

**Client: Jefferies & Co.**  
**Publication: Wall Street Journal**  
**April 20, 2005**

## THE WALL STREET JOURNAL.

As a newly public company, Web-search pioneer **Google Inc.** posted net income last year of \$399 million, more than many older, larger firms. This year's profit may be even larger, thanks in part to an accounting move.

Before its initial public offering last August, Google chose to speed up when it would recognize more than \$750 million in expense related to cheap stock options granted to employees. Using a technique known as "accelerated amortization," Google recognized the bulk of this expense in 2002, 2003 and 2004.

The flip side: Now that it is a public company and must report to investors every three months, this portion of Google's expenses is declining. That will burnish Google's results when compared with last year's. The main impact will begin to appear when Google, based in Mountain View, Calif., reports first-quarter results tomorrow.

This year, Google, with a market value of about \$50 billion, will record an expense related to those cheap options of \$146 million, according to regulatory filings. That is down from \$279 million last year -- a guaranteed \$133 million improvement in Google's bottom line even before the first Internet user clicked on a Google search advertisement. Had Google not shifted the expense schedule and followed a "straight-line" amortization schedule, it would have had to book a \$171 million expense this year, it said in regulatory filings. The benefit to Google grows next year.

Shares of Google are trading at about 10% below their February high of \$210.78, at a level they first reached last October. In 4 p.m. composite trading yesterday on the Nasdaq Stock Market, Google's shares were up \$4.43 at \$191.40.

Other companies have employed similar accelerated-expensing strategies, and financial analysts generally are aware of such maneuvers -- which can make it more difficult to assess just how well a company is doing. But less-sophisticated investors might not catch this subtle boost to Google's profits. In any case, the move sheds light on the level of detail that Google executives managed in preparing to be a public company.

It isn't as if Google needed a lot of help. Excluding the stock-option expense and other items, analysts expect Google to post first-quarter earnings of 92 cents a share, according to a survey by Thomson First Call. That would be up 74% from 53 cents a year earlier. For the full year, analysts expect Google's earnings to rise 44% from last year.

The expense involved relates primarily to stock options that Google granted employees over several years prior to the IPO. As Google prepared for its IPO, it acknowledged that the strike prices on those options--some below \$1 a share--were less than the estimated value of Google stock at the time they were issued. Under accounting rules, Google then had to recognize an expense for the additional value of these options. This expense is different from the expense that Google, and all U.S. public companies, will have to record for all stock options for fiscal years starting after June 15.

Google declined to comment. The Securities and Exchange Commission may have weighed in on the expensing schedule as part of its review of Google's August IPO. An SEC spokesman declined to

comment.

Accounting experts said that Google doesn't appear to have done anything wrong. They say Google likely chose to recognize more of the expense sooner because the bulk of the options vested within the first few years after they were issued.

The company doesn't explicitly say that in its regulatory filings. But "that's implied," said Jack Ciesielski, publisher of the Analyst's Accounting Observer, a research service for institutional investors in Baltimore. "You try to match the amortization with the way the things actually are vesting."

Atheros Communications Inc., a maker of semiconductors for wireless devices, used a similar approach before its IPO last year. As with Google, that resulted in an accelerated expensing of cheap options granted prior to the IPO.

Other companies, such as **International Business Machines Corp.**, have tinkered with their options programs as mandatory expensing draws nearer. Dozens of companies, including **Dow Jones & Co.**, publisher of The Wall Street Journal, have accelerated the vesting of out-of-the-money options so that they can detail expenses related to those options in a footnote, rather than in financial statements, once new expensing rules take effect.

For Google, the impact of options expensing is included in the headline earnings numbers that many media outlets report every quarter, based on generally accepted accounting principles. But Wall Street analysts say they generally exclude option-related expenses when evaluating Google's performance.

"On the surface, it makes the numbers look more favorable on a GAAP basis," said Youssef Squali, an analyst at Jefferies & Co. in New York. But, he said, when comparing Google's core financial performance to its rivals, "GAAP is the last thing you'd use," because of the diverse factors, such as options expenses, it takes into account. Jefferies, which makes a market in Google stock, has no business relationship with Google. Mr. Squali, who has a "buy" rating on the company's shares, has no Google holdings.

Mr. Squali said he expects Google to beat first-quarter earnings estimates, largely because it has stolen market share from rivals. "We're going into the quarter pretty bullish with Google," he said.

Write to Kevin J. Delaney at [kevin.delaney@wsj.com](mailto:kevin.delaney@wsj.com)<sup>1</sup>

<b>Speeding Things Up</b>									
Google's employee stock-based compensation, expense year ended Dec. 31, in millions									
	2002	2003	2004	2005	2006	2007	2008	2009	THEREAFTER
<b>Accelerated basis</b>	\$21.6	229.4	278.7	145.8	70.5	25.9	5.6	1.3	0.4
<b>Straight-line basis</b>	\$13.3	120.5	201.9	171.4	150.1	92.2	30.7	5.0	2.2

Source: Google SEC filing