace, including incumbent telephone companies, cable companies, mobile communications companies, and government-owned service providers. Some of these providers have taken, or have stated that they may take measures, including legal actions, that could degrade, disrupt, or increase the cost of user access to certain of our products by restricting or prohibiting the use of their infrastructure to support or facilitate our offerings, or by charging increased fees to us or our users to provide our offerings. In addition, in some jurisdictions, our products and services have been subject to government-initiated restrictions or blockages. Such interference could result in a loss of existing users and advertisers, and increased costs, and could impair our ability to attract new users and advertisers, thereby harming our revenues and growth.

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

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

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

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

We may have exposure to greater than anticipated tax liabilities.

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

Risks Related to Ownership of Our Stock

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

The trading price of our stock has at times experienced substantial price volatility and may continue to be volatile. For example, from January 1, 2015 through December 31, 2015, the closing price of our Class A common stock ranged from $497.06 per share to $793.96 per share, and the closing price of our Class C capital stock ranged from $492.55 to $776.60 per share.

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

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

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

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Recommendations by securities analysts or changes in earnings estimates.

-

Announcements about our earnings that are not in line with analyst expectations, the risk of which is enhanced because it is our policy not to give guidance on earnings.

-

Announcements by our competitors of their earnings that are not in line with analyst expectations.

- Commentary by industry and market professionals about our products, strategies, and other matters affecting our business and results, regardless of its accuracy.

- The volume of shares of Class A common stock and Class C capital stock available for public sale.

- Sales of Class A common stock and Class C capital stock by us or by our stockholders (including sales by our directors, executive officers, and other employees).

- Short sales, hedging, and other derivative transactions on shares of our Class A common stock and Class C capital stock.

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

- Our stock repurchase program.

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

We cannot guarantee that our recently announced stock repurchase program will be fully consummated or that our stock repurchase program will enhance long-term stockholder value, and stock repurchases could increase the volatility of the price of our stock and could diminish our cash reserves.

In October 2015, our board of directors authorized our company to repurchase up to $5,099,019,513.59 of our Class C capital stock and in January 2016, our board of directors authorized our Company to repurchase an additional amount of approximately 514 thousand shares. The repurchase program does not have an expiration date. Although our board of directors has authorized a stock repurchase program, the share repurchase program does not obligate Alphabet to repurchase any specific dollar amount or to acquire any specific number of shares. The stock repurchase program could affect the price of our stock and increase volatility and may be suspended or terminated at any time, which may result in a decrease in the trading price of our stock.

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

Our Class B common stock has 10 votes per share, our Class A common stock has one vote per share, and our Class C capital stock has no voting rights. As of December 31, 2015, Larry, Sergey, and Eric beneficially owned approximately 92.5% of our outstanding Class B common stock, which represented approximately 58.5% of the voting power of our outstanding capital stock. Larry, Sergey, and Eric therefore have significant influence over management and affairs and over all matters requiring stockholder approval, including the election of directors and significant corporate transactions, such as a merger or other sale of our company or our assets, for the foreseeable future. In addition, because our Class C capital stock carries no voting rights (except as required by applicable law), the issuance of the Class C capital stock, including in future stock-based acquisition transactions and to fund employee equity incentive programs, could prolong the duration of Larry and Sergey's current relative ownership of our voting power and their ability to elect all of our directors and to determine the outcome of most matters submitted to a vote of our stockholders. Together with Eric, they would also continue to be able to control any required stockholder vote with respect to certain change in control transactions involving Alphabet (including an acquisition of Alphabet by another company).

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

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

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

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

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

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

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

-

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

-

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

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

Risks Related to Our Holding Company Reorganization

As a holding company, Alphabet will be dependent on the operations and funds of its subsidiaries.

On October 2, 2015, we completed a reorganization pursuant to which Alphabet became a holding company with no business operations of its own. Alphabet's only significant assets are the outstanding equity interests in Google and any other future subsidiaries of Alphabet. As a result, we rely on cash flows from subsidiaries to meet our obligations, including to service any debt obligations of Alphabet.

We may not obtain the anticipated benefits of our reorganization into a holding company structure.

We believe that our holding company reorganization and a new operating structure will increase management scale and allow us to focus on running our diverse businesses independently with the goal of maximizing each of the business' potential. The anticipated benefits of this reorganization may not be obtained if circumstances prevent us from taking advantage of the strategic and business opportunities that we expect it may afford us. As a result, we may incur the costs of a holding company structure without realizing the anticipated benefits, which could adversely affect our reputation, financial condition, and operating results.

Alphabet's management is dedicating significant effort to the new operating structure. These efforts may divert management's focus and resources from Alphabet's business, corporate initiatives, or strategic opportunities, which could have an adverse effect on our businesses, results of operations, financial condition, or prospects. Additionally, our subsidiaries may be restricted in their ability to pay cash dividends or to make other distributions to Alphabet, as the new holding company.

Section: Item7

>ITEM 7.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Please read the following discussion and analysis of our financial condition and results of operations together with our consolidated financial statements and related notes included under Item 8 of this Annual Report on Form 10-K.

Trends in Our Business

The following trends have contributed to the results of our consolidated operations, and we anticipate that they will continue to impact our future results:

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Users' behaviors and advertising continue to shift online as the digital economy evolves.

The continuing shift from an offline to online world has contributed to the growth of our business since inception, resulting in increasing revenues, and we expect that this online shift will continue to benefit our business.

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As online advertising evolves, we continue to expand our product offerings which may impact our monetization.

As interactions between users and advertisers change, we continue to expand our product offerings to serve their changing needs. Over time, we expect our monetization trends to fluctuate. For example, we have seen an increase in YouTube engagement ads, which monetize at a lower rate than traditional search desktop ads. Additionally, advertisers are beginning to shift to programmatic buying which presents opportunities for advertisers to connect with the right user, in the right moment, in the right context. This may also have different monetization profiles to our existing advertising business. These trends will continue to affect our monetization in the future.

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Users are increasingly using multiple devices to access our products and services, and our advertising revenues are increasingly coming from mobile phones and other new formats.

Our users are accessing the Internet via multiple devices. Mobile computing power continues to grow and users want to feel connected no matter where they are or what they are doing. We seek to expand our products and services to stay in front of this shift in order to maintain and grow our business.

In this multi-device world, we generate our advertising revenues increasingly from mobile phones and newer advertising formats, and the margins from the advertising revenues from these sources have generally been lower than those from desktop computers and tablets. Our traffic acquisition cost (TAC) may also be impacted because the rates at which we share mobile revenues with our partners may differ from our traditional desktop and tablet formats. We expect both of these trends to continue to put pressure on our overall margins, particularly if we fail to realize the opportunities presented during the transition to a dynamic multi-screen environment.

-

As users in developing economies increasingly come online, we generate increasing revenues from international markets, and movements in foreign exchange rates impact such revenues.

The shift to online, as well as the advent of the multi-device world, has brought opportunities outside of the U.S., especially in emerging markets, and we continue to develop localized versions of our products and relevant advertising programs useful to our users in these markets. This has led to a trend of increased revenues from international markets over time and we expect that our results will continue to be impacted by our performance in these markets, particularly as low-cost mobile devices become more available.

Our international revenues represent a significant proportion of our revenues and are subject to fluctuations in foreign currency exchange rates relative to the U.S. dollar. While we have a foreign exchange risk management program designed to reduce our exposure to these fluctuations, this program does not fully offset their effect on our revenues and earnings.

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The portion of our revenues that we derive from non-advertising revenues is increasing.

Non-advertising revenues have grown over time. We expect this trend to continue as we focus on expanding our Google offerings to our users through products like Google Play, cloud and apps and hardware products. Across these initiatives, we currently derive non-advertising revenues primarily from sales of digital content products, hardware sales, service and licensing fees; the margins on these non-advertising businesses vary significantly and may be lower than the margins on our advertising business. A number of our Other Bets initiatives are in their initial development stages, and as such, the sources of revenues from these businesses could change over time and the revenues themselves could be volatile.

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As we continue to look for new ways to serve our users and expand our businesses, we will invest heavily in R&D and our capital expenditures will continue to fluctuate.

We continue to make significant research and development (R&D) investments in areas of strategic focus for Google, such as search and advertising, as well as in new products and services across both Google and Other Bets. The amount of our capital expenditures has fluctuated and may continue to fluctuate in the long term as we invest heavily in our systems, data centers, real estate and facilities, and information technology infrastructure.

In addition, acquisitions remain an important part of our strategy and use of capital, and we expect to continue to spend cash on acquisitions and other investments. These acquisitions generally enhance the breadth and depth of our offerings, as well as expanding our expertise in engineering and other functional areas.

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Our employees are critical to our success and we expect to continue investing in them.

Our employees are among our best assets and are critical for our continued success. Their energy and talent drive Alphabet and create our success. We expect to continue hiring talented employees and to provide competitive compensation programs to our employees. As of

December 31, 2015

, we had

61,814

full-time employees: 23,336 in research and development, 19,082 in sales and marketing, 10,944 in operations, and 8,452 in general and administrative, an increase of

8,214

total headcount from

December 31, 2014

.

Executive Overview of Results

Here are our key financial results for the fiscal year ended

December 31, 2015

(consolidated unless otherwise noted):

-

Revenues of

$75.0 billion

and revenue growth of

14%

year over year, constant currency revenue growth of

20%

year over year.

-

Google segment revenues of

$74.5 billion

with revenue growth of

14%

and Other Bets revenues of $0.4 billion.

-

Revenues from the United States, the United Kingdom, and Rest of World were

$34.8 billion

,

$7.1 billion

, and

$33.1 billion

, respectively.

-

Cost of revenues was

$28.2 billion

, consisting of traffic acquisition costs of $14.4 billion and other cost of revenues of

$13.8 billion

. Our traffic acquisition costs as a percentage of advertising revenues was

21%

.

-

Operating expenses (excluding cost of revenues) were

$27.5 billion

.

-

Income from operations was

$19.4 billion

.

-

Effective tax rate of

17%

.

-

Net income was

$16.3 billion

with diluted net income per share for Class A and B common stock of

$22.84

and for Class C capital stock of

$24.34

.

-

Operating cash flow was

$26.0 billion

.

-

Capital expenditures were

$9.9 billion

.

-

Headcount was

61,814

as of

December 31, 2015

.

Information about Segments

In conjunction with the Alphabet reorganization, in the fourth quarter of 2015, we implemented legal and operational changes in how our Chief Operating Decision Maker (CODM) manages our businesses, including resource allocation and performance assessment. Consequently, we have multiple operating segments, representing the individual businesses that are run separately under the Alphabet structure.

Google is our only reportable segment. None of our other segments meet the quantitative thresholds to qualify as reportable segments; therefore, the operating segments are combined and disclosed below as Other Bets. All prior-period amounts have been adjusted retrospectively to reflect the reportable segment change.

Our reported segments are described below:

-

Google - Google includes our main internet products such as Search, Ads, Commerce, Maps, YouTube, Apps, Cloud, Android, Chrome, Google Play as well as hardware products we sell, such as Chromecast, Chromebooks and Nexus. Our technical infrastructure and newer efforts like Virtual Reality are also included in Google.

-

Other Bets - Other Bets is a combination of multiple operating segments that are not individually material. Other Bets includes businesses such as Access/Google Fiber, Calico, Nest, Verily, GV, Google Capital, X, and other initiatives.

Please refer to

Note 16

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K for further information.

Consolidated Results of Operations

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

Year Ended December 31,

2013

(1)(2)

2014

(1)(2)

2015

Consolidated Statements of Income Data:

Revenues

100.0

%

100.0

%

100.0

%

Costs and expenses:

Cost of revenues

39.6

38.9

37.6

Research and development

12.9

14.9

16.3

Sales and marketing

11.8

12.3

12.1

General and administrative

8.0

8.9

8.2

Total costs and expenses

72.3

%

75.0

%

74.2

%

Income from operations

27.7

25.0

25.8

Other income (expense), net

0.9

1.1

0.4

Income from continuing operations before income taxes

28.6

26.1

26.2

Provision for income taxes

4.9

5.5

4.4

Net income from continuing operations

23.7

20.6

21.8

Net income (loss) from discontinued operations

(0.8

)

0.8

0.0

Net income

22.9

%

21.4

%

21.8

%

(1)

Financial results of Motorola Home were included in net income (loss) from discontinued operations for the year ended December 31, 2013. Financial results of Motorola Mobile were included in net income (loss) from discontinued operations for the years ended December 31, 2013 and 2014.

(2)

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. Please refer to

Note 1

and

Note 17

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

Alphabet Inc. and Google Inc.

Consolidated Revenues

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

Year Ended December 31,

2013

2014

2015

Google segment

Google websites

$

37,422

$

45,085

$

52,357

Google Network Members' websites

(1)

13,650

14,539

15,033

Google advertising revenues

51,072

59,624

67,390

Google other revenues

(1)

4,435

6,050

7,151

Google segment revenues

$

55,507

$

65,674

$

74,541

Other Bets

Other Bets revenues

$

12

$

327

$

448

Consolidated revenues

$

55,519

$

66,001

$

74,989

(1)

Prior period amounts have been adjusted to reflect the reclassification primarily related to DoubleClick ad serving software revenues from Google other revenues to Advertising Revenues from Google Network Members' websites to conform with the current period presentation.

Google segment

The following table presents our Google segment revenues (in millions), those revenues expressed as a percentage of consolidated revenues, and changes in our aggregate paid clicks and cost-per-click (expressed as a percentage) for the periods presented:

Year Ended December 31,

2013

2014

2015

Google segment revenues

$

55,507

$

65,674

$

74,541

Google segment revenues as a percentage of consolidated revenues

100.0

%

99.5

%

99.4

%

Aggregate paid clicks change

20

%

22

%

Aggregate cost-per-click change

(5

)%

(11

)%

Use of Monetization Metrics

When assessing our advertising revenue performance, we present information regarding the number of "paid clicks" and "cost-per-click" for our Google websites and Google Network Members websites. Management views these as important metrics for understanding our business. We periodically review, refine and update our methodologies for monitoring, gathering, and counting the number of paid clicks and for identifying the revenues generated by click activity.

Paid clicks for our Google websites represent engagement by users and include clicks on advertisements by end-users related to searches on Google.com, clicks related to advertisements on other owned and operated properties including Gmail, Finance, Maps, and Google Play; and viewed YouTube engagement ads like TrueView (counted as an engagement when the user chooses not to skip the ad). Paid clicks for our Google Network Members' websites include clicks by end-users related to advertisements served on Google Network Members' properties participating in our AdSense for Search, AdSense for Content and AdMob businesses. In some cases, such as programmatic and reservation based advertising buying, we charge advertisers by impression; while growing, this represents a small part of our revenue base.

Cost-per-click is defined as click-driven revenue divided by our total number of paid clicks and represents the average cost of each engagement by users we charge advertisers.

The rate of change in revenue and revenue growth, as well as the rate of change in paid clicks and cost-per-click on Google websites and Google Network Members' websites and their correlation with the rate of change in revenues, has fluctuated and may fluctuate in the future because of various factors, including:

- growth rates of our revenues from Google websites, including YouTube, compared to those of our revenues from Google Network Members' websites;
- advertiser competition for keywords;
- changes in foreign currency exchange rates;
- seasonality;
- the fees advertisers are willing to pay based on how they manage their advertising costs;
- changes in advertising quality or formats;
- traffic growth in emerging markets compared to more mature markets and across various advertising verticals and channels;
- a shift in the proportion of non-click based revenue generated in Google websites and Google Network Members' websites, including an increase in programmatic and reservation based advertising buying; and
- general economic conditions.

Our revenue growth rate has generally declined over time as a result of a number of factors, including increasing competition, query growth rates, challenges in maintaining our growth rate as our revenues increase to higher levels, the evolution of the online advertising market, our investments in new business strategies, changes in our product mix, and shifts in the geographic mix of our revenues. We also expect that our revenue growth rate will continue to be affected by evolving user preferences, the acceptance by users of our products and services as they are delivered on diverse devices, our ability to create a seamless experience for both users and advertisers, and movements in foreign currency exchange rates.

Google websites

The following table presents our Google websites revenues (in millions), those revenues expressed as a percentage of Google segment revenues, and changes in our paid clicks and cost-per-click (expressed as a percentage) for the periods presented:

Year Ended December 31,

2013

2014

2015

Google websites

$

37,422

$

45,085

$

52,357

Google websites as a percentage of Google segment revenues

67.4

%

68.6

%

70.2

%

Paid clicks change

29

%

33

%

Cost-per-click change

(7

)%

(15

)%

Google websites revenues consist primarily of:

- AdWords revenue that is generated on Google.com. This includes revenue from traffic generated by search distribution partners who use Google.com as their default search in browsers, toolbars, etc.;

- Advertising revenue generated on YouTube, including, but not limited to YouTube TrueView and Google Preferred; and

- Advertising revenue generated from other Google owned and operated properties like Gmail, Finance, Maps, and Google Play.

Our Google websites revenues

increased

$7,272 million

from

2014

to

2015

and also increased as a percentage of Google segment revenues. Our Google websites revenue growth was primarily driven by increases in mobile search due to ongoing improvements in ad formats, as well as growth in YouTube video advertising across TrueView and Google Preferred, partially offset by the general strengthening of the U.S. dollar compared to certain foreign currencies.

The number of paid clicks through our advertising programs increased from

2014

to

2015

due to an increase in aggregate traffic on Google owned properties, the adoption of advertising formats such as YouTube engagement ads, and continued global expansion of our products, advertisers and user base across all platforms, particularly mobile. The positive impact on our revenues from paid clicks was partially offset by a decrease in the cost-per-click paid by our advertisers. The decrease was primarily driven by continued growth in YouTube engagement ads where cost-per-click remains lower than on our other platforms, as well as changes in property and device mix, product mix, geographic mix, and ongoing product changes, and the general strengthening of the U.S. dollar compared to certain foreign currencies.

Our Google websites revenues

increased

$7,663 million

from

2013

to

2014

and also increased as a percentage of Google segment revenues. Our Google websites revenue growth was driven primarily by growth across all platforms due to ongoing improvements in ad formats, as well as growth in YouTube engagement ads, partially offset by the general strengthening of the U.S. dollar compared to certain foreign currencies.

The increase in the number of paid clicks generated through our advertising programs from

2013

to

2014

was due to certain monetization improvements including new and richer ad formats, an increase in aggregate traffic across all platforms, the continued global expansion of our products, advertisers, and user base, partially offset by certain advertising policy changes. The positive impact on our revenues from paid clicks was partially offset by a decrease in the average cost-per-click paid by our advertisers. The decrease was due to various factors, such as the geographic mix, device mix, property mix, ongoing product and policy changes, and the general strengthening of the U.S. dollar compared to certain foreign currencies.

Google Network Members' websites

The following table presents our Google Network Members' websites revenues (in millions), those revenues expressed as a percentage of Google segment revenues, and changes in our paid clicks and cost-per-click for the periods presented (in percentage terms):

Year Ended December 31,

2013

2014

2015

Google Network Members' websites

(1)

$

13,650

$

14,539

$

15,033

Google Network Members' websites revenues as a percentage of Google segment revenues

(1)

24.6

%

22.1

%

20.2

%

Paid clicks change

2

%

(7

)%

Cost-per-click change

(6

)%

(3

)%

(1)

Prior period amounts have been adjusted to reflect the reclassification primarily related to DoubleClick ad serving software revenues from Google other revenues to Advertising Revenues from Google Network Members' websites to conform with the current period presentation.

Google Network Members' websites revenues consist primarily of:

-

AdSense (such as AdSense for Search, AdSense for Content, etc.);

-

AdExchange;

-

AdMob;

-

All DoubleClick-related revenues including DoubleClick Bid Manager revenues; and

-

Other Network products including AdSense for Domains.

Our Google Network Members' websites revenues

increased

$494 million

from

2014

to

2015

. The

increase

was primarily driven by strength in programmatic advertising buying, offset by our continued AdSense advertising policy changes aimed at enriching the experience for users and the general strengthening of the U.S. dollar compared to certain foreign currencies. The decrease in Network Members' websites revenues as a percentage of Google segment revenues is due to relatively slower growth of Network Members' websites revenues compared to that of Google websites revenues as well as Google other revenues.

The decreases in both paid clicks and cost-per-click paid by our advertisers from 2014 to 2015 were primarily driven by ongoing product and policy changes designed to reduce lower quality inventory on AdSense for Search, changes in property and device mix, product mix, and geographic mix, and the general strengthening of the U.S. dollar compared to certain foreign currencies.

Our Google Network Members' websites revenues

increased

$889 million

from

2013

to

2014

. The

increase

was mainly due to certain monetization improvements including new and richer ad formats and an increase in the number of Google Network Members, partially offset by certain AdSense advertising policy changes aimed at enriching the experience for users. The decrease in Network Members' websites revenues as a percentage of Google segment revenues is due to relatively slower growth of Network Members' websites revenues compared to that of Google websites revenues as well as Google other revenues.

The increase in paid clicks from 2013 to 2014 was due to certain monetization improvements including new and richer ad formats, an increase in aggregate traffic across all platforms, the continued global expansion of our products, advertisers, and user base, and an increase in the number of Google Network Members, partially offset by certain advertising policy changes. The decrease in the average cost-per-click from 2013 to 2014 was due to various factors, such as the geographic mix, device mix, property mix, ongoing product and policy changes, and the general strengthening of the U.S. dollar compared to certain foreign currencies.

Google other revenues

The following table presents our Google other revenues (in millions), and those revenues expressed as a percentage of Google segment revenues, for the periods presented:

Year Ended December 31,

2013

2014

2015

Google other revenues

(1)

$

4,435

$

6,050

$

7,151

Google other revenues as a percentage of Google segment revenues

(1)

8.0

%

9.3

%

9.6

%

(1)

Prior period amounts have been adjusted to reflect the reclassification primarily related to DoubleClick ad serving software revenues from Google other revenues to Advertising Revenues from Google Network Members' websites to conform with the current period presentation.

Google other revenues consist primarily of:

- Sales of apps and media content in the Google Play store;

- Sales of certain Google branded hardware, such as Chromecast;

- Service fees received for cloud and apps and our Maps API; and

- Licensing-related revenue.

Google other revenues

increased

$1,101 million

from

2014

to

2015

and increased as a percentage of Google segment revenues. These increases were primarily due to

the growth of our sales of digital content products in the Google Play store, primarily apps (revenues which we recognize net of payout to partners). In addition, there was an increase in revenues from service fees received for cloud and apps offerings. These increases were partially offset by the general strengthening of the U.S. dollar compared to certain foreign currencies.

Google other revenues

increased

$1,615 million

from

2013

to

2014

and increased as a percentage of Google segment revenues. The increase was primarily due to growth of our sales of digital content products in the Google Play store, primarily apps.

Other Bets

The following table presents our Other Bets revenues (in millions), and those revenues expressed as a percentage of consolidated revenues, for the periods presented:

	Year Ended December 31,		
	2013	2014	2015
Other Bets revenues	$ 12	$ 327	$ 448
Other Bets revenues as a percentage of consolidated revenues	0.0 %	0.5 %	0.6 %

Other Bets revenues consist primarily of:

- Sales of Nest branded hardware;
- Revenues from internet and TV services; and
- Revenues from licensing and R&D services.

Our Other Bets revenues increased $121 million from 2014 to 2015 and remained relatively flat as a percentage of consolidated revenues. The increase was primarily due to increases in revenues from sales of Nest branded hardware and revenues from internet and TV services, partially offset by a decrease in licensing revenues. As Nest was acquired in February 2014, the increase in our Nest revenues is impacted by a partial year of revenues in 2014 as compared to a full year in 2015.

Our Other Bets revenues increased $315 million from 2013 to

2014

and increased as a percentage of consolidated revenues. This is primarily due to the acquisition of Nest in 2014 as well as an increase of licensing revenues.

Consolidated Revenues by Geography

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

Year Ended December 31,

2013

2014

2015

United States

46

%

45

%

46

%

United Kingdom

10

%

10

%

10

%

Rest of the world

44

%

45

%

44

%

For the amounts of revenues by geography, please refer to

Note 16

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

Use of Constant Currency and Constant Currency Growth

The impact of exchange rates on our business is an important factor in understanding period to period comparisons. Our international revenues are favorably impacted as the U.S. dollar weakens relative to other foreign currencies, and unfavorably impacted as the U.S dollar strengthens relative to other foreign currencies. We believe the presentation of results on a constant currency basis in addition to reported results helps improve the ability to understand our performance because they exclude the effects of foreign currency volatility that are not indicative of our core operating results.

Constant currency information compares results between periods as if exchange rates had remained constant period over period. We define constant currency revenues as total revenues excluding the impact of foreign exchange rate movements and hedging activities, and use it to determine the constant currency revenue growth on a year-on-year basis. Constant currency revenues are calculated by translating current period revenues using prior period exchange rates, as well as excluding any hedging gains realized in the current period.

Constant currency revenue growth (expressed as a percentage) is calculated by determining the increase in current period revenues over prior period revenues where current period foreign currency revenues are translated using prior period exchange rates and hedging benefits are excluded from revenues of both periods.

These results should be considered in addition to, not as a substitute for, results reported in accordance with GAAP. Results on a constant currency basis, as we present them, may not be comparable to similarly titled measures used by other companies and are not a measure of performance presented in accordance with GAAP.

The following table presents our foreign exchange impact on United Kingdom revenues for the periods presented (in millions; unaudited):

Year Ended December 31,

2013

2014

2015

United Kingdom revenues

$

5,600

$

6,483

$

7,067

Exclude: Foreign exchange impact on current year revenues using prior period rates

67

(304

)

538

Exclude: Hedging gains recognized

(63

)

(3

)

(133

)

Constant currency United Kingdom revenues

$

5,604

$

6,176

$

7,472

United Kingdom revenue growth rate

16

%

9

%

United Kingdom constant currency revenue growth rate

12

%

15

%

In

2015

, our revenues from the United Kingdom were unfavorably impacted by changes in foreign currency exchange rates over the prior year, primarily as the U.S. dollar strengthened relative to the British pound.

In

2014

, our revenues from the United Kingdom were favorably impacted by changes in foreign currency exchange rates over the prior year, primarily as the U.S. dollar weakened relative to the British pound.

The following table presents our foreign exchange impact on Rest of the world and total revenues for the periods presented (in millions; unaudited):

Year Ended December 31,

2013

2014

2015

Rest of the world revenues

(1)

$

24,332

$

30,036

$

33,112

Exclude: Foreign exchange impact on current year revenues using prior period rates

535

857

5,052

Exclude: Hedging gains recognized

(32

)

(169

)

(1,267

)

Constant currency Rest of the world revenues

$

24,835

$

30,724

$

36,897

Rest of the world revenue growth rate

23

%

10

%

Rest of the world constant currency revenue growth rate

26

%

24

%

United States revenues

(1)

$

25,587

$

29,482

$

34,810

United States revenue growth rate

15

%

18

%

Total consolidated revenues

$

55,519

$

66,001

$

74,989

Constant currency total consolidated revenues

$

56,026

$

66,382

$

79,179

Total consolidated revenue growth rate

19

%

14

%

Constant currency total consolidated revenue growth rate

20

%

20

%

(1)

In the second quarter of 2015, we identified an incorrect classification of certain revenues between legal entities. We revised the classification of such revenues between Rest of the world and U.S. for prior periods. Please refer to

Note 1

and

Note 17

of the Notes to Consolidated Financial Statements included in Part II of this Annual report t on Form

10-K for further information.

In

2015

, our revenues from the Rest of the world (excluding the United Kingdom) were unfavorably impacted by changes in foreign currency exchange rates, primarily because the U.S. dollar strengthened relative to the Euro, Brazilian real, Australian dollar and Japanese yen.

In

2014

, our revenues from the Rest of the world (excluding the United Kingdom) were unfavorably impacted by changes in foreign currency exchange rates, as the U.S. dollar strengthened relative to certain currencies, most notably the Japanese yen and the Australian dollar, and partially offset by the favorable impact of the U.S. dollar weakening against certain currencies, most notably the Euro.

Consolidated Costs and Expenses

Cost of Revenues

Cost of revenues consists primarily of traffic acquisition costs which are the advertising revenues shared with our Google Network Members and the amounts paid to our distribution partners who distribute our browser or otherwise direct search queries to our website.

Additionally, other cost of revenues (which is the cost of revenues excluding traffic acquisition costs) includes the following:

-

The expenses associated with the operation of our data centers (including depreciation, labor, energy, and bandwidth costs);

-

Content acquisition costs primarily related to payments to certain content providers from whom we license their video and other content for distribution on YouTube and Google Play (we share the fees these sales generate with content providers or pay a fixed fee to these content providers);

-

Credit card and other transaction fees related to processing customer transactions;

-

Stock-based compensation expense;

-

Revenue share payments to mobile carriers;

-

Inventory costs for hardware we sell; and

-

Amortization of certain intangible assets.

The following tables present our cost of revenues and cost of revenues as a percentage of revenues, and our traffic acquisition costs and traffic acquisition costs as a percentage of advertising revenues, for the periods presented (in millions):

Year Ended December 31,

2013

2014

2015

Traffic acquisition costs

$

12,258

$

13,497

$

14,343

Other cost of revenues

9,735

12,194

13,821

Total cost of revenues

$

21,993

$

25,691

$

28,164

Total cost of revenues as a percentage of revenues

39.6

%

38.9

%

37.6

%

Year Ended December 31,

2013

2014

2015

Traffic acquisition costs to Google Network Members

$

9,293

$

9,864

$

10,242

Traffic acquisition costs to distribution partners

2,965

3,633

4,101

Traffic acquisition costs

$

12,258

$

13,497

$

14,343

Traffic acquisition costs as a percentage of advertising revenues

24.0

%

22.6

%

21.3

%

The cost of revenues that we incur related to revenues generated from ads placed through our AdSense program on the websites of our Google Network Members are significantly higher than the costs of revenues we incur related to revenues generated from ads placed on Google websites because most of the advertiser fees from ads served on Google Network Members' websites are shared with our Google Network Members. For the past five years, growth in advertising revenues from Google websites has generally exceeded that from our Google Network Members' websites. This had a positive impact on our income from operations during this period.

Cost of revenues

increased

$2,473 million

from

2014

to

2015

. The

increase

was primarily due to data center costs and an increase in content acquisition costs as a result of increased activities related to YouTube and digital content. The remaining increase was driven by increases in traffic acquisition costs of

$846 million

, resulting from more advertiser fees generated through our AdSense program driven primarily by an increase in advertising revenues, as well as more fees paid to our distribution partners for additional traffic directed to our websites. Additionally, there was an impairment charge of $378 million recognized in 2014 related to a patent licensing royalty asset acquired in connection with the Motorola acquisition that did not recur in 2015. The decrease in aggregate traffic acquisition costs as a percentage of advertising revenues was primarily a result of a shift of mix from Google Network Members' websites revenue to Google websites revenue.

Cost of revenues increased

$3,698 million

from

2013

to

2014

. The increase was partially due to increases in traffic acquisition costs of $1,239 million resulting from more distribution fees paid for additional traffic directed to Google websites, as well as more advertiser fees paid to Google Network Members, driven primarily by an increase in advertising revenues. The remaining increase was primarily driven by an increase in data center costs, content acquisition costs as a result of increased usage activities related to YouTube and digital content by our users, and revenue share payments to mobile carriers and original equipment manufacturers (OEMs). In addition, the increase was also driven by the impairment charge described above. The decrease in traffic acquisition costs as a percentage of advertising revenues was primarily a result of a shift of mix between Google websites revenue and Google Network Members' websites revenue.

We expect cost of revenues will increase in dollar amount and fluctuate as a percentage of total revenues in 2016 and future periods, based on a number of factors, including the following:

-

The relative growth rates of revenues from Google websites and from our Google Network Members' website;

-

The growth rates of expenses associated with our data center operations, as well as our hardware inventory costs;

-

Increased proportion of other non-advertising revenues as part of our total revenues;

-

Whether we are able to enter into more revenue share arrangements with Google Network Members and distribution partners that provide for lower revenue share obligations or whether increased competition for arrangements with existing and potential Google Network Members and distribution partners results in less favorable revenue share arrangements;

-

Whether we are able to continue to improve the monetization of traffic on Google websites and our Google Network Members' websites; and

-

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

Research and Development

The following table presents our R&D expenses, and those expenses as a percentage of revenues, for the periods presented (in millions):

Year Ended December 31,

2013

2014

2015

Research and development expenses

$

7,137

$

9,832

$

12,282

Research and development expenses as a percentage of revenues

12.9

%

14.9

%

16.3

%

R&D expenses consist primarily of:

-

Labor and facilities-related costs for employees responsible for R&D of our existing and new products and services;

-

Depreciation and equipment-related expenses; and

-

Stock-based compensation expense.

R&D expenses

increased

$2,450 million

and increased as a percentage of revenues from

2014

to

2015

. These

increase

s were primarily due to an increase in labor and facilities-related costs of $1,502 million and an increase in stock-based compensation expense of $487 million, both largely as a result of a 16% increase in R&D headcount.

The increase in labor and facilities-related costs was also impacted by expenses resulting from project milestones in Other Bets established several years ago. In addition, there was an increase in depreciation and equipment-related expenses of approximately $248 million and an increase in professional services of $174 million due to additional expenses incurred for consulting and outsourced services.

R&D expenses increased

$2,695 million

and increased as a percentage of revenues from

2013

to

2014

. These increases were primarily due to an increase in labor and facilities-related costs of $1,289 million and an increase in stock-based compensation expense of $559 million, both largely as a result of a 27% increase in R&D headcount. In addition, there was an increase in depreciation and equipment-related expenses of $425 million and an increase in professional services of $371 million due to additional expenses incurred for consulting and outsourced services.

We expect that R&D expenses will increase in dollar amount and may fluctuate as a percentage of revenues in 2016 and future periods.

Sales and Marketing

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

Year Ended December 31,

	2013	2014	2015
Sales and marketing expenses	$ 6,554	$ 8,131	$ 9,047
Sales and marketing expenses as a percentage of revenues	11.8 %	12.3 %	12.1 %

Sales and marketing expenses consist primarily of:

- Labor and facilities-related costs for our personnel engaged in sales and marketing, sales support, and certain customer service functions;

-

Advertising and promotional expenditures related to our products and services; and

-

Stock-based compensation expense.

Sales and marketing expenses

increased

$916 million

and remained relatively flat as a percentage of revenues from

2014

to

2015

. The

increase

in dollar amount was primarily due to an increase in labor and facilities-related costs of $329 million and an increase in stock-based compensation expense of $184 million, largely resulting from a 12% increase in sales and marketing headcount. In addition, there was an increase in advertising and promotional expenses of $184 million and an increase in professional service fees of $158 million due to additional expenses incurred for consulting and outsourced services.

Sales and marketing expenses increased

$1,577 million

from

2013

to

2014

and increased as a percentage of revenues from

2013

to

2014

. These increases were primarily due to an increase in advertising and promotional expenses of $614 million. In addition, there was an increase in labor and facilities-related costs of $571 million and an increase in stock-based compensation expense of $163 million, both largely resulting from a 15% increase in sales and marketing headcount.

We expect that sales and marketing expenses will increase in dollar amount and may fluctuate as a percentage of revenues in 2016 and future periods.

General and Administrative

The following table presents our general and administrative expenses, and those expenses as a percentage of revenues, for the periods presented (in millions):

Year Ended December 31,

2013

2014

2015

General and administrative expenses

$

4,432

$

5,851

$

6,136

General and administrative expenses as a percentage of revenues

8.0

%

8.9

%

8.2

%

General and administrative expenses consist primarily of:

-

Labor and facilities-related costs for personnel in our facilities, finance, human resources, information technology, and legal organizations;

-

Depreciation and equipment-related expenses;

-

Professional services fees primarily related to outside legal, audit, information technology consulting, and outsourcing services;

-

Amortization of certain intangible assets; and

-

Stock-based compensation expense.

General and administrative expenses

increased

$285 million

and decreased as a percentage of revenues from

2014

to

2015

. The

increase

in dollar amount was primarily due to an increase in stock-based compensation expense of $136 million and an increase in labor and facilities-related costs of $69 million, both largely resulting from a 15% increase in general and administrative headcount. In addition, there was an increase in depreciation and equipment-related expenses of $121 million and an increase of $80 million of miscellaneous general and administrative expenses. These factors were partially offset by a decrease in professional service fees and expenses of $128 million, primarily due to lower legal-related costs.

General and administrative expenses

increased

$1,419 million

and increased as a percentage of revenues from

2013

to

2014

. The

increase

s were primarily due to an increase in labor and facilities-related costs of $576 million and an increase in stock-based compensation expense of $260 million, both largely resulting from a 24% increase in general and administrative headcount. In addition, there was an increase in professional services related expense of $314 million due to higher legal related costs, as well as additional consulting and outsourced services.

We expect general and administrative expenses will increase in dollar amount and may fluctuate as a percentage of revenues in 2016 and future periods.

Stock-Based Compensation

The following table presents our equity settled stock-based compensation expense, and equity settled stock-based compensation as a percentage of revenues, as reflected in our consolidated results from continuing operations for the periods presented (in millions):

Year Ended December 31,

2013

2014

2015

Stock-based compensation

$

3,127

$

4,175

$

5,203

Stock-based compensation as a percentage of revenues

5.6

%

6.3

%

6.9%

Stock-based compensation related to equity settled awards

increased

$1,028 million

from

2014

to

2015

and

$1,048 million

from

2013

to

2014

, and increased as a percentage of revenues in both periods. These

increase

s were primarily driven by headcount growth. Additionally, we recognized stock-based compensation

expense associated with awards ultimately settled in cash of

$0 million

,

$0 million

, and

$50 million

 in the years ended

December 31,

2013

,

2014

, and

2015

, respectively.

We estimate equity settled stock-based compensation expense to be approximately $5.3 billion in 2016 and $5.8 billion thereafter related to stock awards outstanding as of

December 31, 2015

. This estimate does not include expenses to be recognized related to stock-based awards granted after

December 31, 2015

. If forfeiture rates are different from what we have anticipated, stock-based compensation related to these awards will be different from our expectations.

Consolidated Other Income (Expense), Net

The following table presents other income (expense), net, and other income (expense), net, as a percentage of revenues (in millions):

	Year Ended December 31,		
	2013	2014	2015
Other income (expense), net	$ 496	$ 763	$ 291
Other income (expense), net, as a percentage of revenues	0.9 %	1.1 %	0.4%

Other income (expense), net,

decreased

$472 million

from

2014

to

2015

. This

decrease

was primarily related to a writedown of securities received in conjunction with the sale of a business, as well as, reduced gains on non-marketable investments as compared to 2014. These decreases were partially offset by an increase in interest income as a result of increased cash and fixed income investments.

Other income (expense), net,

increased

$267 million

from

2013

to

2014

. This increase was primarily driven by realized gains on non-marketable equity investments of $159 million and previously-held equity interests of $126 million, as well as a loss recognized on divestiture of businesses (other than Motorola Home) in 2013. These increases were partially offset by an increase in foreign currency exchange loss of $23 million and a decrease in interest income of $20 million.

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

As we expand our international business, costs related to hedging activities under our foreign exchange risk management program may increase in 2016 and future periods.

Consolidated Provision for Income Taxes

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

Year Ended December 31,

2013

(1)

2014

(1)

2015

Provision for income taxes

$

2,739

$

3,639

$

3,303

Effective tax rate

17.2

%

21.1

%

16.8

%

(1)

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. Please refer to

Note 1

and

Note 17

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

Our provision for income taxes and our effective tax rate decreased from

2014

to

2015

, largely due to a discrete benefit recognized in 2015 as a result of the resolution of a multi-year audit in the U.S. and proportionately more earnings realized in countries that have lower statutory tax rates.

Our provision for income taxes and our effective tax rate increased from

2013

to

2014

, largely due to proportionately more earnings realized in countries that have higher statutory tax rates and more benefit recognized in 2013 relative to 2014 due to the retroactive extension of the 2012 federal research and development credit, offset by a benefit taken on a valuation allowance release related to a capital loss carryforward in 2014.

A reconciliation of the federal statutory income tax rate to our effective tax rate is set forth in Note

15

of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries that have lower statutory rates and higher than anticipated in countries that have higher statutory rates, the net gains and losses recognized by legal entities on certain hedges and related hedged intercompany and other transactions under our foreign exchange risk management program, changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws, regulations, or accounting principles, as well as certain discrete items.

We are subject to the continuous examination of our income tax returns by the Internal Revenue Service (IRS) and other domestic and foreign tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. We continue to monitor the progress of ongoing discussions with tax authorities and the impact, if any, of the expected expiration of the statute of limitations

in various taxing jurisdictions. Further information on these issues, the treatment of undistributed foreign earnings and a reconciliation of the federal statutory income tax rate to our effective tax rate can be found in Notes

11

and

15

of Part II, Item 8 of this Annual Report on Form 10-K.

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

Quarterly Results of Operations

The following tables presenting our quarterly results of operations should be read in conjunction with the consolidated financial statements and related notes included in Item 8 of this Annual Report on Form 10-K. We have prepared the unaudited information on the same basis as our audited consolidated financial statements. Our operating results for any quarter are not necessarily indicative of results for any future quarters or for a full year.

The following table presents our unaudited quarterly results of operations for the eight quarters ended

December 31, 2015

. This table includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary for fair presentation of our consolidated financial position and operating results for the quarters presented. Both seasonal fluctuations in internet usage and traditional retail seasonality have affected, and are likely to continue to affect, our business. Internet usage generally slows during the summer months, and commercial queries typically increase significantly in the fourth quarter of each year. These seasonal trends have caused, and will likely continue to cause, fluctuations in our quarterly results, including fluctuations in sequential revenue growth rates.

Quarter Ended

Mar 31,

2014

(1)

Jun 30,

2014

(1)

Sep 30,

2014

(1)

Dec 31,

2014

(1)

Mar 31,

2015

(1)

Jun 30,

2015

Sep 30,

2015

Dec 31,

2015

(In millions, except per share amounts) (unaudited)

Consolidated Statements of Income Data:

Revenues

$

15,420

$

15,955

$

16,523

$

18,103

$

17,258

$

17,727

$

18,675

$

21,329

Costs and expenses:

Cost of revenues

5,961

6,114

6,695

6,921

6,356

6,583

7,037

8,188

Research and development

2,126

2,238

2,655

2,813

2,753

2,789

3,230

3,510

Sales and marketing

1,729

1,941

2,084

2,377

2,065

2,080

2,223

2,679

General and administrative

1,489

1,404

1,365

1,593

1,637

1,450

1,477

1,572

Total costs and expenses

11,305

11,697

12,799

13,704

12,811

12,902

13,967

15,949

Income from operations

4,115

4,258

3,724

4,399

4,447

4,825

4,708

5,380

Other income (expense), net

357

145

133

128

157

131

183

(180

)

Income from continuing operations before income taxes

4,472

4,403

3,857

4,527

4,604

4,956

4,891

5,200

Provision for income taxes

903

984

933

819

1,089

1,025

912

277

Net income from continuing operations

$

3,569

$

3,419

$

2,924

$

3,708

$

3,515

$

3,931

$

3,979

$

4,923

Net income (loss) from discontinued operations

(198

)

(68

)

(185

)

967

0

0

0

0

Net income

$

3,371

$

3,351

$

2,739

$

4,675

$

3,515

$

3,931

$

3,979

$

4,923

Less: Adjustment Payment to Class C capital stockholders

0

0

0

0

0

522

0

0

Net income available to all stockholders

$

3,371

$

3,351

$

2,739

$

4,675

$

3,515

$

3,409

$

3,979

$

4,923

(1)

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. Please refer to

Note 1

and

Note 17

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

The basic and diluted income per share data as included on the consolidated statements of income of Alphabet Inc. were as follows for the periods presented (not required for Google pursuant to Rule 12g-3(a)):

Quarter Ended

Mar 31,

2014

(1)

Jun 30,

2014

(1)

Sep 30,

2014

(1)

Dec 31,

2014

(1)

Mar 31,

2015

(1)

Jun 30,

2015

Sep 30,

2015

Dec 31,

2015

(unaudited)

Basic net income (loss) per share of Class A and B common stock:

Continuing operations

$

5.30

$

5.06

$

4.32

$

5.46

$

5.16

$

4.99

$

5.80

$

7.16

Discontinued operations

(0.29

)

(0.10

)

(0.27

)

1.43

0.00

0.00

0.00

0.00

Basic net income per share of Class A and B common stock

$

5.01

$

4.96

$

4.05

$

6.89

$

5.16

$

4.99

$

5.80

$

7.16

Basic net income (loss) per share of Class C capital stock:

Continuing operations

$

5.30

$

5.06

$

4.32

$

5.46

$

5.16

$

6.51

$

5.80

$

7.16

Discontinued operations

(0.29

)

(0.10

)

(0.27

)

1.43

0.00

0.00

0.00

0.00

Basic net income per share of Class C capital stock

$

5.01

$

4.96

$

4.05

$

6.89

$

5.16

$

6.51

$

5.80

$

7.16

Diluted net income (loss) per share of Class A and B common stock:

Continuing operations

$

5.21

$

4.98

$

4.25

$

5.38

$

5.10

$

4.93

$

5.73

$

7.06

Discontinued operations

(0.29

)

(0.10

)

(0.27

)

1.41

0.00

0.00

0.00

0.00

Diluted net income per share of Class A and B common stock

$

4.92

$

4.88

$

3.98

$

6.79

$

5.10

$

4.93

$

5.73

$

7.06

Diluted net income (loss) per share of Class C capital stock:

Continuing operations

$

5.21

$

4.98

$

4.25

$

5.38

$

5.10

$

6.43

$

5.73

$

7.06

Discontinued operations

(0.29

)

(0.10

)

(0.27

)

1.41

0.00

0.00

0.00

0.00

Diluted net income per share of Class C capital stock

$

4.92

$

4.88

$

3.98

$

6.79

$

5.10

$

6.43

$

5.73

$

7.06

(1)

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. Please refer to

Note 1

and

Note 17

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

The following table presents our unaudited quarterly results of operations as a percentage of revenues for the eight quarters ended

December 31, 2015

:

Quarter Ended

Mar 31,

2014

(1)

Jun 30,

2014

(1)

Sep 30,

2014

(1)

Dec 31,

2014

(1)

Mar 31,

2015

(1)

Jun 30,

2015

Sep 30,

2015

Dec 31,

2015

(unaudited)

Revenues

100.0

%

100.0

%

100.0

%

100.0

%

100.0

%

100.0

%

100.0

%

100.0

%

Costs and expenses:

Cost of revenues

38.7

38.3

40.5

38.2

36.8

37.1

37.7

38.4

Research and development

13.8

14.0

16.1

15.5

16.0

15.7

17.3

16.4

Sales and marketing

11.2

12.2

12.6

13.1

12.0

11.8

11.9

12.6

General and administrative

9.6

8.8

8.3

8.9

9.4

8.2

7.9

7.4

Total costs and expenses

73.3

73.3

77.5

75.7

74.2

72.8

74.8

74.8

Income from operations

26.7

26.7

22.5

24.3

25.8

27.2

25.2

25.2

Other income (expense), net

2.3

0.9

0.8

0.7

0.9

0.8

1.0

(0.8

)

Income from continuing operations before income taxes

29.0

27.6

23.3

25.0

26.7

28.0

26.2

24.4

Provision for income taxes

5.8

6.2

5.6

4.5

6.3

5.8

4.9

1.3

Net income from continuing operations

23.2

21.4

17.7

20.5

20.4

22.2

21.3

23.1

Net income (loss) from discontinued operations

(1.3

)

(0.4

)

(1.1

)

5.3

0.0

0.0

0.0

0.0

Net income

21.9

%

21.0

%

16.6

%

25.8

%

20.4

%

22.2

%

21.3

%

23.1

%

Less: Adjustment Payment to Class C capital stockholders

0.0

%

0.0

%

0.0

%

0.0

%

0.0

%

2.9

%

0.0

%

0.0

%

Net income available to all stockholders

21.9

%

21.0

%

16.6

%

25.8

%

20.4

%

19.2

%

21.3

%

23.1

%

(1)

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. Please refer to

Note 1

and

Note 17

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

Capital Resources and Liquidity

As of

December 31, 2015

, we had

$73.1 billion

of cash, cash equivalents, and marketable securities. Cash equivalents and marketable securities a re comprised of time deposits, money market and other funds, including cash collateral received related to our securities lending program, fixed-income bond funds, highly liquid debt instruments of the U.S. government and its agencies, debt instruments issued by foreign governments, debt instruments issued by municipalities in the U.S., corporate debt securities, agency mortgage-backed securities, and asset-backed securities. From time to time, we may hold marketable equity securities obtained through acquisitions or strategic investments in private companies that subsequently go public.

As of

December 31, 2015

, $42.9 billion of the

$73.1 billion

of cash, cash equivalents, and marketable securities was held by our foreign subsidiaries. If these funds were needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Our principal sources of liquidity are our cash, cash equivalents, and marketable securities, as well as the cash flow that we generate from our operations. As of

December 31, 2015

, we had unused letters of credit of approximately

$752 million

. We believe that our sources of funding will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months. Our liquidity could be negatively affected by a decrease in demand for our products and services. In addition, we may make acquisitions, increase our capital expenditures, or license products and technologies complementary to our business and may need to raise additional capital through future

debt or equity financing to provide for greater flexibility to fund these activities. Additional financing may not be available or on terms favorable to us.

We have a debt financing program of up to

$3.0 billion

through the issuance of commercial paper. Net proceeds from this program are used for general corporate purposes. As of

December 31, 2015

, we had

$2.0 billion

of commercial paper outstanding recorded as short-term debt, with a weighted-average interest rate of

0.2%

that matures at various dates through February 2016. In conjunction with this program, we have a

$3.0 billion

revolving credit facility expiring in July 2016. The interest rate for the credit facility is determined based on a formula using certain market rates. As of

December 31, 2015

, we were in compliance with the financial covenant in the credit facility and no amounts were outstanding.

We intend to align our capital structure so that debt is held at the holding company level. In January 2016, the board of directors of Alphabet authorized the company to issue up to $5.0 billion of commercial paper from time to time and to enter into a $4.0 billion revolving credit facility to replace Google's existing $3.0 billion revolving credit facility.

In May 2011, we issued

$3.0 billion

of unsecured senior notes (2011 Notes) in three equal tranches, due in 2014, 2016, and 2021. The net proceeds from the sale of the 2011 Notes were used to repay a portion of our outstanding commercial paper and for general corporate purposes. In February 2014, we issued

$1.0 billion

of unsecured senior notes (2014 Notes) due in 2024, which was used to repay

$1.0 billion

of the first tranche of our 2011 Notes that matured in May 2014 and for general corporate purposes.

As of

December 31, 2015

, the outstanding notes had a total carrying value of $3.0 billion and a total estimated fair value of $3.1 billion. We are not subject to any financial covenants under the notes.

In August 2013, we entered into a $258 million capital lease obligation on certain property expiring in 2028. We intend to exercise the option to purchase the property in 2016. The effective rate of the capital lease obligation approximates the market rate.

In October 2015, the board of directors of Alphabet authorized the company to repurchase up to

$5,099,019,513.59

of its Class C capital stock, commencing in the fourth quarter of 2015. The repurchases are being executed from time to time, subject to general business and market conditions and other investment opportunities, through open market purchases or privately negotiated transactions, including through the use of 10b5-1 plans. The repurchase program does not have an expiration date. As of

December 31, 2015

, Alphabet repurchased and subsequently retired $1.8 billion of its Class C capital stock. Alphabet's share repurchases in the year ended

December 31, 2015

were funded by Google via a return of capital to Alphabet. In January 2016, the board of directors of Alphabet authorized the company to repurchase an additional amount of approximately 514 thousand shares.

For 2013, 2014 and 2015, our cash flows were as follows (in millions):

Year Ended December 31,

2013

2014

2015

Net cash provided by operating activities

$

18,659

$

22,376

$

26,024

Net cash used in investing activities

(13,679

)

(21,055

)

(23,711

)

Net cash used in financing activities

(857

)

(1,439

)

(3,677

)

Cash Provided by Operating Activities

Our largest source of cash provided by our operations is advertising revenues generated by Google websites and Google Network Members' websites. Additionally, we generate cash through sales of apps and digital content, hardware products, licensing arrangements, and s

ervice fees received for cloud and apps and our Maps API

. Prior to its divestiture in October 2014, we also generated cash from sales of hardware products related to the Motorola Mobile business.

Our primary uses of cash from our operating activities include payments to our Google Network

Members and distribution partners, and payments for content acquisition costs. Prior to the sale of the Motorola Mobile business, our use of cash also included payment for manufacturing and inventory-related costs in the Motorola Mobile business. In addition, uses of cash from operating activities include compensation and related costs, other general corporate expenditures, and income taxes.

Net cash provided by operating activities increased

from

2014

to

2015

primarily due to increased net income adjusted for depreciation and stock-based compensation expense, and loss on sales of marketable and non-marketable securities. This is partially offset by a net decrease in cash from changes in working capital.

Net cash provided by operating activities increased

from

2013

to

2014

primarily due to increased net income adjusted for depreciation and loss on disposal of property and equipment and stock-based compensation expense, and a net increase in cash from changes in working capital primarily driven by changes in prepaid revenue share, expenses, and other assets.

Cash Used in Investing Activities

Cash provided by or used in investing activities primarily consists of purchases of property and equipment, purchases, maturities, and sales of marketable securities in our investment portfolio, investments in reverse repurchase agreements and the cash collateral received or returned from our securities lending program, as well as acquisitions and divestitures of businesses and intangible assets.

Cash used in investing activities increased

from

2014

to

2015

primarily due to net increases in purchases of marketable securities, activities related to security lending and purchases of non-marketable investments. This increase was partially offset by lower spend related to acquisitions, lower investments in reverse repurchase agreements, and a decrease in capital expenditures related to our production equipment, data centers, and real estate purchases.

Cash used in investing activities increased

from

2013

to

2014

primarily due to increases in capital expenditures related to our production equipment, data centers, and real estate purchases, higher spend related to acquisitions, and lower proceeds received in 2014 from divestiture of businesses compared to 2013. This increase was partially offset by a net decrease in purchases of marketable securities.

Cash Used in Financing Activities

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

In Alphabet, cash used in financing activities increased from

2014

to

2015

primarily driven by the repurchases of capital stock and an increase in net payments related to stock-based award activities. In Google, cash used in financing activities increased from

2014

to

2015

is primarily driven by capital transactions with Alphabet, partially offset by net payments related to stock-based award activities.

Cash used in financing activities increased

from

2013

to

2014

is primarily driven by an increase in net payments related to stock-based award activities, offset partially by a decrease in net cash payments related to debt.

Contractual Obligations as of

December 31, 2015

The following summarizes our contractual obligations, excluding open orders for purchases that support normal operations, as of

December 31, 2015

(in millions):

Payments Due By Period

Total

Less than

1 year

1-3

years

3-5

years

More than

5 years

Operating lease obligations, net of sublease income amounts

(1)

$

7,406

$

646

$

1,573

$

1,482

$

3,705

Purchase obligations

(2)

1,697

946

298

150

303

Long-term debt obligations, including capital lease obligations

(3)

3,722

1,306

140

140

2,136

Other long-term liabilities reflected on our balance sheet

(4)

1,580

356

430

367

427

Total contractual obligations

$

14,405

$

3,254

$

2,441

$

2,139

$

6,571

(1)

For further information, refer to

Note 11

of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

(2)

Purchase obligations represent non-cancelable contractual obligations primarily related to data center operations and facility build-outs, video and other content licensing revenue sharing arrangements, as well as purchases of inventory.

(3)

For further information, refer to Note 4 of the Notes to Consolidated Financial Statements included in Part II of this Annual Report on Form 10-K.

(4)

Other long-term liabilities represent cash obligations recorded on our consolidated balance sheets, including the short-term portion of these long-term liabilities and consist primarily of payments owed in connection with certain commercial agreements, investments and asset retirement obligations.

In addition to the amounts above, we had long-term tax payable of $3.7 billion as of December 31, 2015 primarily related to uncertain tax positions. At this time, we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing of tax audit outcomes. As a result, this amount is not included in the above table.

Off-Balance Sheet Arrangements

As of

December 31, 2015

, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in our financial condition, revenues, or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

Critical Accounting Policies and Estimates

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

Please see

Note 1

of Part II, Item 8 of this Annual Report on Form 10-K for the summary of significant accounting policies.

Income Taxes

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

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes and the effective tax rate in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest and penalties. In addition, we are subject to the continuous examination of our income tax returns by the IRS and other tax authorities which may assert assessments against us. We regularly assess the likelihood of adverse outcomes resulting from these examinations and assessments to determine the adequacy of our provision for income taxes.

Loss Contingencies

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

We evaluate, on a monthly basis, developments in our legal matters that could affect the amount of liability that has been previously accrued, and the matters and related reasonably possible losses disclosed, and make adjustments and changes to our disclosures as appropriate. Significant judgment is required to determine both likelihood of there being and the estimated amount of a loss related to such matters. Until the final resolution of such matters, there may be an exposure to loss in excess of the amount recorded, and such amounts could be material. Should any of our estimates and assumptions change or prove to have been incorrect, it could have a material impact on our business, consolidated financial position, results of operations, or cash flows. See

Note 11

of Notes to Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K for additional information regarding contingencies.

Business Combinations

We allocate the fair value of purchase consideration to the tangible assets acquired, liabilities assumed and intangible assets acquired based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When determining the fair values

of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets.

Critical estimates in valuing certain intangible assets include but are not limited to future expected cash flows from customer relationships and acquired patents and developed technology; and discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates.

Other estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed, as more fully discussed in

Note 6

of Notes to Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Goodwill

Goodwill is allocated to reporting units expected to benefit from the business combination. We evaluate our reporting units when changes in our operating structure occur, and if necessary, reassign goodwill using a relative fair value allocation approach. We test goodwill for impairment at the reporting unit level at least annually, or more frequently if events or changes in circumstances indicate that the asset may be impaired. Goodwill impairment tests require judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. As of

December 31, 2015

, no impairment of goodwill has been identified.

Long-lived Assets

Long-lived assets, including property and equipment, long-term prepayments, and intangible assets, excluding goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The evaluation is performed at the lowest level of identifiable cash flows independent of other assets. An impairment loss would be recognized when estimated undiscounted future cash flows generated from the assets are less than their carrying amount. Measurement of an impairment loss would be based on the excess of the carrying amount of the asset group over its fair value.

Impairment of Marketable and Non-Marketable Securities

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

Section: Item7a

>ITEM 7A.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in currency exchange rates and interest rates.

Foreign Currency Exchange Risk

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

December 31, 2015

, our most significant currency exposures are the British pound, Euro, and Japanese yen.

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

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that changes in exchange rates of 20% could be experienced in the near term. If the U.S. dollar weakened by 20% as of

December 31, 2014

and

December 31, 2015

, the amount recorded in AOCI reflecting intrinsic value related to our foreign exchange options before tax effect would have been approximately $686 million and $280 million lower as of

December 31, 2014

and

December 31, 2015

, and the total amount of expense recorded as other income (expense), net, would have been approximately $90 million and $275 million higher in the years ended

December 31, 2014

and

December 31, 2015

. If the U.S. dollar strengthened by 20% as of

December 31, 2014

and

December 31, 2015

, the amount recorded in accumulated AOCI related to our foreign exchange options before tax effect would have been approximately $2.5 billion and $3.1 billion higher as of

December 31, 2014

and

December 31, 2015

, and the total amount of expense recorded as other income (expense), net, would have been approximately $164 million and $372 million higher in the years ended

December 31, 2014

and

December 31, 2015

. In both scenarios, the change in the intrinsic value would be expected to offset a corresponding foreign currency change in forecasted hedged revenues when recognized.

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

We considered the historical trends in currency exchange rates and determined that it was reasonably possible that adverse changes in exchange rates of 20% for all currencies could be experienced in the near term. These reasonably possible adverse changes in exchange rates of 20% were applied to total monetary assets and liabilities denominated in currencies other than the local currencies at the balance sheet dates to compute the adverse impact these changes would have had on our income before income taxes in the near term. These changes would have resulted in an adverse impact on income before income taxes of approximately $93 million and $122 million as of

December 31, 2014

and

December 31, 2015

. The adverse impact as of

December 31, 2014

and

December 31, 2015

is after consideration of the offsetting effect of approximately $948 million and $1.1 billion from foreign exchange contracts in place for the months of

December 31, 2014

and

December 31, 2015

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Interest Rate Risk

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

December 31, 2014

and

December 31, 2015

, unrealized losses on our marketable debt securities were primarily due to temporary interest rate fluctuations as a result of higher market interest rates compared to interest rates at the time of purchase. We account for both fixed and variable rate securities at fair value with changes on gains and losses recorded in AOCI until the securities are sold. We use interest rate derivative contracts to hedge gains and losses on our securities. These derivative contracts are accounted for as hedges at fair value with changes in fair value recorded in other income (expense), net.

We considered the historical volatility of short-term interest rates and determined that it was reasonably possible that an adverse change of 100 basis points could be experienced in the near term. A hypothetical 1.00% (100 basis points) increase in interest rates would have resulted in a decrease in the fair value of our marketable securities of approximately $1.2 billion and $1.3 billion as of

December 31, 2014

and

December 31, 2015

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Alphabet Inc. and Google Inc.

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