TYLER TECHNOLOGIES INC
Form 10-Q
July 22, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended June 30, 2015

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
Commission File Number 1-10485

TYLER TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	75-2303920
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)

5101 TENNYSON PARKWAY

PLANO, TEXAS

75024

(Address of principal executive offices)

(Zip code)

(972) 713-3700

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller Reporting Company	¨

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

The number of shares of common stock of registrant outstanding on July 17, 2015 was 33,864,000.

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements
TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except per share amounts)

(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2015	2014	2015	2014
Revenues:				
Software licenses and royalties	$14,586	$12,083	$28,886	$23,315
Subscriptions	26,949	20,934	52,237	41,441
Software services	34,563	30,128	65,367	54,435
Maintenance	59,463	51,951	116,811	102,191
Appraisal services	6,691	5,444	12,780	10,295
Hardware and other	4,043	3,831	5,180	5,320
Total revenues	146,295	124,371	281,261	236,997
Cost of revenues:				
Software licenses and royalties	483	343	1,036	874
Acquired software	456	444	912	925
Software services, maintenance and subscriptions	69,678	58,274	135,055	113,273
Appraisal services	4,278	3,665	8,413	6,976
Hardware and other	3,147	3,087	3,713	3,861
Total cost of revenues	78,042	65,813	149,129	125,909
Gross profit	68,253	58,558	132,132	111,088
Selling, general and administrative expenses	30,396	27,419	58,941	52,786
Research and development expense	7,110	6,389	14,114	12,561
Amortization of customer and trade name intangibles	1,151	1,128	2,303	2,257
Operating income	29,596	23,622	56,774	43,484
Other income (expense), net	185	(216)	366	(475)
Income before income taxes	29,781	23,406	57,140	43,009
Income tax provision	10,945	8,666	21,031	16,386
Net income	$18,836	$14,740	$36,109	$26,623
Earnings per common share:				
Basic	$0.56	$0.45	$1.07	$0.81
Diluted	$0.52	$0.42	$1.00	$0.75

Comprehensive income	$18,836	$14,740	$36,109	$26,623

See accompanying notes.

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TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and share amounts)

	June 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 204,103	$ 206,167
Accounts receivable (less allowance for losses of $1,361 in 2015 and $1,725 in 2014)	152,178	112,660
Prepaid expenses	18,979	17,851
Other current assets	10,590	358
Deferred income taxes	9,674	9,674
Total current assets	395,524	346,710
Accounts receivable, long-term portion	391	1,761
Property and equipment, net	67,908	65,910
Other assets:		
Goodwill	131,960	124,142
Other intangibles, net	31,507	34,722
Cost method investment	15,000	—
Other non-current assets	3,744	737
	$ 646,034	$ 573,982
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,385	$ 4,119
Accrued liabilities	34,810	39,508
Deferred revenue	201,549	189,212
Total current liabilities	240,744	232,839
Deferred income taxes	4,673	4,170
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $10.00 par value; 1,000,000 shares authorized; none issued	—	—
Common stock, $0.01 par value; 100,000,000 shares authorized; 48,147,969 shares issued in 2015 and 2014	481	481
Additional paid-in capital	221,838	201,389
Accumulated other comprehensive loss, net of tax	(46)	(46)
Retained earnings	297,259	261,150

Treasury stock, at cost; 14,294,303 and 14,678,782 shares in 2015 and 2014, respectively	(118,915)	(126,001)
Total shareholders' equity	400,617	336,973
	$ 646,034	$ 573,982

See accompanying notes.

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TYLER TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six months ended June 30, 2015	2014
Cash flows from operating activities:		
Net income	$36,109	$26,623
Adjustments to reconcile net income to cash provided by operations:		
Depreciation and amortization	7,484	7,281
Share-based compensation expense	8,861	7,002
Excess tax benefit from exercises of share-based arrangements	(8,827)	(3,206)
Changes in operating assets and liabilities, exclusive of effects of acquired companies:		
Accounts receivable	(36,624)	(38,203)
Income taxes	2,735	7,746
Prepaid expenses and other current assets	(549)	(2,069)
Accounts payable	(371)	51
Accrued liabilities	(5,685)	(4,237)
Deferred revenue	11,680	27,840
Net cash provided by operating activities	14,813	28,828
Cash flows from investing activities:		
Purchase of cost method investment	(15,000)	—
Purchase of held-to-maturity securities	(6,449)	—
Cost of acquisitions, net of cash acquired	(6,447)	—
Additions to property and equipment	(6,126)	(6,477)
(Increase) decrease in other	(9)	343
Net cash used by investing activities	(34,031)	(6,134)
Cash flows from financing activities:		
Purchase of treasury shares	(645)	(22,815)
Proceeds from exercise of stock options	6,729	4,117
Contributions from employee stock purchase plan	2,243	2,014
Excess tax benefit from exercises of share-based arrangements	8,827	3,206
Net cash provided (used) by financing activities	17,154	(13,478)
Net (decrease) increase in cash and cash equivalents	(2,064)	9,216
Cash and cash equivalents at beginning of period	206,167	78,876
Cash and cash equivalents at end of period	$204,103	$88,092

See accompanying notes.

Tyler Technologies, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Tables in thousands, except per share data)

(1) Basis of Presentation

We prepared the accompanying condensed consolidated financial statements following the requirements of the Securities and Exchange Commission ("SEC") and accounting principles generally accepted in the United States, or GAAP, for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP can be condensed or omitted for interim periods. Balance sheet amounts are as of June 30, 2015 and December 31, 2014 and operating result amounts are for the three months and six months ended June 30, 2015 and 2014, and include all normal and recurring adjustments that we considered necessary for the fair summarized presentation of our financial position and operating results. As these are condensed financial statements, one should also read the financial statements and notes included in our latest Form 10-K for the year ended December 31, 2014. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year.

(2) Acquisitions

)

$
(1.24
)

$
(1.08
)

$
(0.82
)

$
(0.71
)
Diluted
$
(0.50

)

$
(1.24
)

$
(1.08
)

$
(0.82
)

$
(0.71
)
Weighted-average shares used to compute net loss per share attributable to common stockholders:

Basic
341,555

170,498

142,042

127,845

119,220

Diluted
341,555

170,498

142,042

127,845

119,220

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Operating expenses include share-based compensation expense as follows:

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands)				
Product development	$91,404	$54,738	$24,758	$8,820	$3,984
Sales and marketing	14,122	7,360	3,738	1,235	668
General and administrative	33,260	20,194	7,604	4,603	3,462
Total share-based compensation	$138,786	$82,292	$36,100	$14,658	$8,114

	December 31,			
	2016	2015	2014	2013
	(in thousands)			
Consolidated Balance Sheet Data:				
Cash and cash equivalents	$452,030	$461,329	$222,315	$166,176
Settlements receivable	321,102	142,727	115,481	64,968
Working capital	423,961	371,361	218,761	124,061
Total assets	1,211,362	894,772	541,888	318,341
Customers payable	388,058	215,365	145,663	95,794
Total stockholders' equity	576,153	508,048	273,672	162,294

Key Operating Metrics and Non-GAAP Financial Measures

We collect and analyze operating and financial data to evaluate the health of our business, allocate our resources, and assess our performance. In addition to revenue, net income (loss), and other results under generally accepted accounting principles (GAAP), the following table sets forth key operating metrics and non-GAAP financial measures we use to evaluate our business. We believe these metrics and measures are useful to facilitate period-to-period comparisons of our business, and to facilitate comparisons of our performance to that of other payment processors. Each of these metrics and measures excludes the effect of our processing agreement with Starbucks. As of December 31, 2016, Starbucks has completed its previously announced transition to another payments solutions provider. As a result, we believe it is useful to exclude Starbucks activity to clearly show the impact Starbucks has had on our financial results historically, and to provide insight into the impact of the termination of the Starbucks agreement on our revenues going forward. Our agreements with other sellers generally provide both those sellers and us the unilateral right to terminate such agreements at any time, without fine or penalty. Furthermore, we generally do not enter into long-term contractual agreements with sellers.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands, except for GPV and per share data)				
Gross Payment Volume (GPV) (in millions)	$49,683	$35,643	$23,780	$14,822	$6,518
Adjusted Revenue	$686,618	$452,168	$276,310	$160,144	$67,627
Adjusted EBITDA	$44,887	$(41,115)	$(67,741)	$(51,530)	$(70,579)
Adjusted Net Income (Loss) Per Share:					
Basic	$0.04	$(0.39)	$(0.62)	$(0.46)	$(0.62)
Diluted	$0.04	$(0.39)	$(0.62)	$(0.46)	$(0.62)

Gross Payment Volume (GPV)

We define GPV as the total dollar amount of all card payments processed by sellers using Square, net of refunds. GPV excludes card payments processed for Starbucks. Additionally, GPV excludes non-revenue generating activity related to our Square Cash peer-to-peer payments service.

Adjusted Revenue

Adjusted Revenue is a non-GAAP financial measure that we define as our total net revenue less transaction-based costs, adjusted to eliminate the effect of activity with Starbucks. As described above, Starbucks completed its previously announced transition to another payments provider and has ceased using our payments solutions altogether, and we believe that providing Adjusted Revenue metrics that exclude the impact of our agreement with Starbucks is useful to investors.

We believe it is useful to subtract transaction-based costs from Adjusted Revenue as this is a primary metric used by management to measure our business performance, and it affords greater comparability to other payments solution providers. Substantially all of the transaction-based costs subtracted from Adjusted Revenue are interchange fees set by payment card networks and are paid to card issuers, with the remainder of such transaction costs consisting of assessment fees paid to payment card networks, fees paid to third-party payment processors, and bank settlement fees. While some payments solution providers present their revenue in a similar fashion to us, others present their revenue net of transaction-based costs because they pass through these costs directly to their sellers. Under our standard pricing model, we do not pass through these costs directly to our sellers.

Adjusted Revenue has limitations as a financial measure, should be considered as supplemental in nature, and is not meant as a substitute for the related financial information prepared in accordance with GAAP. These limitations include the following:

- Adjusted Revenue is net of transaction-based costs, which is our largest cost of revenue item; and
- other companies, including companies in our industry, may calculate Adjusted Revenue differently from how we calculate this measure or not at all, which reduces its usefulness as a comparative measure.

Because of these limitations, you should consider Adjusted Revenue alongside other financial performance measures, including total net revenue and our financial results presented in accordance with GAAP. The following table presents a reconciliation of total net revenue to Adjusted Revenue for each of the periods indicated:

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands)				
Total net revenue	$1,708,721	$1,267,118	$850,192	$552,433	$203,449
Less: Starbucks transaction-based revenue	78,903	142,283	123,024	114,456	9,471
Less: transaction-based costs	943,200	672,667	450,858	277,833	126,351
Adjusted Revenue	$686,618	$452,168	$276,310	$160,144	$67,627

Adjusted EBITDA, Adjusted Net Income (Loss), and Adjusted Net Income (Loss) Per Share

Adjusted EBITDA, Adjusted Net Income (Loss), and Adjusted Net Income (Loss) Per Share are non-GAAP financial measures that represent our net income (loss) and net income (loss) per share, adjusted to eliminate the effect of Starbucks transactions and certain other items as described below. We have included these non-GAAP financial measures in this Annual Report on Form 10-K because they are key measures used by our management to evaluate our operating performance, generate future operating plans, and make strategic decisions, including those relating to operating expenses and the allocation of internal resources. Accordingly, we believe these measures provide useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors. In addition, they provide useful measures for period-to-period comparisons of our business, as they remove the effect of certain non-cash items and certain variable charges.

- We exclude Starbucks transaction-based revenue and Starbucks transaction-based costs. As described above, Starbucks completed its previously announced transition to another payments solution provider and has ceased using our payments solutions altogether, and we believe that providing non-GAAP financial measures that exclude the impact of our agreement with Starbucks is useful to investors.

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- We believe it is useful to exclude non-cash charges, such as amortization of intangible assets, and share-based compensation expenses, from our non-GAAP financial measures because the amount of such expenses in any specific period may not directly correlate to the underlying performance of our business operations.

- We exclude the litigation settlement with Robert E. Morley described in Note 1 of the accompanying notes to our consolidated financial statements, gain or loss on the sale of property and equipment, and impairment of intangible assets from non-GAAP financial measures because we do not believe that these items are reflective of our ongoing business operations.

In addition to the items above, Adjusted EBITDA as a non-GAAP financial measure also excludes depreciation, interest income and expense, other income and expense and provision or benefit from income taxes, as these items are not components of our core business operations.

Non-GAAP financial measures have limitations, should be considered as supplemental in nature and are not meant as a substitute for the related financial information prepared in accordance with GAAP. These limitations include the following:

- share-based compensation expense has been, and will continue to be for the foreseeable future, a significant recurring expense in our business and an important part of our compensation strategy;

- the intangible assets being amortized may have to be replaced in the future, and the non-GAAP financial measures do not reflect cash capital expenditure requirements for such replacements or for new capital expenditures or other capital commitments; and

- non-GAAP measures do not reflect changes in, or cash requirements for, our working capital needs.

In addition to the limitations above, Adjusted EBITDA as a non-GAAP financial measure does not reflect the effect of depreciation expense and related cash capital requirements, income taxes that may represent a reduction in cash available to us, and the effect of foreign currency exchange gains or losses which is included in other income and expense.

Other companies, including companies in our industry, may calculate the non-GAAP financial measures differently from how we calculate these measures or not at all, which reduces their usefulness as comparative measures.

Because of these limitations, you should consider the non-GAAP financial measures alongside other financial performance measures, including net loss and our other financial results presented in accordance with GAAP.

The following table presents a reconciliation of net loss to Adjusted EBITDA for each of the periods indicated (in thousands):

	Year Ended December 31,				
	2016	2015	2014	2013	2012
Net loss	$(171,590)	$(179,817)	$(154,093)	$(104,493)	$(85,199)
Starbucks transaction-based revenue	(78,903)	(142,283)	(123,024)	(114,456)	(9,471)
Starbucks transaction-based costs	69,761	165,438	150,955	139,803	12,547
Share-based compensation expense	138,786	82,292	36,100	14,658	8,114
Depreciation and amortization	37,745	27,626	18,586	8,272	3,579
Litigation settlement expense	48,000	—	—	—	—
Interest and other (income) expense, net	(780)	1,613	2,162	(962)	(162)

Provision for income taxes	1,917	3,746	1,440	513	—
(Gain) loss on sale of property and equipment	(49)	270	133	2,705	13
Impairment of intangible assets	—	—	—	2,430	—
Adjusted EBITDA	$44,887	$(41,115)	$(67,741)	$(51,530)	$(70,579)

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The following table presents a reconciliation of net loss to Adjusted Net Income (Loss) and Adjusted Net Income (Loss) Per Share for each of the periods indicated (in thousands, except per share data):

	Year Ended December 31,				
	2016	2015	2014	2013	2012
Net loss	$(171,590)	$(179,817)	$(154,093)	$(104,493)	$(85,199)
Starbucks transaction-based revenue	(78,903)	(142,283)	(123,024)	(114,456)	(9,471)
Starbucks transaction-based costs	69,761	165,438	150,955	139,803	12,547
Share-based compensation expense	138,786	82,292	36,100	14,658	8,114
Amortization of intangible assets	9,013	7,503	2,133	54	54
Litigation settlement expense	48,000	—	—	—	—
(Gain) loss on sale of property and equipment	(49)	270	133	2,705	13
Impairment of intangible assets	—	—	—	2,430	—
Adjusted Net Income (Loss)	$15,018	$(66,597)	$(87,796)	$(59,299)	$(73,942)
Adjusted Net Income (Loss) Per Share:					
Basic	$0.04	$(0.39)	$(0.62)	$(0.46)	$(0.62)
Diluted	$0.04	$(0.39)	$(0.62)	$(0.46)	$(0.62)
Weighted-average shares used to compute Adjusted Net Income (Loss) Per Share:					
Basic	341,555	170,498	142,042	127,845	119,220
Diluted	370,258	170,498	142,042	127,845	119,220

Basic Adjusted Net Income (Loss) Per Share is computed by dividing the Adjusted Net Income (Loss) by the weighted-average number of shares of common stock outstanding during the period.

Diluted Adjusted Net Income Per Share is computed by dividing Adjusted Net Income by the weighted-average number of shares of common stock outstanding, including all potentially dilutive shares.

Diluted Adjusted Net Loss Per Share is the same as Basic Adjusted Net Loss Per Share because the effects of potentially dilutive items were anti-dilutive given the Adjusted Net Loss position.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis in conjunction with the information set forth under “Selected Financial Data” and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The statements in this discussion regarding our expectations of our future performance; liquidity and capital resources; our plans, estimates, beliefs, and expectations that involve risks and uncertainties; and other non-historical statements in this discussion are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described under “Risk Factors” and elsewhere in this Annual Report on Form 10-K. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

Overview

We started Square in February 2009 to enable businesses (sellers) to accept card payments, an important capability that was previously inaccessible to many businesses. However, sellers also need innovative solutions to thrive, and we have since expanded to provide additional products and services to provide these businesses with access to the same tools as large businesses. Square is a cohesive commerce ecosystem that combines sophisticated software with affordable hardware to enable sellers to turn mobile devices and computing devices into powerful payments and point-of-sale solutions. We focus on technology and design to create products and services that are cohesive, fast, self-serve, and dependable.

The foundation of our ecosystem is a full service, managed payments offering. With our offering, a seller can accept payments in person via magnetic stripe (a swipe), EMV (Europay, MasterCard, and Visa) (a dip), or NFC (Near Field Communication) (a tap); or online via Square Invoices, Square Virtual Terminal, or the seller’s website. Once on our system, sellers gain access to technology and features such as reporting and analytics, next-day settlements, digital receipts, payment dispute management and chargeback protection, and PCI compliance. On the consumer (buyer) side, Square Cash offers individuals access to a fast, easy way to send and receive money electronically to and from individuals and businesses. We monetize these features through a per transaction fee which we record as revenue upon authorization of a transaction by the seller's customer's bank. We recognize revenue net of refunds, which arise from reversals of transactions initiated by sellers.

Our commerce ecosystem also includes powerful point-of-sale software and services that help sellers make informed business decisions through the use of analytics and reporting. As a result, sellers can manage orders, inventory, locations, employees, and payroll; engage and grow their sales with customers; and gain access to business loans. Some of these advanced point-of-sale features are broadly applicable to our seller base and include Employee Management, and Customer Engagement. We monetize these features through either a per transaction fee, a subscription fee, or a service fee.

With Square Capital, we facilitate the offering of loans to sellers based on their payment processing history, and the product is broadly applicable across our seller base. We recognize revenue upon the sale of the loans to third-party investors or over time as the sellers pay down the outstanding amounts for the loans that we hold as available for sale. We also earn a servicing fee from third-party investors that we record as revenue as we provide the services.

We also serve sellers through Caviar, a food ordering service that helps restaurants reach new customers and increase sales without additional overhead. Caviar revenue consists of seller fees charged to restaurants, delivery fees, and service fees from consumers. All fees are recognized upon delivery of the food, net of refunds.

We also provide our sellers with contactless and chip readers, chip card readers, Square Stand, and third-party peripherals. We recognize revenue from the sale of this hardware net of returns upon delivery of the hardware to the end user.

We have grown rapidly to serve millions of sellers that represent a diverse set of industries, including retail, services, and food-related businesses, and sizes, ranging from a single vendor at a farmers' market to multi-location businesses. These sellers also span geographies including the United States, Canada, Japan, and Australia.

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Operating Metric Overview (in thousands, except for GPV, percentages and per share data)

	Year Ended December 31,			2015 to 2016	2014 to 2015
	2016	2015	2014	% Change	% Change
Gross Payment Volume (GPV) (in millions)	$49,683	$35,643	$23,780	39 %	50 %
Total net revenue	$1,708,721	$1,267,118	$850,192	35 %	49 %
Adjusted Revenue	$686,618	$452,168	$276,310	52 %	64 %
Net loss attributable to common stockholders	$(171,590)	$(212,017)	$(154,093)		
Adjusted EBITDA	$44,887	$(41,115)	$(67,741)		
Net loss per share attributable to common stockholders:					
Basic	$(0.50)	$(1.24)	$(1.08)		
Diluted	$(0.50)	$(1.24)	$(1.08)		
Adjusted Net Income (Loss) Per Share:					
Basic	$0.04	$(0.39)	$(0.62)		
Diluted	$0.04	$(0.39)	$(0.62)		

Components of Results of Operations

Changes to the Description of Revenue and Cost of Revenue Line Items

We have renamed some of the revenue and cost of revenues financial statement line items in our consolidated statements of operations to better describe how we monetize our product and service offerings. Accordingly, we have renamed the previously-presented transaction revenue and Starbucks transaction revenue as transaction-based revenue and Starbucks transaction-based revenue, respectively. We have also renamed software and data product revenue as subscription and services-based revenue. The products and services revenues included in the previously presented line items remain the same. We have similarly renamed the cost of revenues line items while the components of costs of revenues in the line items have remained the same.

Revenue

Transaction-based revenue. We charge our sellers a transaction fee for managed payments solutions that is generally calculated based on a percentage of the total transaction amount processed. We also selectively offer custom pricing for larger sellers.

Starbucks transaction-based revenue. Under our processing agreement with Starbucks, we charged a percentage of the total transaction amount for payments solutions we offered to certain Starbucks-owned stores in the United States. As of December 31, 2016, Starbucks has completed its previously announced transition to another payments solution provider and accordingly we do not expect revenue from Starbucks to recur in the future.

Subscription and services-based revenue. In addition to managed payments and point-of-sale services, we offer our sellers a range of paid services, with Square Capital and Caviar currently comprising the majority of our subscription and services-based revenue. Our other subscription and services-based products include Gift Cards, Square Appointments, Instant Deposit, Customer Engagement, Employee Management, Payroll, and other subscription and services-based products offered through our Square Marketplace.

Square Capital primarily facilitates loans to pre-qualified sellers. Previously we provided MCAs to sellers but we discontinued the MCAs in 2016 and are currently still servicing and collecting such MCAs in accordance with their terms. The loans have no stated coupon rate but the seller is charged by our bank partner a one-time origination fee based upon their risk rating, which is derived primarily from processing activity. Generally, a fixed percentage of the seller’s daily processing volume is withheld to repay the loan. Our intention is to continue selling loans to third-party investors for an upfront fee while being retained as the loan servicer. We record the net amounts we pay to the bank partner as the cost of the loans we purchase and

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subsequently record any gain we make on the sale of these loans to third-party investors as a component of revenue. We record the ongoing servicing fee, which is a fixed percentage of each repayment, as revenue as the service is performed. We may retain some of the loans purchased from our bank partner on our balance sheet which we hold as available for sale. We recognize a portion of the excess of the expected seller repayments over the cost of the loan as revenue in proportion to the loan principal reduction for the time we own the loan. Selling the loans to investors provides us with funding and allows us to mitigate our balance sheet risk.

Revenue for Caviar, our food ordering service, is derived from seller fees, which are a percentage of total food order value, delivery fees, and service fees paid by the consumer based on total food order value.

Hardware revenue. Hardware revenue includes revenue from sales of contactless and chip readers, chip card readers, Square Stand, and third-party peripherals. Third-party peripherals include cash drawers, receipt printers, and barcode scanners, all of which can be integrated with Square Stand to provide a comprehensive point-of-sale solution. In the second quarter of 2015, we began selling our first chip card reader, and in the fourth quarter of 2015, we began selling our contactless and chip reader.

Cost of Revenue and Gross Margin

Transaction-based costs. Transaction-based costs consist primarily of interchange fees set by payment card networks and that are paid to the card-issuing financial institution, assessment fees paid to payment card networks, fees paid to third-party payment processors, and bank settlement fees.

Starbucks transaction-based costs. Starbucks transaction-based costs consist of the same components as our overall transaction-based costs.

Subscription and services-based costs. Subscription and services-based costs consist primarily of Caviar-related costs, which include payments to third-party couriers for deliveries and the costs of equipment provided to sellers. Cost of revenue for other subscription and services-based products consists primarily of the amortization related to the development of certain subscription and services-based products.

Hardware costs. Hardware costs consist primarily of product costs associated with contactless and chip readers, chip card readers, Square Stand, and third-party peripherals. Product costs include manufacturing-related overhead and personnel costs, certain royalties, packaging, and fulfillment costs. We currently offer our contactless and chip card readers at a price modestly below our manufacturing costs. For Square Stand, our manufacturing costs substantially exceed our revenue. However, we believe both Square Stand and contactless and chip readers are attractive offerings to many of our larger sellers, and, as a result, we intend to continue to offer each at prices less than our costs. In conjunction with the sale of contactless and chip readers, we will also begin to recognize additional costs related to the design and distribution of those units.

Amortization of acquired technology. These costs consist of amortization related to technologies acquired through acquisitions that have the capability of producing revenue.

Operating Expenses

Operating expenses consist of product development, sales and marketing, general and administrative expenses, transaction, loan and advance losses, and amortization of acquired customer assets. For product development and general and administrative expenses, the largest single component is personnel-related expenses, including salaries, commissions and bonuses, employee benefit costs, and share-based compensation. In the case of sales and marketing expenses, a significant portion is related to paid advertising expenses in addition to personnel-related expenses. Operating expenses also include allocated overhead costs for facilities, human resources, and IT.

Product development. Product development expenses currently represent the largest component of our operating expenses and consist primarily of expenses related to our engineering, data science, and design personnel; fees and supply costs related to maintenance and capacity expansion at third-party data center facilities; hardware related development and tooling costs; and fees for software licenses, consulting, legal, and other services that are directly related to growing and maintaining our portfolio of products and services. Additionally, product development expenses include the depreciation of product-related infrastructure and tools, including data center equipment, internally developed software, and computer equipment. We continue to focus our product development efforts on adding new features and apps, and on enhancing the functionality and ease of use

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of our offerings. Our ability to realize returns on these investments is substantially dependent upon our ability to successfully address current and emerging requirements of sellers and buyers through the development and introduction of these new products and services. While we expect total product development expenses to increase as we invest further in engineering and design personnel, over time we also expect our product development expenses to decline as a percentage of total net revenue.

Sales and marketing. Sales and marketing expenses consist primarily of four components. The first component is comprised of costs incurred to acquire new sellers through various paid advertising channels, including online, mobile, email, direct mail, and direct response TV, all of which are expensed as incurred. The second component includes expenses related to our direct sales, account management, local and product marketing, retail and ecommerce, partnerships, and communications personnel. The third component includes the costs associated with the manufacturing and distribution of our magstripe reader, which is offered for free on our website and provided through various marketing events and distribution channels. New sellers who purchase a magstripe reader from one of our retail distribution partners are offered a rebate equal to the price paid. The cost to us of manufacturing and distributing magstripe readers are partially offset by amounts received from retail distribution partners. As our sellers transition to using our contactless and chip reader, we expect to distribute relatively fewer magstripe readers, thus reducing that component of our sales and marketing expenses. The fourth component includes costs associated with free Square Cash peer-to-peer transactions. While we expect sales and marketing expenses to increase as the scale of our business grows, over the long term we also expect sales and marketing expenses to decline as a percentage of total net revenue. Over the short term, however, sales and marketing expenses as a percentage of total net revenue may demonstrate variability based on the timing and magnitude of marketing and customer acquisition initiatives.

General and administrative. General and administrative expenses consist primarily of expenses related to our finance, legal, customer support, Caviar operations, risk operations, human resources, and administrative personnel. General and administrative expenses also include costs related to fees paid for professional services, including legal, tax, and accounting services. While we expect general and administrative expenses to increase in dollar amount to support our growth and costs of compliance associated with being a public company, over time we expect general and administrative expenses to decline as a percentage of total net revenue.

Transaction, loan and advance losses. We are exposed to transaction losses due to chargebacks as a result of fraud or uncollectibility. Examples of transaction losses include chargebacks for unauthorized credit card use and inability to collect on disputes between buyers and sellers over the delivery of goods or services. We base our reserve estimates on prior chargeback history and current period data points indicative of transaction loss. We reflect additions to the reserve in current operating results, while we make charges to the reserve when we incur losses.

The establishment of appropriate reserves is an inherently uncertain process, and ultimate losses may vary from the current estimates. We regularly update our reserve estimates as new facts become known and events occur that may affect the settlement or recovery of losses. For the period from January 1, 2014 through December 31, 2016, our transaction losses accounted for approximately 0.1% of GPV.

We are not exposed to losses for the Square Capital loans that are sold to third parties in accordance with our arrangements with them. These third-party arrangements cover a majority of the dollar value of loans purchased from our bank partner. We account for the Square Capital loans that we retain at the lower of cost or fair value. To determine the fair value of these loans, we utilize industry standard modeling, such as discounted cash flow models. To date the fair values of the loans have exceeded the cost and we have not had to write-down the value of the loans.

We are exposed to losses related to the uncollectibility of MCAs that we still carry on our books, and similar to the loss provisions for transaction losses, we have established loss provisions for uncollectible receivables. We have estimated the allowance based on prior default rates and seller-specific activity. During the first quarter of 2016, we fully transitioned from offering MCAs to loans. Activity includes updates to our provision estimates for historical balances and charge offs of certain MCA receivables based on payment inactivity.

Amortization of acquired customer assets. Amortization of acquired customer assets includes customer relationships, restaurant relationships, courier relationships, subscriber relationships, and partner relationships.

Interest and Other Income and Expense

Interest and other income and expense consists primarily of interest expense related to our revolving credit facility, interest expense on our capital lease financings, and interest income on cash balances. Other income and expense historically

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consisted primarily of changes in the fair value of our customer warrant liability measurements and foreign currency-related gains and losses.

Provision for Income Taxes

The provision for income taxes consists primarily of local, state, federal, and foreign tax. Our effective tax rate fluctuates from period to period due to changes in the mix of income and losses in jurisdictions with a wide range of tax rates, the effect of acquisitions, changes resulting from the amount of recorded valuation allowance, permanent differences between U.S. generally accepted accounting principles and local tax laws, certain one-time items, and changes in tax contingencies.

Deemed Dividend on Series E Preferred Stock

For the year ended December 31, 2015, we issued 10,299,696 shares of our common stock to certain holders of Series E preferred stock in the form of a deemed stock dividend of $32.2 million. There were no similar occurrences in any other period presented.

Results of Operations

Revenue (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
Transaction-based revenue	$1,456,160	$1,050,445	$707,799	39 %	48 %
Starbucks transaction-based revenue	78,903	142,283	123,024	(45)%	16 %
Subscription and services-based revenue	129,351	58,013	12,046	123 %	382 %
Hardware revenue	44,307	16,377	7,323	171 %	124 %
Total net revenue	$1,708,721	$1,267,118	$850,192	35 %	49 %

Comparison of Years Ended December 31, 2016 and 2015

Total net revenue for the year ended December 31, 2016, increased by $441.6 million, or 35%, compared to the year ended December 31, 2015.

Transaction-based revenue for the year ended December 31, 2016, increased by $405.7 million, or 39%, compared to the year ended December 31, 2015. This increase was attributable to growth in GPV processed of $14.0 billion, or 39%, to $49.7 billion from $35.6 billion. We continue to benefit from positive dollar-based retention from our existing sellers, in addition to meaningful contributions from new sellers.

Starbucks transaction-based revenue for the year ended December 31, 2016, decreased by $63.4 million, or 45%, compared to the year ended December 31, 2015. Starbucks-related payment volume continued to decline throughout 2016 and during the fourth quarter of 2016, as Starbucks completed its previously announced transition to another payments solution provider. Accordingly, we do not expect revenue from Starbucks to recur in the future.

Subscription and services-based revenue for the year ended December 31, 2016 increased by $71.3 million, or 123%, compared to the year ended December 31, 2015. The increase was primarily driven by continued growth and expansion of Square Capital and Caviar, and to a lesser extent, the launch and expansion of new products and services, including Instant Deposit. During the year ended December 31, 2016 and 2015, Square Capital and Caviar were the largest contributors to subscription and services-based revenue. Subscription and services-based revenue grew to 8% of total net revenue in the year ended December 31, 2016, up from 5% in the year ended December 31, 2015.

Hardware revenue for the year ended December 31, 2016, increased by $27.9 million, or 171%, compared to the year ended December 31, 2015. The increase primarily reflected growth in shipments of our contactless and chip reader following its launch in the fourth quarter of 2015. To a lesser extent, we generated increased sales across all of our other paid hardware products, including Square Stand, our chip card reader, and third-party peripherals.

Comparison of Years Ended December 31, 2015 and 2014

Total net revenue for the year ended December 31, 2015, increased by $416.9 million, or 49%, compared to the year ended December 31, 2014.

Transaction-based revenue for the year ended December 31, 2015, increased by $342.6 million, or 48%, compared to the year ended December 31, 2014. This increase was attributable to growth in GPV processed of $11.9 billion, or 50%, to $35.6 billion from $23.8 billion.

Starbucks transaction-based revenue for the year ended December 31, 2015, increased by $19.3 million, or 16%, compared to the year ended December 31, 2014. Under an amended processing agreement that was effective October 1, 2015, Starbucks agreed to pay increased processing rates for as long as it continued to process transactions with us. In 2015, we continued to process a portion of Starbucks payments, generating transaction-based revenue at these increased rates.

Subscription and services-based revenue for the year ended December 31, 2015 increased by $46.0 million, or 382%, compared to the year ended December 31, 2014. The increase was driven by the launch and expansion of several new products and services in 2014 and 2015, in particular Square Capital, which remained the largest contributor to subscription and services-based revenue. The year ended December 31, 2015 also included a full twelve months of revenue contributions from Caviar, which we acquired in August 2014. Subscription and services-based revenue grew to 5% of total net revenue in the year ended December 31, 2015, up from 1% in the year ended December 31, 2014.

Hardware revenue for the year ended December 31, 2015, increased by $9.1 million, or 124%, compared to the year ended December 31, 2014. The increase reflected growth in sales of Square Stand and third-party peripherals, as well as the launch of our chip card reader in the second quarter of 2015 and the launch of our contactless and chip reader in the fourth quarter of 2015.

Total Cost of Revenue (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
Transaction-based costs	$943,200	$672,667	$450,858	40 %	49 %
Starbucks transaction-based costs	69,761	165,438	150,955	(58)%	10 %
Subscription and services-based costs	43,132	22,470	2,973	92 %	NM
Hardware costs	68,562	30,874	18,330	122 %	68 %
Amortization of acquired technology	8,028	5,639	1,002	42 %	NM
Total cost of revenue	$1,132,683	$897,088	$624,118	26 %	44 %

Comparison of Years Ended December 31, 2016 and 2015

Total cost of revenue for the year ended December 31, 2016, increased by $235.6 million, or 26%, compared to the year ended December 31, 2015.

Transaction-based costs for the year ended December 31, 2016, increased by $270.5 million, or 40%, compared to the year ended December 31, 2015. This increase was attributable to growth in GPV processed of $14.0 billion, or 39%, and is consistent with the growth in transaction-based revenue.

Starbucks transaction-based costs for the year ended December 31, 2016, decreased by $95.7 million, or 58%, compared to the year ended December 31, 2015. As noted above, Starbucks-related payment volume continued to decline throughout 2016, and during the fourth quarter of 2016, Starbucks completed its previously announced transition to another payments solution provider. Additionally, Starbucks transaction-based costs decreased by a greater percentage than Starbucks transaction-based revenue as a result of Starbucks' agreement to pay us increased processing rates effective October 1, 2015.

Subscription and services-based costs for the year ended December 31, 2016, increased by $20.7 million compared to the year ended December 31, 2015, primarily reflecting increased costs associated with the growth of Caviar. To a lesser extent, we also incurred increased amortization costs related to the development of certain subscription and services-based products.

Hardware costs for the year ended December 31, 2016, increased by $37.7 million, or 122%, compared to the year ended December 31, 2015. Hardware costs grew more slowly than hardware revenue mainly as a result of the growth in sales of our contactless and chip reader which have relatively better terms than Square Stand.

Amortization of acquired technology assets for the year ended December 31, 2016, increased by $2.4 million compared to the year ended December 31, 2015. The increase was primarily related to new technology assets obtained through acquisitions that occurred in 2015.

Comparison of Years Ended December 31, 2015 and 2014

Total cost of revenue for the year ended December 31, 2015, increased by $273.0 million, or 44%, compared to the year ended December 31, 2014.

Transaction-based costs for the year ended December 31, 2015, increased by $221.8 million, or 49%, compared to the year ended December 31, 2014. This increase was attributable to growth in GPV processed of $11.9 billion, or 50%, reflecting a decline in transaction-based costs as a percentage of GPV compared to the prior year period.

Starbucks transaction-based costs for the year ended December 31, 2015, increased by $14.5 million, or 10%, compared to the year ended December 31, 2014. As a result of Starbucks' agreement to pay us increased processing rates effective October 1, 2015, growth in Starbucks transaction-based revenue outpaced growth in Starbucks transaction-based costs beginning in the fourth quarter of 2015.

Subscription and services-based costs for the year ended December 31, 2015, increased by $19.5 million compared to the year ended December 31, 2014. The increase primarily reflects increased costs associated with Caviar, which we acquired in August 2014. To a lesser extent, we also incurred increased costs related to the growth in our Gift Cards product, as well as increased amortization costs related to the development of certain subscription and services-based products.

Hardware costs for the year ended December 31, 2015, increased by $12.5 million, or 68%, compared to the year ended December 31, 2014. The increase was attributable to increased sales of Square Stand and third-party peripherals, as well as the launch of our chip card reader in the second quarter of 2015, and the launch of our contactless and chip reader in the fourth quarter of 2015. For the year ended December 31, 2015, hardware costs grew more slowly than hardware revenue as a result of increased sales of third-party peripherals and the introduction of our contactless and chip reader.

Amortization of technology assets for the year ended December 31, 2015, increased by $4.6 million compared to the year ended December 31, 2014. The increase was related to new technology assets obtained through acquisitions that occurred in 2014 and 2015.

Product Development (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
Product development	$268,537	$199,638	$144,637	35 %	38 %
Percentage of total net revenue	16 %	16 %	17 %		

Product development expenses for the year ended December 31, 2016, increased by $68.9 million, or 35%, compared to the year ended December 31, 2015, due to the following:

- the addition of personnel in our engineering, product, and design teams; and
- product development expenses included $91.4 million in share-based compensation expense, a $36.7 million increase compared to the prior year.

Product development expenses for the year ended December 31, 2015, increased by $55.0 million, or 38%, compared to the year ended December 31, 2014, due to the following:

- the addition of personnel in our engineering, product, and design teams, including those who joined as a result of acquisitions; and
- product development expenses included $54.7 million in share-based compensation expense, a $30.0 million increase compared to the prior year.

Sales and Marketing (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016	2014 to 2015
	2016	2015	2014		

				% Change	% Change
Sales and marketing	$173,876	$145,618	$112,577	19 %	29 %
Percentage of total net revenue	10 %	11 %	13 %		

Sales and marketing expenses for the year ended December 31, 2016, increased by $28.3 million, or 19%, compared to the year ended December 31, 2015, due to the following:

- an increase in sales and marketing personnel to support growth in the business;
- sales and marketing expenses included $14.1 million in share-based compensation expense, a $6.8 million increase compared to the prior year;

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- an increase of $4.7 million in costs associated with our Square Cash peer-to-peer transfer service; and
- paid marketing expenditures were stable compared to the prior year.

Sales and marketing expenses for the year ended December 31, 2015, increased by $33.0 million, or 29%, compared to the year ended December 31, 2014, due to the following:

- an increase in sales and marketing personnel;
- an increase of $18.0 million in costs associated with our Square Cash peer-to-peer payments service;
- an increase of $13.2 million in advertising costs primarily from increased direct mail, online, and mobile marketing campaigns during the period;
- sales and marketing expenses included $7.4 million in share-based compensation expense, a $3.6 million increase compared to the prior year; and
- offset in part by lower costs associated with distributing our magstripe readers.

General and Administrative (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
General and administrative	$251,993	$143,466	$94,220	76 %	52 %
Percentage of total net revenue	15 %	11 %	11 %		

General and administrative expenses for the year ended December 31, 2016, increased by $108.5 million, or 76%, compared to the year ended December 31, 2015, due to the following:

- the balance included $48.0 million of non-recurring expense related to the settlement of legal proceedings with Robert E. Morley, with no similar activity in the prior year;
- additions to our customer support, legal, compliance, risk, finance, Square Capital operations, and Caviar operations personnel that together will drive long-term operating efficiencies as our business scales;
- increased third-party legal, finance, consulting, and certain software license expenses primarily related to our first year of operations as a public company; and
- general and administrative expenses included $33.3 million in share-based compensation expense, a $13.1 million increase compared to the prior year.

General and administrative expenses for the year ended December 31, 2015, increased by $49.2 million, or 52%, compared to the year ended December 31, 2014, due to the following:

- additions to our customer support, risk operations, legal, compliance, and finance teams;
- increased third-party legal, finance, consulting, and certain software license expenses; and

- general and administrative expenses included $20.2 million in share-based compensation expense, a $12.6 million increase compared to the prior year.

Transaction. Loan and Advance Losses (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
Transaction, loan and advance losses	$51,235	$54,009	$24,081	(5)%	124 %

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Transaction, loan and advance losses for the year ended December 31, 2016, decreased by $2.8 million, or 5%, compared to the year ended December 31, 2015, due to better use of data science and improvements in our risk operations to mitigate exposure to transaction losses despite the growth in GPV during 2016, and due to the net effect of the following:

- an $8.5 million charge recorded in the year ended December 31, 2015, comprised of a $4.4 million charge related to fraud loss from a single seller and an increase of $4.1 million loss provision made to reflect updates to our risk model; and

- an out of period adjustment of $5.5 million recorded in the year ended December 31, 2016, as a result of a correction to the calculation of our reserve for transaction losses.

Transaction, loan and advance losses for the year ended December 31, 2015, increased by $29.9 million, or 124%, compared to the year ended December 31, 2014 due to the following:

- an $8.5 million charge recorded in the year ended December 31, 2015, comprised of a $4.4 million accrual related to fraud loss from a single seller and an increase of $4.1 million loss provision made to reflect updates to our risk model;

- $3.8 million incremental provisions for MCAs; and

- increased GPV which resulted in the recording of a higher reserve.

Amortization of Acquired Customer Assets (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016	2014 to 2015
	2016	2015	2014	% Change	% Change
Amortization of acquired customer assets	$850	$1,757	$1,050	(52)%	67 %

Amortization of acquired customer assets for the year ended December 31, 2016, decreased by $0.9 million, or 52%, compared to the year ended December 31, 2015, as a result of certain customer assets reaching end of life.

Amortization of acquired customer assets for the year ended December 31, 2015, increased by $0.7 million, or 67%, compared to the year ended December 31, 2014, primarily reflecting the first full year of amortization related to our acquisition of Caviar in August 2014.

Interest and Other Income and Expense, net (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016	2014 to 2015
	2016	2015	2014	% Change	% Change
Interest and other (income) expense, net	$(780)	$1,613	$2,162	(148)%	(25)%

Interest and other (income) expense, net, for the year ended December 31, 2016, changed by $2.4 million, or 148%, compared to the year ended December 31, 2015, primarily driven by interest income earned on our investment in marketable securities offsetting interest expense and driven by fluctuations in foreign exchange rates.

Interest and other (income) expense, net, for the year ended December 31, 2015, increased by $0.5 million, or 25%, compared to the year ended December 31, 2014, driven primarily by the interest expense related to the draw on our revolving credit facility in June 2014, which was repaid in July 2015, and also as a result of a benefit from the remeasurement of our share-based instruments in 2015 with no similar occurrences in 2014, offset in part by foreign exchange rate losses. As of December 31, 2015, no amounts were outstanding under our revolving credit facility.

Provision for Income Taxes (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016	2014 to 2015
	2016	2015	2014	% Change	% Change
Provision for income taxes	$1,917	$3,746	$1,440	(49)%	160 %

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Provision for income taxes for the year ended December 31, 2016, decreased by $1.8 million compared to the year ended December 31, 2015, primarily related to the reduction in federal income tax expense.

Provision for income taxes for the year ended December 31, 2015, increased by $2.3 million compared to the year ended December 31, 2014, primarily due to a decrease in income tax benefit arising from acquisitions.

Deemed Dividend on Series E Preferred Stock (in thousands, except for percentages)

	Year Ended December 31,			2015 to 2016	2014 to 2015
	2016	2015	2014	% Change	% Change
Deemed dividend on Series E preferred stock	$ —	$ (32,200)	$ —	NM	NM

For the year ended December 31, 2015, we issued 10,299,696 shares of our common stock to certain holders of Series E preferred stock, in the form of a deemed stock dividend of $32.2 million. There were no similar occurrences in any other period presented.

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Quarterly Results of Operations

The following tables set forth selected unaudited quarterly statements of operations data for the last eight quarters. The information for each of these quarters has been prepared on the same basis as the audited annual financial statements included elsewhere in this Annual Report on Form 10-K and, in the opinion of management, includes all adjustments, which consist only of normal recurring adjustments, necessary for the fair presentation of the results of operations for these periods. This data should be read in conjunction with our audited consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. These quarterly operating results are not necessarily indicative of the results we may achieve in future periods.

	Three Months Ended,							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands, except per share data) (unaudited)							
Revenue:								
Transaction-based revenue	$402,496	$388,347	$364,864	$300,453	$298,516	$280,955	$259,864	$211,110
Starbucks transaction-based revenue	34	7,164	32,867	38,838	47,084	32,332	33,630	29,237
Subscription and services-based revenue	40,518	35,320	29,717	23,796	22,385	14,694	12,928	8,006
Hardware revenue	8,869	8,171	11,085	16,182	6,375	4,207	3,591	2,204
Total net revenue	451,917	439,002	438,533	379,269	374,360	332,188	310,013	250,557
Cost of revenue:								
Transaction-based costs	260,006	254,061	234,857	194,276	192,730	182,007	165,823	132,107
Starbucks transaction-based costs	(49)	4,528	28,672	36,610	46,896	41,410	40,921	36,211
Subscription and services-based costs	11,431	12,524	10,144	9,033	8,650	5,593	5,072	3,155
Hardware costs	12,118	15,689	14,015	26,740	14,238	5,726	6,713	4,197
Amortization of acquired technology	1,886	1,886	1,886	2,370	2,753	1,142	1,142	602
Total cost of revenue	285,392	288,688	289,574	269,029	265,267	235,878	219,671	176,272
Gross profit	166,525	150,314	148,959	110,240	109,093	96,310	90,342	74,285
Operating expenses:								
Product development	64,889	70,418	68,638	64,592	59,186	55,020	45,887	39,545
Sales and marketing	49,406	46,754	39,220	38,496	38,448	39,259	31,730	36,181
General and administrative	53,027	52,075	50,784	96,107	45,723	37,820	31,804	28,119
Transaction, loan and advance losses	13,034	12,885	17,455	7,861	13,169	16,005	8,513	16,322
Amortization of acquired customer assets	147	164	222	317	384	423	482	468
Total operating expenses	180,503	182,296	176,319	207,373	156,910	148,527	118,416	120,635
Operating loss	(13,978)	(31,982)	(27,360)	(97,133)	(47,817)	(52,217)	(28,074)	(46,350)
Interest and other (income) expense, net	153	111	(327)	(717)	(772)	781	394	1,210
Loss before income tax	(14,131)	(32,093)	(27,033)	(96,416)	(47,045)	(52,998)	(28,468)	(47,560)

Provision for income taxes	1,036	230	312	339	1,244	932	1,152	418
Net loss	(15,167)	(32,323)	(27,345)	(96,755)	(48,289)	(53,930)	(29,620)	(47,978)
Deemed dividend on Series E preferred stock	—	—	—	—	(32,200)	—	—	—
Net loss attributable to common stockholders	$(15,167)	$(32,323)	$(27,345)	$(96,755)	$(80,489)	$(53,930)	$(29,620)	$(47,978)
Net loss per share attributable to common stockholders:								
Basic	$(0.04)	$(0.09)	$(0.08)	$(0.29)	$(0.34)	$(0.35)	$(0.20)	$(0.33)
Diluted	$(0.04)	$(0.09)	$(0.08)	$(0.29)	$(0.34)	$(0.35)	$(0.20)	$(0.33)
Weighted-average shares used to compute net loss per share attributable to common stockholders:								
Basic	356,343	343,893	334,488	331,324	234,548	152,334	149,253	145,069
Diluted	356,343	343,893	334,488	331,324	234,548	152,334	149,253	145,069

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Costs and expenses include share-based compensation expense as follows:

	Three Months Ended,							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Share-Based Compensation	(unaudited)							
Product development	$21,340	$23,949	$24,168	$21,947	$21,451	$13,938	$10,391	$8,958
Sales and marketing	4,159	3,697	3,363	2,903	2,836	1,750	1,345	1,429
General and administrative	8,388	9,133	9,391	6,348	8,519	5,105	3,496	3,074
Total share-based compensation	$33,887	$36,779	$36,922	$31,198	$32,806	$20,793	$15,232	$13,461

The following table sets forth the key operating metrics and non-GAAP financial measures we use to evaluate our business for each of the periods indicated:

	Three Months Ended,							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands, except for GPV and per share data)							
Key Operating Metrics and non-GAAP Financial Measures	(unaudited)							
GPV (in millions)	$13,694	$13,248	$12,451	$10,290	$10,193	$9,540	$8,793	$7,117
Adjusted Revenue	$191,877	$177,777	$170,809	$146,155	$134,546	$117,849	$110,560	$89,213
Adjusted EBITDA	$29,793	$11,623	$12,554	$(9,083)	$(6,069)	$(15,776)	$859	$(20,129)
Adjusted Net Income (Loss)	$20,766	$3,677	$5,685	$(15,110)	$(12,476)	$(22,467)	$(5,446)	$(26,208)
Adjusted Net Income (Loss) Per Share Basic	$0.06	$0.01	$0.02	$(0.05)	$(0.05)	$(0.15)	$(0.04)	$(0.18)
Adjusted Net Income (Loss) Per Share Diluted	$0.05	$0.01	$0.02	$(0.05)	$(0.05)	$(0.15)	$(0.04)	$(0.18)

The following table presents a reconciliation of total net revenue to Adjusted Revenue for each of the periods indicated:

	Three Months Ended,							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Adjusted Revenue Reconciliation	(unaudited)							
Total net revenue	$451,917	$439,002	$438,533	$379,269	$374,360	$332,188	$310,013	$250,557
Less: Starbucks transaction-based revenue	34	7,164	32,867	38,838	47,084	32,332	33,630	29,237
Less: Transaction-based costs	260,006	254,061	234,857	194,276	192,730	182,007	165,823	132,107
Adjusted Revenue	$191,877	$177,777	$170,809	$146,155	$134,546	$117,849	$110,560	$89,213

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The following table presents a reconciliation of net loss to Adjusted EBITDA for each of the periods indicated:

	Three Months Ended,							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Adjusted EBITDA Reconciliation	(unaudited)							
Net loss	$(15,167)	$(32,323)	$(27,345)	$(96,755)	$(48,289)	$(53,930)	$(29,620)	$(47,978)
Starbucks transaction-based revenue	(34)	(7,164)	(32,867)	(38,838)	(47,084)	(32,332)	(33,630)	(29,237)
Starbucks transaction-based costs	(49)	4,528	28,672	36,610	46,896	41,410	40,921	36,211
Share-based compensation expense	33,887	36,779	36,922	31,198	32,806	20,793	15,232	13,461
Depreciation and amortization	9,928	9,681	9,018	9,118	9,100	6,570	6,410	5,546
Litigation settlement (benefit) expense	—	—	(2,000)	50,000	—	—	—	—
Interest and other (income) expense, net	153	111	(327)	(717)	(772)	781	394	1,210
Provision for income taxes	1,036	230	312	339	1,244	932	1,152	418
Loss (gain) on sale of property and equipment	39	(219)	169	(38)	30	—	—	240
Adjusted EBITDA	$29,793	$11,623	$12,554	$(9,083)	$(6,069)	$(15,776)	$859	$(20,129)

The following table presents a reconciliation of net loss to Adjusted Net Income (Loss) for each of the periods indicated:

	Three Months Ended,							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands, except per share data)							
Adjusted Net Income (Loss) Reconciliation	(unaudited)							
Net loss	$(15,167)	$(32,323)	$(27,345)	$(96,755)	$(48,289)	$(53,930)	$(29,620)	$(47,978)
Starbucks transaction-based revenue	(34)	(7,164)	(32,867)	(38,838)	(47,084)	(32,332)	(33,630)	(29,237)
Starbucks transaction-based costs	(49)	4,528	28,672	36,610	46,896	41,410	40,921	36,211
Share-based compensation expense	33,887	36,779	36,922	31,198	32,806	20,793	15,232	13,461
Amortization of intangible assets	2,090	2,076	2,134	2,713	3,165	1,592	1,651	1,095
Litigation settlement (benefit) expense	—	—	(2,000)	50,000	—	—	—	—
Loss (gain) on sale of property and equipment	$39	$(219)	$169	$(38)	$30	$—	$—	$240
Adjusted Net Income (Loss)	$20,766	$3,677	$5,685	$(15,110)	$(12,476)	$(22,467)	$(5,446)	$(26,208)

Adjusted Net Income (Loss) Per Share:								
Basic	$0.06	$0.01	$0.02	$(0.05)	$(0.05)	$(0.15)	$(0.04)	$(0.18)
Diluted	$0.05	$0.01	$0.02	$(0.05)	$(0.05)	$(0.15)	$(0.04)	$(0.18)
Weighted-average shares used to compute Adjusted Net Income (Loss) Per Share:								
Basic	356,343	343,893	334,488	331,324	234,548	152,334	149,253	145,069
Diluted	382,531	370,746	365,731	331,324	234,548	152,334	149,253	145,069

Quarterly Trends

Transaction-based revenue is highly correlated with the level of GPV generated by sellers using our managed payments services. Historically our transaction-based revenue has been strongest in our fourth quarter and weakest in our first quarter, as our sellers typically generate additional GPV during the holiday season. We believe that this seasonality has affected and will continue to affect our quarterly results; however, to date its effect has been masked by our rapid growth. Starbucks transaction-based revenue continued to decline throughout 2016, and, during the fourth quarter of 2016, Starbucks completed its previously announced transition to another payments solution provider and accordingly we do not expect revenue from Starbucks to recur in the future.

Subscription and services-based revenue generally demonstrates less seasonality than transaction-based revenue. The sequential increase is primarily driven by continued growth and expansion of Square Capital and Caviar.

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Hardware revenue generally demonstrates less seasonality than transaction-based revenue, with most fluctuations tied to periodic product launches, promotions, or other arrangements with our retail partners.
Changes in product development expenses primarily reflect the timing of additions of engineering, product, and design personnel. To a lesser extent, they also reflect the timing of fees and supply costs related to maintenance and capacity expansion at third-party data center facilities, development and tooling costs related to the design, testing, and shipping of our hardware products, and fees for software licenses, consulting, legal, and other services that are directly related to growing and maintaining our products and services.
Changes in sales and marketing expenses reflect the variable nature of the timing and magnitude of paid marketing and customer acquisition initiatives across our advertising channels. Changes in sales and marketing expenses are also affected by the timing of additions of direct sales, account management, local, product and paid marketing, retail and ecommerce, partnerships, and communications personnel. Additionally, sales and marketing expenses are affected by the timing and magnitude of costs related to our Square Cash peer-to-peer service and the total shipments of our magstripe readers in a given period, as they include the cost of manufacturing and distributing those readers.
Changes in general and administrative expenses primarily reflect the timing of additions of finance, legal, risk operations, human resources, and administrative personnel, as well as the timing of tax payments and reserves. They also reflect the timing of costs related to customer support personnel and systems, as well as fees paid for professional services, including legal and financial services. During the first quarter of 2016, general and administrative expenses included $50.0 million of non-recurring expense related to legal proceedings with Robert E. Morley, which was settled the following quarter, with no similar activity in the other periods presented.

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Liquidity and Capital Resources

The following table summarizes our cash and cash equivalents, investments in marketable securities, and restricted cash (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Cash and cash equivalents	$452,030	$461,329	$222,315
Short-term investments	59,901	—	—
Long-term investments	27,366	—	—
Short-term restricted cash	22,131	13,537	11,950
Long-term restricted cash	14,584	14,686	14,394

The following table summarizes our cash flow activities (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Net cash (used in) provided by operating activities	$23,131	$21,123	$(112,379)
Net cash used in investing activities:	(122,733)	(45,096)	(24,554)
Net cash provided by financing activities	90,741	264,763	194,152
Effect of foreign exchange rate on cash and cash equivalents	(438)	(1,776)	(1,080)
Net increase (decrease) in cash and cash equivalents	$(9,299)	$239,014	$56,139

Our principal sources of liquidity are our cash, cash equivalents, and investments in marketable securities. As of December 31, 2016, we had $539.3 million of cash, cash equivalents, and investments in marketable securities, which were held primarily in cash deposits, money market funds, U.S. government and agency securities, commercial paper, and corporate bonds. We consider all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Our investments in marketable securities are classified as available-for-sale. In November 2015, we completed our initial public offering in which we received total net proceeds of $245.7 million after deducting underwriting discounts and commissions of $14.7 million and other offering expenses of $6.9 million. Prior to our initial public offering, our principal source of liquidity was private sales of convertible preferred stock with total cash proceeds to us of $544.9 million.

In addition, we have a revolving secured credit facility that matures in November 2020. To date, no funds have been drawn under the credit facility, with $375.0 million remaining available. Loans under the credit facility bear interest at our option of (i) a base rate based on the highest of the prime rate, the federal funds rate plus 0.50%, and an adjusted LIBOR rate for a one-month interest period, in each case plus a margin ranging from 0.00% to 1.00%, or (ii) an adjusted LIBOR rate plus a margin ranging from 1.00% to 2.00%. This margin is determined based on our total leverage ratio for the preceding four fiscal quarters. We are obligated to pay other customary fees for a credit facility of this size and type including an annual administrative agent fee of $0.1 million and an unused commitment fee of 0.15%.

Historically we funded a majority of our MCAs from arrangements with third-party investors to purchase the future receivables related to these advances. During the first quarter of 2016, we fully transitioned from offering MCAs to facilitating the offering of loans by our bank partner. We purchase these loans from our bank partner and sell a majority of them to third-party investors, only retaining a small portion on our balance sheet.

We believe that our existing cash and cash equivalents, marketable securities, and availability under our line of credit will be sufficient to meet our working capital needs and planned capital expenditures for at least the next 12 months. From time to time, we may seek to raise additional capital through equity, equity-linked, and debt financing arrangements. We cannot be assured that any additional financing will be available to us on acceptable terms or at all.

Short-term restricted cash of $22.1 million as of December 31, 2016 reflects pledged cash deposited into savings accounts at the financial institutions that process our sellers' payments transactions and as collateral pursuant to an agreement with the originating bank for the Company's loan product. We use the restricted cash to secure letters of credit with these financial institutions to provide collateral for liabilities arising from cash flow timing differences in the processing of these payments. We have recorded this amount as a current asset on our consolidated balance sheets given the short-term nature of these cash flow timing differences and that there is no minimum time frame during which the cash must remain restricted.
Long-term restricted cash of $14.6 million as of December 31, 2016 reflects cash deposited into money market accounts that is used as collateral pursuant to multi-year lease agreements entered into in 2012 and 2014 for our office buildings. The Company has recorded this amount as a non-current asset on the consolidated balance sheets as the terms extend beyond one year.

We experience significant day-to-day fluctuations in our cash and cash equivalents, settlements receivable, and customers payable, and hence working capital. These fluctuations are primarily due to:

- Timing of period end. For periods that end on a weekend or a bank holiday, our cash and cash equivalents, settlements receivable, and customers payable amounts typically will be more than for periods ending on a weekday, as we settle to our sellers for payment processing activity on business days; and
- Fluctuations in daily GPV. When daily GPV increases, our cash and cash equivalents, settlements receivable, and customers payable amounts increase. Typically our cash, cash equivalents, settlements receivable, and customers payable balances at period end represent one to four days of receivables and disbursements to be made in the subsequent period. Customers payable and settlements receivable balances typically move in tandem, as pay-out and pay-in largely occur on the same business day. However, customers payable balances will be greater in amount than settlements receivable balances due to the fact that a subset of funds are held due to unlinked bank accounts, risk holds, and chargebacks. Holidays and day-of-week may also cause significant volatility in daily GPV amounts.

Cash Flows from Operating Activities

Cash used in operating activities consisted of net loss adjusted for certain non-cash items including depreciation and amortization, share-based compensation expense, provision for transaction losses, provision for uncollectible MCAs, deferred income taxes, and gain (loss) on disposal of property and equipment, as well as the effect of changes in operating assets and liabilities, including working capital.

For the year ended December 31, 2016, cash provided by operating activities was $23.1 million, primarily as a result of a net loss of $171.6 million, offset by non-cash items consisting of share-based compensation expense of $138.8 million, provision for transaction losses of $50.8 million, depreciation and amortization of intangible assets of $37.7 million, and provision for uncollectible receivables related to MCAs of $1.2 million. Additional uses of cash were from changes in our operating assets and liabilities, including purchase of loans held for sale of $669.0 million, increases in settlements receivable of $178.4 million and other current assets of $15.0 million, and charge-offs and recoveries to accrued transaction losses of $47.9 million. This activity was offset in part by proceeds from sales and principal repayments of loans held for sale of $627.6 million, increases in customers payable of $172.4 million and other current liabilities of $44.1 million, and decreases in merchant cash advance receivable of $31.1 million.

For the year ended December 31, 2015, cash provided by operating activities was $21.1 million, primarily as a result of a net loss of $179.8 million, offset by non-cash items consisting of share-based compensation expense of $82.3 million, provision for transaction losses of $43.4 million, provision for uncollectible receivables related to MCAs of $6.2 million, and depreciation and amortization of intangible assets of $27.6 million. Additional cash provided from changes in our operating assets and liabilities, including increases in customers payable of $69.5 million, accrued expenses of $21.5 million, other current liabilities of $19.8 million, other liabilities of $11.1 million, and accounts payable of $7.8 million was partially offset by charge-offs and recoveries to accrued transaction losses of $34.7 million, and increases in settlements receivable of $27.4 million, merchant cash advance receivable of $13.4 million, and other current assets of $12.4 million.

For the year ended December 31, 2014, cash used by operating activities was $112.4 million, as a result of a net loss of $154.1 million, offset by non-cash items consisting of share-based compensation expense of $36.1 million, depreciation and amortization of intangible assets of $18.6 million, and provision for transaction losses of $18.5 million. Additional cash used by changes in our operating assets and liabilities, including increases in settlements receivable of $50.4 million, merchant cash

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advance receivable of $31.7 million, charge-offs and recoveries to accrued transaction losses of $17.5 million, and other current assets of $14.3 million, were offset by increases in customers payable of $50.0 million, other liabilities of $23.3 million, and accrued expenses of $8.1 million.

Cash Flows from Investing Activities

Cash flows used in investing activities primarily relate to capital expenditures to support our growth, investments in marketable securities, changes in restricted cash, and business acquisitions.

For the year ended December 31, 2016, cash used in investing activities was $122.7 million as a result of the purchase of marketable securities of $164.8 million, offset in part by proceeds from maturities and sales of marketable securities of $77.4 million. Additional uses of cash were as a result of capital expenditures of $25.4 million, business acquisitions of $1.4 million, an increase of restricted cash of $8.5 million, and acquisition of intangible assets of $0.4 million, partially offset by proceeds from the sale of property and equipment of $0.3 million.

For the year ended December 31, 2015, cash used in investing activities was $45.1 million as a result of capital expenditures of $37.4 million, business acquisitions of $4.5 million, an increase of restricted cash of $1.9 million, and acquisition of intangible assets of $1.3 million.

For the year ended December 31, 2014, cash used in investing activities was $24.6 million as a result of capital expenditures of $28.8 million and an increase in restricted cash of $7.1 million, partially offset by business acquisitions net of cash acquired of $11.7 million from our acquisition of Caviar.

Cash Flows from Financing Activities

For the year ended December 31, 2016, cash provided by financing activities was $90.7 million as a result of proceeds from issuances of common stock from the exercise of options, warrants, and employee stock purchase plan of $96.4 million, offset by payments in offering costs related to our initial public offering of $5.5 million and payments on capital lease obligations of $0.2 million.

For the year ended December 31, 2015, cash provided by financing activities was $264.8 million as a result of proceeds from our initial public offering of $251.3 million, proceeds from our issuance of convertible preferred stock of $30.0 million, proceeds from the exercise of stock options of $13.8 million, and an excess tax benefit from share-based award activity of $1.1 million, offset by principal payments on debt of $30.0 million and payments of debt issuance costs of $1.4 million.

For the year ended December 31, 2014, cash provided by financing activities was $194.2 million as a result of proceeds from our issuance of convertible preferred stock of $148.7 million, proceeds from long-term debt under our revolving credit facility of $30.0 million, proceeds from the exercise of stock options of $14.1 million, and an excess tax benefit from share-based award activity of $1.3 million.

Contractual Obligations and Commitments

Our principal commitments consist of operating leases, capital leases, and purchase commitments. The following table summarizes our commitments to settle contractual obligations in cash as of December 31, 2016.

	Payments due by period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years

	(in thousands)				
Operating leases	116,703	16,639	32,192	31,929	35,943
Capital leases	1,882	694	1,187	1	—
Purchase commitments	18,077	18,077	—	—	—
Total	$136,662	$35,410	$33,379	$31,930	$35,943

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Lease Commitments

We have entered into various non-cancelable operating leases for certain offices with contractual lease periods expiring between 2017 and 2025. We recognized total rental expenses under operating leases of $11.3 million, $12.8 million, and $11.4 million during the years ended December 31, 2016, 2015, and 2014, respectively.

Purchase commitments

We had non-cancelable purchase obligations to hardware suppliers for $18.1 million for the year ended December 31, 2016.

Off-balance Sheet Arrangements

We do not have any off-balance sheet arrangements during the periods presented.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. GAAP requires us to make certain estimates and judgments that affect the amounts reported in our financial statements. We base our estimates on historical experience, anticipated future trends, and other assumptions we believe to be reasonable under the circumstances. Because these accounting policies require significant judgment, our actual results may differ materially from our estimates.

We believe accounting policies and the assumptions and estimates associated with revenue recognition, accrued transaction losses, valuation of loans held for sale, business combinations, goodwill and intangible assets, income taxes, and share-based compensation to have the greatest potential effect on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates. For further information on all of our significant accounting policies, see Note 1 of the accompanying notes to our consolidated financial statements.

Recent Accounting Pronouncements

See “Recent Accounting Pronouncements” in Note 1 of the accompanying notes to our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have operations both within the United States and globally, and we are exposed to market risks in the ordinary course of our business, including the effects of interest rate changes and foreign currency fluctuations. Information relating to quantitative and qualitative disclosures about these market risks is described below.

Interest Rate Sensitivity

Cash and cash equivalents and marketable securities as of December 31, 2016, were held primarily in cash deposits, money market funds, U.S. government and agency securities, commercial paper, and corporate bonds. The fair value of our cash, cash equivalents, and marketable securities would not be significantly affected by either an increase or decrease in interest rates due mainly to the short-term nature of a majority of these instruments. Additionally, we have the ability to hold these instruments until maturity if necessary to reduce our risk. Any future borrowings incurred under our credit facility would accrue interest at a floating rate based on a formula tied to certain market rates at the time of incurrence (as described above). A hypothetical 10% increase or decrease in interest rates would not have a material effect on our financial results.

Foreign Currency Risk

Most of our revenue is earned in U.S. dollars, and therefore our revenue is not currently subject to significant foreign currency risk. Our foreign operations are denominated in the currencies of the countries in which our operations are located, and may be subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Japanese Yen, Canadian Dollar, and Australian Dollar. Fluctuations in foreign currency exchange rates may cause us to recognize transaction gains and losses in our statement of operations. A 10% increase or decrease in current exchange rates would not have a material impact on our financial results.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SQUARE, INC.
INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

The supplementary financial information required by this Item 8 is included in Part II, Item 7 under the caption "Quarterly Results of Operations," which is incorporated herein by reference.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Square, Inc.:

We have audited the accompanying consolidated balance sheets of Square, Inc. and subsidiaries (the Company) as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Square, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Square, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 24, 2017 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP
San Francisco, California
February 24, 2017

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Square, Inc.:

We have audited Square, Inc.’s (the Company) internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Square, Inc.’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting (Item 9A). Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Square, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Square, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive loss, stockholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2016, and our report dated February 24, 2017 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
San Francisco, California

February 24, 2017

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SQUARE, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	December 31,	
	2016	2015
Assets		
Current assets:		
Cash and cash equivalents	$452,030	$461,329
Short-term investments	59,901	—
Restricted cash	22,131	13,537
Settlements receivable	321,102	142,727
Customer funds held	43,574	9,446
Loans held for sale	42,144	604
Merchant cash advance receivable, net	4,212	36,473
Other current assets	56,331	41,447
Total current assets	1,001,425	705,563
Property and equipment, net	88,328	87,222
Goodwill	57,173	56,699
Acquired intangible assets, net	19,292	26,776
Long-term investments	27,366	—
Restricted cash	14,584	14,686
Other assets	3,194	3,826
Total assets	$1,211,362	$894,772
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$12,602	$18,869
Customers payable	388,058	215,365
Customer funds obligation	43,574	9,446
Accrued transaction losses	20,064	17,176
Accrued expenses	39,543	44,401
Other current liabilities	73,623	28,945
Total current liabilities	577,464	334,202
Debt (Note 11)	—	—
Other liabilities	57,745	52,522
Total liabilities	635,209	386,724
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock, $0.0000001 par value: 100,000,000 shares authorized at December 31, 2016 and December 31, 2015. None issued and outstanding at December 31, 2016 and December 31, 2015.	—	—
Class A common stock, $0.0000001 par value: 1,000,000,000 shares authorized at December 31, 2016 and December 31, 2015; 198,746,620 and 31,717,133 issued and outstanding at December 31, 2016 and December 31, 2015, respectively.	—	—
Class B common stock, $0.0000001 par value: 500,000,000 shares authorized at December 31, 2016 and December 31, 2015; 165,800,756 and 303,232,312 issued and outstanding at December 31, 2016 and December 31, 2015, respectively.	—	—
Additional paid-in capital	1,357,381	1,116,882
Accumulated other comprehensive loss	(1,989)	(1,185)

Accumulated deficit	(779,239)	(607,649)
Total stockholders' equity	576,153	508,048
Total liabilities and stockholders' equity	$1,211,362	$894,772

See accompanying notes to consolidated financial statements.

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SQUARE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended December 31, 2016	2015	2014
Revenue:			
Transaction-based revenue	$1,456,160	$1,050,445	$707,799
Starbucks transaction-based revenue	78,903	142,283	123,024
Subscription and services-based revenue	129,351	58,013	12,046
Hardware revenue	44,307	16,377	7,323
Total net revenue	1,708,721	1,267,118	850,192
Cost of revenue:			
Transaction-based costs	943,200	672,667	450,858
Starbucks transaction-based costs	69,761	165,438	150,955
Subscription and services-based costs	43,132	22,470	2,973
Hardware costs	68,562	30,874	18,330
Amortization of acquired technology	8,028	5,639	1,002
Total cost of revenue	1,132,683	897,088	624,118
Gross profit	576,038	370,030	226,074
Operating expenses:			
Product development	268,537	199,638	144,637
Sales and marketing	173,876	145,618	112,577
General and administrative	251,993	143,466	94,220
Transaction, loan and advance losses	51,235	54,009	24,081
Amortization of acquired customer assets	850	1,757	1,050
Total operating expenses	746,491	544,488	376,565
Operating loss	(170,453)	(174,458)	(150,491)
Interest and other (income) expense, net	(780)	1,613	2,162
Loss before income tax	(169,673)	(176,071)	(152,653)
Provision for income taxes	1,917	3,746	1,440
Net loss	(171,590)	(179,817)	(154,093)
Deemed dividend on Series E preferred stock	—	(32,200)	—
Net loss attributable to common stockholders	$(171,590)	$(212,017)	$(154,093)
Net loss per share attributable to common stockholders:			
Basic	$(0.50)	$(1.24)	$(1.08)
Diluted	$(0.50)	$(1.24)	$(1.08)
Weighted-average shares used to compute net loss per share attributable to common stockholders:			
Basic	341,555	170,498	142,042
Diluted	341,555	170,498	142,042

See accompanying notes to consolidated financial statements.

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SQUARE, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Net loss	$(171,590)	$(179,817)	$(154,093)
Net foreign currency translation adjustments	(716)	(356)	(114)
Net unrealized loss on revaluation of intercompany loans	(11)	(22)	—
Net unrealized loss on marketable securities	(77)	—	—
Total comprehensive loss	$(172,394)	$(180,195)	$(154,207)

See accompanying notes to consolidated financial statements.

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SQUARE, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except for number of shares)

	Convertible preferred stock		Class A and B common stock		Additional paid-in	Accumulated other comprehensive	Accumulated	Total stockholders’
	Shares	Amount	Shares	Amount	capital	loss	deficit	equity
Balance at December 31, 2013	134,528,520	$366,197	138,017,900	$ —	$38,329	$ (693)	$(241,539)	$162,294
Net loss	—	—	—	—	—	—	(154,093)	(154,093)
Shares issued in connection with:								
Exercise of stock options	—	—	9,403,147	—	8,685	—	—	8,685
Issuance of common stock in connection with business combinations	—	—	8,384,156	—	59,576	—	—	59,576
Issuance of common stock	—	—	24,220	—	—	—	—	—
Series E preferred stock financing	9,700,289	148,748	—	—	—	—	—	148,748
Vesting of early exercised stock options	—	—	—	—	11,128	—	—	11,128
Contribution of preferred stock	(8,976,000)	—	—	—	—	—	—	—
Repurchase of common stock	—	—	(1,225,740)	—	—	—	—	—
Change in other comprehensive loss	—	—	—	—	—	(114)	—	(114)
Share-based compensation	—	—	—	—	36,100	—	—	36,100
Tax benefit from share-based award activity	—	—	—	—	1,348	—	—	1,348
Balance at December 31, 2014	135,252,809	$514,945	154,603,683	$ —	$155,166	$ (807)	$(395,632)	$273,672
Net loss	—	—	—	—	—	—	(179,817)	(179,817)
Shares issued in connection with:								
Issuance of common stock upon initial public offering, net of issuance costs	—	—	29,700,000		245,726	—	—	245,726
Series E preferred stock financing	1,940,058	29,952	—	—	—	—	—	29,952

Conversion of Series A, B, C, D & E preferred stock upon initial public offering to common stock	(137,192,867)	(544,897)	137,192,867		544,897	—	—	—
Deemed dividend on Series E preferred stock	—	—	10,299,696	—	32,200	—	(32,200)	—
Exercise of stock options	—	—	5,544,785	—	14,766	—	—	14,766
Issuance of common stock related to acquisitions	—	—	3,591,014	—	35,776	—	—	35,776
Issuance of common stock	—	—	3,777	—	—	—	—	—
Vesting of early exercised stock options	—	—	—	—	4,958	—	—	4,958
Contribution of common stock	—	—	(5,068,238)	—	—	—	—	—
Repurchase of common stock	—	—	(918,139)	—	—	—	—	—
Change in other comprehensive loss	—	—	—	—	—	(378)	—	(378)
Share-based compensation	—	—	—	—	82,292	—	—	82,292
Tax benefit from share-based award activity	—	—	—	—	1,101	—	—	1,101
Balance at December 31, 2015	—	$—	334,949,445	$ —	$1,116,882	$ (1,185)	$ (607,649)	$ 508,048
Net loss	—	—	—	—	—	—	(171,590)	(171,590)
Shares issued in connection with:								

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	Convertible preferred stock		Class A and B common stock		Additional paid-in	Accumulated other comprehensive	Accumulated	Total stockholders’
	Shares	Amount	Shares	Amount	capital	loss	deficit	equity
Exercise of stock options and warrants	—	—	24,413,821	—	82,438	—	—	82,438
Purchases under employee stock purchase plan	—	—	1,852,900	—	14,201	—	—	14,201
Vesting of RSUs	—	—	3,392,726	—	—	—	—	—
Vesting of early exercised stock options	—	—	—	—	2,313	—	—	2,313
Cancellation of shares related to business combinations	—	—	(228)	—	—	—	—	—
Repurchase of common stock	—	—	(61,288)	—	—	—	—	—
Change in other comprehensive loss	—	—	—	—	—	(804)	—	(804)
Share-based compensation	—	—	—	—	141,547	—	—	141,547
Balance at December 31, 2016	—	$ —	364,547,376	$ —	$ 1,357,381	$ (1,989)	$ (779,239)	$ 576,153

See accompanying notes to consolidated financial statements.

SQUARE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Cash flows from operating activities:			
Net loss	$(171,590)	$(179,817)	$(154,093)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation and amortization	37,745	27,626	18,586
Share-based compensation	138,786	82,292	36,100
Excess tax benefit from share-based payment activity	—	(1,101)	(1,348)
Provision for transaction losses	50,819	43,379	18,478
Provision for uncollectible receivables related to merchant cash advances	1,159	6,240	2,431
Deferred provision for income taxes	58	26	(2,664)
(Gain) loss on disposal of property and equipment	(49)	270	133
Changes in operating assets and liabilities:			
Settlements receivable	(178,405)	(27,420)	(50,361)
Customer funds held	(34,128)	(6,462)	(2,985)
Purchase of loans held for sale	(668,976)	(816)	—
Proceeds from sales and principal payments of loans held for sale	627,627	21	—
Merchant cash advance receivable	31,102	(13,411)	(31,733)
Other current assets	(14,986)	(12,430)	(14,323)
Other assets	631	1,220	(636)
Accounts payable	(2,147)	7,831	179
Customers payable	172,446	69,547	49,971
Customer funds obligation	34,128	6,462	2,985
Charge-offs and recoveries to accrued transaction losses	(47,931)	(34,655)	(17,514)
Accrued expenses	(409)	21,450	8,113
Other current liabilities	44,102	19,760	3,007
Other liabilities	3,149	11,111	23,295
Net cash (used in) provided by operating activities	23,131	21,123	(112,379)
Cash flows from investing activities:			
Purchase of marketable securities	(164,766)	—	—
Maturities of marketable securities	43,200	—	—
Sales of marketable securities	34,222	—	—
Purchase of property and equipment	(25,433)	(37,432)	(28,794)
Proceeds from sale of property and equipment	296	—	—
Payment for acquisition of intangible assets	(400)	(1,286)	(400)
Increases in restricted cash	(8,492)	(1,878)	(7,075)
Business acquisitions (net of cash acquired)	(1,360)	(4,500)	11,715
Net cash used in investing activities:	(122,733)	(45,096)	(24,554)
Cash flows from financing activities:			
Proceeds from issuance of preferred stock, net	—	29,952	148,748
Proceeds from issuance of common stock upon initial public offering, net of offering costs	—	251,257	—
Payments of offering costs related to initial public offering	(5,530)	—	—
Proceeds from debt	—	—	30,000
Principal payments on debt	—	(30,000)	—

Payments of debt issuance costs	—	(1,387)	—
Principal payments on capital lease obligation	(168)	—	—
Proceeds from issuances of common stock from the exercise of options and employee stock purchase plan	96,439	13,840	14,056
Excess tax benefit from share-based payment award	—	1,101	1,348
Net cash provided by financing activities	90,741	264,763	194,152
Effect of foreign exchange rate on cash and cash equivalents	(438)	(1,776)	(1,080)

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Net increase (decrease) in cash and cash equivalents	(9,299)	239,014	56,139
Cash and cash equivalents, beginning of the year	461,329	222,315	166,176
Cash and cash equivalents, end of the year	$452,030	$461,329	$222,315

See accompanying notes to consolidated financial statements.

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SQUARE, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

Square, Inc. (together with its subsidiaries, Square or the Company) is a cohesive commerce ecosystem that helps its sellers start, run, and grow their businesses – from managed payments solutions to point of sale, hardware to software, loans to payroll and more. Businesses and individuals can also use Square Cash, an easy way to send and receive money, as well as Caviar, a food ordering service for restaurants. Square was founded in 2009 and is headquartered in San Francisco, with offices in the United States, Canada, Japan, and Australia.

Out of Period Adjustments to Reserve for Transaction Losses

During the second quarter of the year ended December 31, 2016, the Company recorded an out of period adjustment of $6.0 million to transaction, loan and advance losses as a result of a correction to the calculation of its reserve for transaction losses. The adjustment was recorded to correct an understatement of transaction losses in prior periods. Of the total amount of this adjustment, $0.5 million is related to the three months ended March 31, 2016, and $2.6 million and $1.6 million is related to the years ended December 31, 2015 and 2014, respectively. The remaining $1.3 million is related to historical periods. The Company evaluated the error from a qualitative and quantitative perspective in accordance with the requirements of the Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 99, Materiality, (SAB 99) and concluded that such amounts were not material with respect to the operating loss or net loss for the current fiscal year or any previously reported consolidated financial statements. The correction of this error had no impact on the net cash flows from operations in any of the periods.

Immaterial Correction to Cash and Cash Equivalents

During the fourth quarter of 2016, the Company identified an error that impacted the consolidated balance sheet as of December 31, 2015, the consolidated statement of cash flows for the years ended December 31, 2015 and 2014, and in the unaudited condensed consolidated balance sheets and statements of cash flows as of and for the three months ended March 31, 2016, the six months ended June 30, 2016, and the nine months ended September 30, 2016, all related to the reported amounts of cash and cash equivalents. During these periods, the Company erroneously classified and reported certain customer funds as cash and cash equivalents instead of classifying these customer funds as a component of current assets. These customer funds represent cash balances stored by customers utilizing the Square Cash app that the customers can withdraw at a subsequent time or use to make transfers or payments, or customer cash that was in transit. The Company held these stored balances as short term deposits with a third-party bank.

The effect of correcting these errors was to decrease cash and cash equivalents at December 31, 2015 by $9.5 million and increase customer funds as a component of current assets of the same amount. These adjustments did not change current assets, total assets, or net loss.

The effect of the revisions within the consolidated statement of cash flows was to decrease the cash flows from operations and the change in cash and cash equivalents for the year ended December 31, 2015 by $6.5 million.

Management evaluated the materiality of the errors described above from a qualitative and quantitative perspective in accordance with the requirements of the SAB 99. Based on such evaluation, the Company has concluded that their correction would not be material to any individual prior period.

Changes to the Description of Revenue and Cost of Revenue Line Items

The Company has renamed some of the revenue and cost of revenues financial statement line items in its consolidated statements of operations to better describe how the Company monetizes its product offerings. Accordingly, the previously presented transaction revenue and Starbucks transaction revenue have been renamed transaction-based revenue and Starbucks transaction-based revenue, respectively, while software and data product revenue has been renamed subscription and services-based revenue. The products and services revenues included in the previously presented line items remains the same. The cost of revenues line items have similarly been renamed while the components of costs of revenues in the line items have remained the same.

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Litigation Settlement

On June 8, 2016, a final, definitive settlement agreement (Settlement Agreement) was entered into by Robert E. Morley, REM Holdings 3, LLC, Jack Dorsey, Jim McKelvey, and the Company. The Settlement Agreement required an aggregate total payment of $50.0 million to plaintiffs, including meaningful contributions by Mr. Dorsey and Mr. McKelvey. The Company made a payment of $48.0 million to plaintiffs and met its obligations under the Settlement Agreement. This amount was classified within general and administrative expenses on the consolidated statements of operations for the year ended December 31, 2016. On June 17, 2016, the Court entered an Order dismissing the complaints in their entirety, with prejudice.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of the Company’s consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, as well as related disclosure of contingent assets and liabilities. Actual results could differ from the Company’s estimates. To the extent that there are material differences between these estimates and actual results, the Company’s financial condition or operating results will be materially affected. The Company bases its estimates on past experience and other assumptions that the Company believes are reasonable under the circumstances, and the Company evaluates these estimates on an ongoing basis.

Significant estimates, judgments, and assumptions in these consolidated financial statements include, but are not limited to, those related to revenue recognition, accrued transaction losses, valuation of loans held for sale, business combinations, goodwill and intangible assets, income taxes, and share-based compensation.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery of obligations to its customers has occurred, the related fees are fixed or determinable, and collectibility is reasonably assured. Revenue is generated from the following:

Transaction-based revenue and Starbucks transaction-based revenue

The Company charges its sellers a transaction fee for managed payments solutions that is generally calculated as a percentage of the total transaction amount processed. The Company selectively offers custom pricing for larger sellers. The Company had a processing agreement with Starbucks, for certain Starbucks-owned stores in the United States. As of December 31, 2016, Starbucks has completed its previously announced transition to another payments solution provider.

The Company recognizes the transaction fees a seller pays to the Company as revenue upon authorization of a transaction by the seller's customer's bank. Revenue is recognized net of refunds, which arise from reversals of transactions initiated by sellers. The Company acts as the merchant of record for its sellers and works directly with payment card networks and banks so that its sellers do not need to manage the complex systems, rules, and requirements of the payments industry. As the merchant of record, Square is liable for settlement of the transactions the Company processes for its sellers.

The gross transaction fees collected from sellers are recognized as revenue on a gross basis as the Company is the primary obligor to the seller and is responsible for processing the payment, has latitude in establishing pricing with respect to the sellers and other terms of service, has sole discretion in selecting the third party to perform the settlement, and assumes the credit risk for the transaction processed.

Subscription and services-based revenue

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Subscription and services-based revenue primarily consists of revenue related to services provided through software offerings or deriving from the use of underlying data. Subscription and services-based revenue is primarily generated by Square Capital, Caviar, and other software as a service.

Square Capital facilitates a loan that is offered through a partnership with a Utah-chartered, member FDIC industrial bank that is generally repaid through withholding a percentage of the collections of the seller's receivables processed by the Company. During the first quarter of 2016, the Company fully transitioned from offering merchant cash advances (MCAs) to loans. The Company facilitates loans to sellers pre-qualified through an analysis of the aggregated data of the seller’s business which includes, but is not limited to, the seller’s historical processing volumes, transaction count, chargebacks, growth, and length of time as a Square customer. The loans are originated by a bank partner, from whom the Company purchases the loans obtaining all rights, title, and interest. The loans have no stated coupon rate but the seller is charged a one-time origination fee by the bank partner based upon their risk rating, which is derived primarily from processing activity. It is the Company’s intent to sell all of its rights, title, and interest in certain of these loans to third-party investors for an upfront fee when the loans are sold. The Company records the net amounts paid to the bank as the cost of the loans purchased and subsequently records a gain on sale of the loans to the third-party investors. The Company is retained by the third-party investors to service the loans and earns a servicing fee for facilitating the repayment of these receivables through its payments solutions. The Company recognizes the gain on sale of the loans to the investors as revenue upon transfer of title to investors. The Company records servicing revenue as servicing is delivered. For the loans which are not sold to third-party investors, the Company recognizes a portion of the expected seller repayments over the cost of the loans as revenue in proportion to the loan principal reduction.

Caviar is a courier order management app that facilitates food delivery services for restaurants. Caviar revenue consists of seller fees charged to restaurants, delivery fees, and service fees from consumers. All fees are recognized upon delivery of the food, net of refunds.

Software as a service provides the use of software on a stand-alone basis for a fee which is recognized ratably as service is provided.

Hardware revenue

Hardware revenue is generated from sales of contactless and chip readers, chip card readers, Square Stand, and third-party peripherals. Hardware revenue is recorded net of returns and is recognized upon delivery of hardware to the end customer. The Company considers delivery to have occurred once title and risk of loss has been transferred to the end customer. The Company records deferred revenue when it receives payments in advance of the delivery of products.

Cost of Revenue

Transaction-based costs and Starbucks transaction-based costs

Transaction-based costs and Starbucks transaction-based costs consist primarily of interchange fees set by payment card networks that are paid to the card-issuing financial institution, assessment fees paid to payment networks, fees paid to third-party payment card processors, and bank settlement fees. Contracts with third-party payment processors are typically for a term of two to four years.

Subscription and services-based costs

Subscription and services-based costs consist primarily of Caviar-related costs, which include payments to third-party couriers for deliveries and seller-facing equipment. Cost of revenue for other subscription and services-based costs consists primarily of the amortization related to the development of certain subscription and services-based products.

Hardware costs

Hardware costs consist of all product costs associated with contactless and chip readers, chip card readers, Square Stand, and third-party peripherals. Product costs include manufacturing-related overhead and personnel costs, certain royalties, packaging, and fulfillment costs.

Advertising Costs

Advertising costs are expensed as incurred and included in sales and marketing expense on the consolidated statements of operations. Total advertising costs for the years ended December 31, 2016, 2015, and 2014 were $58.3 million, $58.3 million, and $45.1 million, respectively.

Share-based Compensation

Share-based compensation expense relates to stock options, restricted stock units (RSUs), and purchases under the Company's 2015 Employee Stock Purchase Plan (ESPP) which is measured based on the grant-date fair value. The Company estimates the fair value of stock options and employee stock purchase plan shares granted to employees on the date of grant using the Black-Scholes-Merton option valuation model. The fair value of RSUs is based on the market value of the Company's common stock on grant date. The Company recognizes compensation expense net of estimated forfeitures over the vesting period of the applicable award using the straight-line method. Forfeiture rates are estimated based on historical forfeitures of share-based awards and are adjusted to reflect changes in facts and circumstances, if any.

There are unvested restricted shares issued to employees of certain acquired companies. A portion of these awards is generally subject to continued post-acquisition employment, which is accounted for as post-acquisition share-based compensation expense. The shares are measured based on the grant-date fair value and recognized as compensation expense on a straight-line basis over the required service period.

Income Taxes

The Company reports income taxes under the asset and liability approach. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as net operating loss and tax credit carryforwards. Deferred tax amounts are determined by using the enacted tax rates expected to be in effect when the temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance reduces the deferred tax assets to the amount that is more likely than not to be realized.

The Company uses financial projections to support its net deferred tax assets, which contain significant assumptions and estimates of future operations. If such assumptions were to differ significantly from actual future results of operations, it may have a material impact on the Company's ability to realize its deferred tax assets. At the end of each period, the Company assesses the ability to realize the deferred tax assets. If it is more likely than not that the Company would not realize the deferred tax assets, then the Company would establish a valuation allowance for all or a portion of the deferred tax assets.

The Company recognizes the effect of uncertain income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that has a greater than 50% likelihood of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties related to uncertain tax positions in the provision for income tax expense on the consolidated statements of operations.

Cash and Cash Equivalents and Restricted Cash

The Company considers all highly liquid investments, including money market funds, with an original maturity of three months or less when purchased to be cash equivalents.

As of December 31, 2016 and 2015, restricted cash of $22.1 million and $13.5 million, respectively, is related to pledged cash deposited into savings accounts at the financial institutions that process the Company's sellers' payment transactions and as collateral pursuant to an agreement with the originating bank for the Company's loan product. The Company uses the restricted cash to secure letters of credit with the financial institution to provide collateral for cash flow timing differences in the processing of these payments. The Company has recorded this amount as a current asset on the consolidated balance sheets due to the short-term nature of these cash flow timing differences and that there is no minimum time frame during which the cash must remain restricted.

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As of December 31, 2016 and 2015, the remaining restricted cash of $14.6 million and $14.7 million, respectively, is primarily related to cash deposited into money market funds that is used as collateral pursuant to multi-year lease agreements entered into in 2012 and 2014 (Note 16). The Company has recorded this amount as a non-current asset on the consolidated balance sheets as the terms of the related leases extend beyond one year.

Concentration of Credit Risk

For the year ended December 31, 2016, the Company had no customer who accounted for greater than 10% of total net revenue. For the years ended December 31, 2015 and 2014, the Company had no customer other than Starbucks who accounted for greater than 10% of total net revenue. The Company terminated its relationship with Starbucks during the year ended December 31, 2016.

The Company had three third-party processors that represented approximately 52%, 35%, and 10% of settlements receivable as of December 31, 2016. The Company had three third-party processors that represented approximately 56%, 23%, and 16% of settlements receivable as of December 31, 2015.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities, settlements receivables, customer funds held, merchant cash advance receivables, and loans held for sale. The associated risk of concentration for cash and cash equivalents is mitigated by banking with creditworthy institutions. At certain times, amounts on deposit exceed federal deposit insurance limits. The associated risk of concentration for marketable securities is mitigated by holding a diversified portfolio of highly rated investments. Settlements receivable are amounts due from well established payment processing companies and normally take one or two business days to settle which mitigates the associated risk of concentration. The associated risk of concentration for merchant cash advance receivables and loans held for sale is mitigated by ongoing credit evaluations of the Company's customers.

Fair Value of Financial Instruments

The Company applies fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value accounting establishes a three-level hierarchy priority for disclosure of assets and liabilities recorded at fair value. The ordering of priority reflects the degree to which objective prices in external active markets are available to measure fair value. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable.

The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.

- Level 2 Inputs: Other than quoted prices included in Level 1 Inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

Loans Held for Sale

The Company facilitates the offering of loans by its bank partner to sellers pre-qualified through an analysis of the aggregated data of the seller's business which includes, but is not limited to, the seller's historical processing volumes, transaction count, chargebacks, growth, and length of time as a Square customer. The loans are originated by a bank partner, from whom the Company purchases the loans obtaining all rights, title, and interest. Loans are classified as held for sale upon purchase, as it is the Company's intent to sell all of its rights, title, and interest in certain of these loans to third-party investors for an agreed-

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upon purchase price when the loans are sold. A loan that is initially designated as held for sale may be reclassified to held for investment if and when the Company's intent for that loan changes. There have been no reclassifications made to date. Loans are recorded at the lower of cost or fair value. To determine the fair value of loans, the Company utilizes industry standard modeling, such as discounted cash flow models, to arrive at an estimate of fair value.

Settlements Receivable

Settlements receivable represents amounts due from third-party payment processors for customer transactions. Settlements receivable are typically received within one or two business days of the transaction date. No valuation allowances have been established, as funds are due from large, well-established financial institutions with no historical collections issue.

Provision for Uncollectible Receivables Related to MCAs

Merchant cash advance receivable, net, represents the aggregate amount of advances to merchants outstanding as of the balance sheet date, net of an allowance for potential uncollectible amounts. The Company estimates the allowance based on an assessment of various factors, including historical experience, merchants' current processing volume, and other factors that may affect the merchants' ability to generate future receivables. Additions to the allowance are reflected in current operating results, while charges against the allowance are made when charge-offs are recognized. The additions are classified within transaction and advance losses on the consolidated statements of operations. During the first quarter of 2016, the Company had fully transitioned from offering MCAs to loans. Activity subsequent to this transition relates primarily to updates to the Company's provision estimates for historical balances, write-offs or recoveries. The Company is not exposed to losses for the merchant cash advance receivables that are sold to third-party investors in accordance with the Company's arrangements with them.

Customer Funds

Customer funds held represent cash stored by customers within the Square Cash App that the customers would later use to send money or make payments, or customer cash in transit. As of December 31, 2016 and 2015, the Company held these stored balances as short term deposits within a bank account. Customer funds obligation represents the Company's liability to the customers for the customer funds held.

Inventory

Inventory is comprised of contactless and chip readers, chip card readers, Square Stand, and third-party peripherals. Inventory is stated at the lower of cost (generally on a first-in, first-out basis) or market. Inventory that is obsolete or in excess of forecasted usage is written down to its estimated net realizable value based on assumptions about future demand and market conditions.

Deferred Magstripe Reader Costs

The Company capitalizes the cost of its magstripe readers, which are included in other current assets on the consolidated balance sheets. The amount capitalized represents the cost of the readers, including packaging and shipping costs, held on-hand by the Company as of each consolidated balance sheet date. Once the readers are shipped to a third-party distributor or an end-customer, they are recorded as marketing expense on the consolidated statements of operations.

Property and Equipment

Property and equipment are recorded at historical cost less accumulated depreciation, which is computed on a straight-line basis over the asset's estimated useful life.

The estimated useful lives of property and equipment are described below:

Property and Equipment	Useful Life
Capitalized software	18 months
Computer and data center equipment	Three years
Furniture and fixtures	Seven years
Leasehold improvements	Lesser of estimated useful life or remaining lease term

When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from their respective accounts, and any gain or loss on such sale or disposal is reflected in operating expenses.

Capitalized Software

The Company capitalizes certain cost incurred in developing internal-use software when capitalization requirements have been met. Costs prior to meeting the capitalization requirements are expensed as incurred. Capitalized costs are included in property and equipment, net, and amortized on a straight-lined basis over the estimated useful life of the software and included in product development costs or allocated to subscription and service-based costs on the consolidated statements of operations. The Company capitalized $7.9 million, $4.5 million and $6.4 million of internally developed software during the years ended December 31, 2016, 2015 and 2014, respectively, and recognized $7.1 million, $3.2 million and $2.7 million of amortization expense during the years ended December 31, 2016, 2015 and 2014, respectively.

Leases

The Company leases office space and equipment under non-cancellable capital and operating leases with various expiration dates. The Company records the total rent expense on a straight-line basis over the lease term.

When lease agreements provide allowances for leasehold improvements, the Company capitalizes the leasehold improvement assets and recognizes the related depreciation expense on a straight-line basis over the lesser of the lease term or the estimated useful life of the asset, and reduces rent expense on a straight-line basis over the term of the lease by the amount of the allowances provided. The Company classifies the cash payments for the leasehold improvements within investing activities while reimbursements from the landlords are classified within operating activities.

The Company records a liability for the estimated fair value for any asset retirement obligation (ARO) associated with its leases, with an offsetting asset. In the determination of the fair value of AROs, the Company uses various assumptions and judgments, including such factors as the existence of a legal obligation, estimated amounts and timing of settlements, and discount and inflation rates. The liability is subsequently accreted while the asset is depreciated. As of December 31, 2016, the Company had a liability for ARO, gross of accretion, of $3.2 million and an associated asset, net of depreciation, of $2.6 million.

Business Combinations

The purchase price of an acquisition is allocated to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition dates. The excess of total consideration over the fair values of the assets acquired and the liabilities assumed is recorded as goodwill. During the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments would be recorded on the consolidated statements of operations.

Long-Lived Assets, including Goodwill and Acquired Intangibles

The Company evaluates the recoverability of property and equipment and finite lived intangible assets for impairment whenever events or circumstances indicate that the carrying amounts of such assets may not be recoverable.

Recoverability is measured by comparing the carrying amount of an asset or an asset group to estimate undiscounted future net cash flows expected to be generated. If the carrying amount of the long–lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying amount exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values, and third–part independent appraisals, as considered necessary. For the periods presented, the Company had recorded no impairment charges.

Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired in a business combination. The Company performs a goodwill impairment test annually on December 31 and more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the reporting unit's fair value. The Company has the option to first assess qualitative factors to determine whether events or circumstances indicate that it is more likely than not that the fair value of a reporting unit is less than its carrying amount and determine whether further action is needed. If, after assessing the totality of events or circumstances, the Company determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. For the periods presented, the Company had recorded no impairment charges.

Acquired intangibles consist of acquired technology and customer relationships associated with various acquisitions. Acquired technology is amortized over its estimated useful life on a straight-line basis within cost of revenue. Customer relationships acquired are amortized on a straight-line basis over their estimated useful lives within operating expenses. The Company evaluates the remaining estimated useful life of its intangible assets being amortized on an ongoing basis to determine whether events and circumstances warrant a revision to the remaining period of amortization.

Customers Payable

Customers payable represents the transaction amounts, less revenue earned by the Company, owed to sellers. The payable amount comprises amounts owed to customers due to timing differences as we typically settle within one business day, amounts held by the Company in accordance with its risk management policies, and amounts held for customers who have not yet linked a bank account.

Accrued Transaction Losses

The Company establishes a reserve for estimated transaction losses due to chargebacks, which represent a potential loss due to disputes between a seller and their customer or due to a fraudulent transaction. The reserve is estimated based on available data as of the reporting date, including expectations of future chargebacks, and historical trends related to loss rates. Additions to the reserve are reflected in current operating results, while charges to the reserve are made when losses are recognized. These amounts are classified within transaction and advance losses on the consolidated statements of operations.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers, and issued subsequent amendments to the initial guidance within ASU 2015-04, ASU 2016-08, ASU 2016-10, ASU 2016-12, and ASU 2016-20. The new guidance will replace all current U.S. GAAP guidance on this topic and eliminate all industry specific guidance. The core principal of this new guidance is that revenue is recognized when promised goods or services are transferred to customers in an amount that reflects the consideration for which the Company expects to be entitled in exchange for those goods or services. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The Company does not plan to early adopt the guidance. The guidance can be adopted either through the full retrospective approach which requires restatement of all periods presented or through a modified retrospective approach which requires a cumulative effect adjustment as of the date of adoption. The modified retrospective approach also requires additional disclosures of the impact of the new guidance to each of the financial statements line items and qualitative explanation of the significant changes between the reported results under the new revenue guidance and the previous revenue guidance. The Company plans to apply the modified retrospective approach in the year of adoption of this guidance and is currently assessing the impact that the adoption of the guidance would have on the consolidated financial statements and related disclosures. The Company is also assessing any financial reporting system changes that would be necessary to implement the new guidance.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, as part of its simplification initiative. The current guidance requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. Under the new guidance, inventory is measured at the lower of cost and net realizable value, which would eliminate the other two options that currently exist for market replacement cost and net realizable value less an approximately normal profit margin. The amendment is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes. The new guidance eliminates the current requirement to present deferred tax assets and liabilities as current and noncurrent on the consolidated balance sheets. Instead, organizations will be required to classify all deferred tax assets and liabilities as noncurrent. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The Company early adopted this new guidance on a prospective basis as a change in accounting policy and therefore prior periods were not retrospectively adjusted.

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. This guidance is intended to improve the recognition, measurement, presentation, and disclosure of financial instruments. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted with certain restrictions. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which will require, among other items, lessees to recognize most leases as assets and liabilities on the balance sheet. Qualitative and quantitative disclosures will be enhanced to better understand the amount, timing and uncertainty of cash flows arising from leases. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The Company does not plan to early adopt this guidance. The Company’s operating leases primarily comprise of office spaces, with the most significant leases relating to corporate headquarters in San Francisco and an office in New York. Based on the Company's initial assessment of its current leases and potential, the Company does not anticipate the adoption of this guidance to have a material impact on its operating results. The Company will continue to evaluate the impact of recording right to use assets and related liabilities on its consolidated balance sheets.

In March 2016, the FASB issued ASU No. 2016-04, Recognition of Breakage for Certain Prepaid Stored-Value Products. This guidance specifies how prepaid stored-value product liabilities should be derecognized, thereby eliminating the current and potential future diversity in practice. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected credit losses for financial assets held. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. This guidance addresses several specific cash flow issues with the objective of reducing the existing diversity in practice. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, which amends existing guidance on the recognition of current and deferred income tax impacts for intra-entity asset transfers other than inventory. This standard is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The amendments in this guidance should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Restricted Cash, which provides guidance on the classification of restricted cash to be included with cash and cash equivalents when reconciling the beginning of period and end of period total amounts on the statement of cash flows. This standard is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. For the years ended December 31, 2016, 2015 and 2014,

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$36.7 million, $28.2 million and $26.3 million, respectively, of restricted cash would have been included in cash and cash equivalents in the consolidated statements of cash flows if this new guidance had been adopted as of the respective dates.

In December 2016, the FASB issued ASU No. 2016-19, Technical Corrections and Improvements. The amendments cover a wide range of topics in the Accounting Standards Codification, covering differences between original guidance and the Accounting Standards Codification, guidance clarification and reference corrections, simplification and minor improvements. Most of the amendments in this update do not require transition guidance and are effective upon issuance of this update. Early adoption is permitted for the amendments that require transition guidance. The Company is currently evaluating the impact this new update may have on the consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Clarifying the Definition of a Business. The amendment seeks to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. This standard is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The amendments should be applied prospectively on or after the effective dates. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-03, Amendments to SEC Paragraphs Pursuant to Staff Announcements. The amendment provides guidance to the Company in relation to the disclosure of the impact that ASU 2014-09, ASU 2016-02 and ASU 2016-13 will have on the Company's financial statements when adopted. Specifically, registrants should consider additional qualitative disclosures if the impact of an issued but not yet adopted ASU is unknown or cannot be reasonably estimated and to include a description of the effect of the accounting policies that the registrant expects. The Company has implemented this guidance within its current disclosures.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. This amendment modified the concept of impairment assessment from the condition that exists when the carrying amount of goodwill exceeds its implied fair value to the condition that exists when the carrying amount of a reporting unit exceeds its fair value. This standard should be adopted when the Company performs its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted. The amendments should be applied on a prospective basis. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements.

NOTE 2 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial assets and liabilities that are measured at fair value on a recurring basis are classified as follows (in thousands):

	December 31, 2016			December 31, 2015		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Cash and cash equivalents:						
Money market funds	$207,168	$—	$ —	$337,234	$ —	$ —
Commercial paper	—	7,496	—	—	—	—
Municipal securities	—	1,000	—	—	—	—
Short-term securities:						
U.S. agency securities	—	9,055	—	—	—	—
Corporate bonds	—	6,980	—	—	—	—
Commercial paper	—	17,298	—	—	—	—
Municipal securities	—	8,028	—			
U.S. government securities	18,540	—	—	—	—	—
Long-term securities:						
U.S. agency securities	—	3,502	—	—	—	—
Corporate bonds	—	12,914	—	—	—	—
Municipal securities	—	2,492	—	—	—	—
U.S. government securities	8,458	—	—	—	—	—
Total	$234,166	$68,765	$ —	$337,234	$ —	$ —

The carrying amounts of certain financial instruments, including cash equivalents, settlements receivable, customer funds held, merchant cash advance receivable, accounts payable, customers payable, customer funds obligation, and settlements payable, approximate their fair values due to their short-term nature.

Loans held for sale are recorded at the lower of cost or fair value. To determine the fair value of loans, the Company utilizes industry-standard valuation modeling, such as discounted cash flow models, to arrive at an estimate of fair value.

A summary of loans disclosed at fair value on a recurring basis is as follows (in thousands):

	December 31, 2016	
	Carrying Value	Fair Value (Level 3)
Loans held for sale	$42,144	$42,633
Total	$42,144	$42,633

As of December 31, 2015, the difference between the fair value of loans and the carrying value was insignificant.

If applicable, the Company will recognize transfers into and out of levels within the fair value hierarchy at the end of the reporting period in which the actual event or change in circumstance occurs. During the years ended December 31, 2016, 2015 and 2014, the Company did not have any transfers between Level 2 or Level 3 assets.

NOTE 3 - INVESTMENTS

The Company determines the appropriate classification of its investments in marketable securities at the time of purchase and reevaluates such designation at each balance sheet date. The Company has classified and accounted for its marketable securities as available-for-sale.

The Company's short-term and long-term investments as of December 31, 2016 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term securities:				
U.S. agency securities	$ 9,048	$ 7	$ —	$ 9,055
Corporate bonds	17,318	—	(20)	17,298
Commercial paper	6,980	—	—	6,980
Municipal securities	8,037	—	(9)	8,028
U.S. government securities	18,537	3	—	18,540
Total	$ 59,920	$ 10	$ (29)	$ 59,901
Long-term securities:				
U.S. agency securities	$ 3,502	$ —	$ —	$ 3,502
Corporate bonds	12,939	—	(25)	12,914
Municipal securities	2,505	—	(13)	2,492
U.S. government securities	8,478	—	(20)	8,458
Total	$ 27,424	$ —	$ (58)	$ 27,366

For the year ended December 31, 2016, gains or losses realized on the sale of investments were not material. Investments are reviewed periodically to identify possible other-than-temporary impairments. As the Company has the ability and intent to hold these investments with unrealized losses until a recovery of fair value, or for a reasonable period of time sufficient for the recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired as of December 31, 2016.

The contractual maturities of the Company's short-term and long-term investments as of December 31, 2016 are as follows (in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$ 59,920	$ 59,901
Due in one to five years	27,424	27,366
Total	$ 87,344	$ 87,267

NOTE 4 - MERCHANT CASH ADVANCE RECEIVABLE, NET

The following table summarizes the activities of the Company’s allowance for uncollectible receivables (in thousands):

	Year Ended December 31, 2016	Year Ended December 31, 2015
Allowance for uncollectible MCA receivables, beginning of the period	$ 7,443	$ 2,431
Provision for uncollectible MCA receivables	1,159	6,240
MCA receivables charged off	(4,039)	(1,228)
Allowance for uncollectible MCA receivables, end of the period	$ 4,563	$ 7,443

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During the first quarter of 2016, the Company had fully transitioned from offering MCAs to loans.

NOTE 5 - PROPERTY AND EQUIPMENT, NET

The following is a summary of property, equipment, and internally-developed software at cost, less accumulated depreciation and amortization (in thousands):

	December 31, 2016	December 31, 2015
Computer equipment	$ 52,915	$ 43,531
Office furniture and equipment	10,737	9,339
Leasehold improvements	73,366	65,298
Capitalized software	24,642	14,533
Construction in process	—	490
Total	161,660	133,191
Less: Accumulated depreciation and amortization	(73,332)	(45,969)
Property and equipment, net	$ 88,328	$ 87,222

Depreciation and amortization expense on property and equipment was $28.7 million, $20.1 million, and $16.5 million, for the years ended December 31, 2016, 2015, and 2014, respectively.

NOTE 6 - ACQUISITIONS

Fiscal 2016

During the year ended December 31, 2016, the Company completed an acquisition for a total consideration of $1.6 million in cash. This acquisition was accounted for as a business combination. This method requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. Of the total purchase consideration, $1.1 million was allocated to acquired intangible assets and $0.5 million was allocated to goodwill. Intangible assets and goodwill generated from this acquisition is deductible for tax purposes. Goodwill is primarily attributable to expected synergies from future growth opportunities.

The results of operations from this acquisition have been consolidated with those of the Company as of the acquisition date. The acquisition's impact on revenue and net earnings for the year ended December 31, 2016 was not material. There was also no material impact on the Company's revenue and net earnings on a pro forma basis for all periods presented.

Fiscal 2015

During the year ended December 31, 2015, the Company completed acquisitions for a total consideration of $32.0 million, consisting of 2,923,881 shares of common stock, options to purchase 26,173 shares of common stock, and $4.5 million in cash. These acquisitions were accounted for as business combinations. This method requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. Of the total purchase consideration of $32.0 million, $16.4 million has been allocated to goodwill, $14.9 million to acquired intangible assets, $0.8 million to property and equipment, and $0.2 million to deferred tax liabilities. Goodwill from these acquisitions is primarily attributable to expected synergies and cost reductions. $29.8 million of the intangible assets and goodwill generated from these acquisitions is deductible for tax purposes. Acquisition-related costs of $0.6 million were recognized in general and administrative expenses. Of the total purchase price, 355,284 shares of common stock and 22,818 options have been accounted for as post-combination compensation expense. As of December 31, 2016, 292,813 shares of the total share consideration remain withheld for indemnification purposes.

Additionally, the Company completed an acquisition of certain assets for a total purchase consideration of $9.5 million, consisting of 667,133 shares of common stock, and $1.0 million in cash. This transaction was accounted for as a purchase of assets, which consists of $9.0 million in intangible assets and $0.5 million of other assets.

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Fiscal 2014

During the year ended December 31, 2014, the Company completed acquisitions for a total consideration of $59.6 million, consisting of 8,552,990 shares of common stock and options to purchase 168,834 shares of common stock. These acquisitions were accounted for as business combinations. This method requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. Of the total purchase consideration $39.7 million was allocated to goodwill, $11.4 million to acquired intangible assets, and $8.5 million to net tangible assets. Goodwill from these acquisitions was primarily attributable to expected synergies and cost reductions. None of the goodwill was deductible for tax. Acquisition-related costs of $0.5 million were recognized in general and administrative expenses. As of December 31, 2016, 1,291,979 shares of the total share consideration remain withheld for indemnification purposes.

NOTE 7 - GOODWILL

Goodwill is recorded when the consideration paid for an acquisition of a business exceeds the fair value of identifiable net tangible and intangible assets acquired.

The following table summarizes activities related to the carrying value of goodwill (in thousands):

Balance at December 31, 2014	40,267
Acquisitions completed during the year ended December 31, 2015	$16,432
Balance at December 31, 2015	$56,699
Acquisitions completed during the year ended December 31, 2016	$474
Balance at December 31, 2016	$57,173

The Company performed its annual goodwill impairment test as of December 31, 2016. The Company determined that the consolidated business is represented by a single reporting unit and concluded that it was more likely than not that the fair value of the reporting unit was greater than its carrying amount. As a result, the two-step goodwill impairment test was not required, and no impairments of goodwill were recognized during the year ended December 31, 2016.

NOTE 8 - ACQUIRED INTANGIBLE ASSETS

The following table presents the detail of acquired intangible assets as of the periods presented (in thousands):

	Balance at December 31, 2016		
	Cost	Accumulated Amortization	Net
Patents	$1,285	$ (454)	$831
Technology Assets	29,075	(14,702)	14,373
Customer Assets	7,745	(3,657)	4,088
Total	$38,105	$ (18,813)	$19,292

	Balance at December 31, 2015		
	Cost	Accumulated Amortization	Net
Patents	$1,285	$ (348)	$937
Technology Assets	28,645	(6,644)	22,001
Customer Assets	6,645	(2,807)	3,838
Total	$36,575	$ (9,799)	$26,776

The weighted average amortization periods for acquired patents, acquired technology, and customer intangible assets are approximately 13 years, 3 years, and 7 years, respectively.

Amortization expense associated with other intangible assets was $9.0 million, $7.5 million, and $2.1 million for the years ended December 31, 2016, 2015, and 2014, respectively.

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The total estimated annual future amortization expense of these intangible assets as of December 31, 2016, are as follows (in thousands):

2017	$7,380
2018	5,881
2019	3,097
2020	1,140
2021	696
Thereafter	1,098
Total	$19,292

NOTE 9 - OTHER CONSOLIDATED BALANCE SHEET COMPONENTS (CURRENT)

Other Current Assets

The following table presents the detail of other current assets (in thousands):

	December 31, 2016	December 31, 2015
Inventory	$ 13,724	$ 11,864
Accounts receivable	6,191	4,808
Prepaid expenses	7,365	7,101
Deferred magstripe reader costs	3,911	4,018
Tenant improvement reimbursement receivable	1,189	1,788
Deferred hardware costs	4,546	1,709
Processing costs receivable	8,593	7,847
Other	10,812	2,312
Total	$ 56,331	$ 41,447

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Accrued Expenses

The following table presents the detail of accrued expenses (in thousands):

	December 31, 2016	December 31, 2015
Accrued hardware costs	$ 3,148	$ 11,622
Processing costs payable	9,655	11,417
Accrued professional fees	5,788	7,642
Accrued payroll	5,799	2,660
Accrued marketing	3,972	2,443
Other accrued liabilities	11,181	8,617
Total	$ 39,543	$ 44,401

Other Current Liabilities

The following table presents the detail of other current liabilities (in thousands):

	December 31, 2016	December 31, 2015
Settlements payable	$ 51,151	$ 13,105
Employee early exercised stock options	674	2,141
Accrued redemptions	1,628	1,066
Current portion of deferred rent	2,862	2,393
Deferred revenue	5,407	6,623
Other	11,901	3,617
Total	$ 73,623	$ 28,945

NOTE 10 - OTHER CONSOLIDATED BALANCE SHEET COMPONENTS (NON-CURRENT)

Other Non-Current Assets

The following table presents the detail of other non-current assets (in thousands):

	December 31, 2016	December 31, 2015
Deposits	$ 1,775	$ 1,993
Deferred tax assets	306	188
Other	1,113	1,645
Total	$ 3,194	$ 3,826

Other Non-Current Liabilities

The following table presents the detail of other non-current liabilities (in thousands):

	December 31, 2016	December 31, 2015
Deferred rent	$ 23,119	$ 25,543
Employee early exercised stock options	66	1,128
Deferred tax liabilities	476	299
Statutory liabilities	29,497	25,492
Other	4,587	60
Total	$ 57,745	$ 52,522

NOTE 11 - DEBT

In November 2015, the Company entered into a revolving credit agreement with certain lenders, which extinguished the prior revolving credit agreement and provided for a $375.0 million revolving secured credit facility maturing in November 2020. This revolving credit agreement is secured by certain tangible and intangible assets.

Loans under the credit facility bear interest, at the Company’s option of (i) a base rate based on the highest of the prime rate, the federal funds rate plus 0.50% and an adjusted LIBOR rate for a one-month interest period in each case plus a margin ranging from 0.00% to 1.00%, or (ii) an adjusted LIBOR rate plus a margin ranging from 1.00% to 2.00%. This margin is determined based on the Company’s total leverage ratio for the preceding four fiscal quarters. The Company is obligated to pay other customary fees for a credit facility of this size and type including an annual administrative agent fee of $0.1 million and an unused commitment fee of 0.15%. To date no funds were drawn under the credit facility, with $375.0 million remaining available. The Company paid $0.6 million and $0.5 million in unused commitment fees during the years ended December 31, 2016 and 2015, respectively.

NOTE 12 - ACCRUED TRANSACTION LOSSES

The Company is exposed to transaction losses due to chargebacks as a result of fraud or uncollectibility.
The following table summarizes the activities of the Company’s reserve for transaction losses (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Accrued transaction losses, beginning of the year	$17,176	$8,452	$7,488
Provision for transaction losses	50,819	43,379	18,478
Charge-offs and recoveries to accrued transaction losses	(47,931)	(34,655)	(17,514)
Accrued transaction losses, end of the year	$20,064	$17,176	$8,452

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NOTE 13 - INCOME TAXES

The domestic and foreign components of loss before income taxes are as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Domestic	$(145,499)	$(157,229)	$(139,675)
Foreign	(24,174)	(18,842)	(12,978)
Loss before income taxes	$(169,673)	$(176,071)	$(152,653)

The components of the provision for income taxes are as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Current:			
Federal	$63	$1,662	$2,746
State	527	836	531
Foreign	1,269	1,222	827
Total current provision for income taxes	1,859	3,720	4,104
Deferred:			
Federal	173	67	(2,503)
State	18	11	(161)
Foreign	(133)	(52)	—
Total deferred provision for income taxes	58	26	(2,664)
Total provision for income taxes	$1,917	$3,746	$1,440

The following is a reconciliation of the statutory federal income tax rate to the Company's effective tax rate:

	Balance at December 31,		
	2016	2015	2014
Tax at federal statutory rate	34.0 %	34.0 %	34.0 %
State taxes, net of federal benefit	(0.1)	(0.2)	(0.1)
Foreign rate differential	(2.4)	(1.8)	(1.5)
Nondeductible expenses	(3.3)	(3.3)	(1.8)
Credits	8.5	8.2	2.7
Other items	(0.4)	(0.4)	0.7
Change in valuation allowance	(37.4)	(38.6)	(35.0)
Total	(1.1)%	(2.1)%	(1.0)%

The tax effects of temporary differences and related deferred tax assets and liabilities are as follows (in thousands):

	Balance at December 31,		
	2016	2015	2014
Deferred tax assets:			
Capitalized costs	$61,897	$67,051	$28,102
Accrued expenses	29,421	27,964	19,714
Net operating loss carryforwards	65,507	36,633	54,528
Tax credit carryforwards	38,927	25,349	11,662
Property, equipment and intangible assets	5,721	—	—
Share-based compensation	52,091	36,689	13,153
Other	1,640	1,469	542
Total deferred tax assets	255,204	195,155	127,701
Valuation allowance	(254,898)	(195,103)	(125,368)
Total deferred tax assets, net of valuation allowance	306	52	2,333
Deferred tax liabilities:			
Property, equipment and intangible assets	(476)	(163)	(2,333)
Total deferred tax liabilities	(476)	(163)	(2,333)
Net deferred tax liabilities	$(170)	$(111)	$—

Realization of deferred tax assets is dependent upon the generation of future taxable income, the timing and amount of which are uncertain. Due to the history of losses generated in the U.S. and certain foreign jurisdictions, the Company believes that it is more likely than not that its deferred tax assets in these jurisdictions will not be realized as of December 31, 2016. Accordingly, the Company retained a full valuation allowance on its deferred tax assets in these jurisdictions. The amount of deferred tax assets considered realizable in future periods may change as management continues to reassess the underlying factors it uses in estimating future taxable income.

The valuation allowance increased by approximately $59.8 million, $69.7 million, and $50.5 million during the years ended December 31, 2016, 2015, and 2014, respectively.

As of December 31, 2016, the Company had $261.1 million of federal, $272.4 million of state, and $76.2 million of foreign net operating loss carryforwards, which will begin to expire in 2035 for federal and 2021 for state tax purposes. The foreign net operating loss carryforwards do not expire.

The benefit of stock options will only be recorded to stockholders’ equity when cash taxes payable is reduced. As of December 31, 2016, approximately $252.8 million of net operating loss is attributable to certain employee stock option deductions. This amount will be credited to stockholders’ equity when it is realized on the tax return.

As of December 31, 2016, the Company had $26.7 million of federal, $17.9 million of state, and $0.7 million of Canadian research credit carryforwards. The federal credit carryforward will begin to expire in 2029, the state credit carryforward has no expiration date, and the Canadian credit carryforward will begin to expire in 2035.

The Company also has a federal AMT credit carryforward of $2.6 million that has no expiration date and California Enterprise Zone credit carryforwards of $2.7 million, which will begin to expire in 2023.

Utilization of the net operating loss carryforwards and credits may be subject to annual limitations due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitations may result in the expiration of net operating losses and credits before they are able to be utilized. The Company does not expect any previous ownership changes, as defined under Section 382 and 383 of the Internal Revenue Code, to result in a limitation that will reduce the total amount of net operating loss carryforwards and credits that can be utilized.

As of December 31, 2016, the unrecognized tax benefit was $92.1 million, of which $2.8 million would impact the annual effective tax rate if recognized and the remainder of which would result in a corresponding adjustment to the valuation allowance.
A reconciliation of the beginning and ending amount of unrecognized tax benefit is presented below (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Balance at the beginning of the year	$90,372	$78,031	$14,152
Gross increases and decreases related to prior period tax positions	5,190	—	26,690
Gross increases and decreases related to current period tax positions	(3,428)	12,341	37,189
Balance at the end of the year	$92,134	$90,372	$78,031

The Company recognizes interest and penalties related to income tax matters as a component of income tax expense. As of December 31, 2016, there were no significant accrued interest and penalties related to uncertain tax positions. The Company does not believe that its unrecognized tax benefits will significantly change within the next 12 months.
The Company is subject to taxation in the United States and various state and foreign jurisdictions. The Company is currently under examination in Japan for tax year 2015, California for tax years 2013 and 2014, and New York State for tax years 2013, 2014, and 2015. The Company’s various tax years starting with 2009 to 2016 remain open in various taxing jurisdictions.
As of December 31, 2016, the Company has not provided deferred U.S. income taxes or foreign withholding taxes on temporary differences resulting from earnings for certain non-U.S. subsidiaries, which are permanently reinvested outside the U.S. Cumulative undistributed earnings for these non-U.S. subsidiaries as of December 31, 2016 are $3.9 million. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be repatriated.

NOTE 14 - STOCKHOLDERS' EQUITY

Initial Public Offering

In November 2015, the Company completed its IPO in which it issued and sold 29,700,000 shares of Class A common stock at a public offering price of $9.00 per share. The total net proceeds received from the IPO were $245.7 million after deducting underwriting discounts and commissions of $14.7 million and other offering expenses of approximately $6.9 million.

Convertible Preferred Stock

As of December 31, 2016, the Company is authorized to issue 100,000,000 shares of preferred stock, with a $0.0000001 par value. No shares of preferred stock are outstanding as of December 31, 2016.

Deemed Dividend on Series E Preferred Stock

On November 24, 2015, upon the closing of the IPO, certain holders of Series E preferred stock were issued an incremental 10,299,696 shares of Class B common stock pursuant to the Company's Restated Certificate of Incorporation dated as of September 8, 2014, as amended (the 2014 Certificate). The 2014 Certificate allowed for an adjustment to the Series E original conversion price based on a prescribed formula upon the Company's IPO. The conversion of the Series E preferred stock resulted in a beneficial conversion feature, analogous to a deemed dividend. The beneficial conversion feature was calculated as the difference between fair value of the Company's common stock ultimately issued, based on the commitment date fair value of the Company's common stock, and the initial proceeds received for the Series E preferred stock. As a result, the Company recorded a one-time $32.2 million deemed stock dividend that resulted in an increase to net loss to arrive at net loss attributable to common stockholders.

Common Stock

The Company has authorized the issuance of Class A common stock and Class B common stock. Holders of the Company's Class A common stock and Class B common stock are entitled to dividends when, as and if, declared by the Company's board of directors, subject to the rights of the holders of all classes of stock outstanding having priority rights to dividends. As of December 31, 2016, the Company did not declare any dividends. Holders of shares of Class A common stock are entitled to one vote per share, while holders of shares of Class B common stock are entitled to ten votes per share. Shares of the Company's Class B common stock are convertible into an equivalent number of shares of its Class A common stock and generally convert into shares of its Class A common stock upon transfer. Class A common stock and Class B common stock are referred to as common stock throughout these Notes to the Consolidated Financial Statements, unless otherwise noted. The holders of Class A common stock and Class B common stock have no preemptive or other subscription rights and there are no redemption or sinking fund provisions with respect to such shares.

As of December 31, 2016, the Company was authorized to issue 1,000,000,000 shares of Class A common stock and 500,000,000 shares of Class B common stock, each with a par value of $0.0000001 per share. As of December 31, 2016, the Company had outstanding 198,746,620 shares of Class A common stock and 165,800,756 shares of Class B common stock, each with a par value of $0.0000001 per share.

Warrants

On August 7, 2012, the Company entered into a processing agreement with Starbucks and issued warrants to purchase 15,761,575 shares of common stock that would become exercisable if certain performance conditions, specified in the agreement as subsequently amended between 2012 and 2015, were achieved. In 2015, warrants to purchase 6,304,620 shares of common stock were canceled.

As of December 31, 2016, the Company had outstanding warrants to purchase an aggregate of 9,456,955 shares of its capital stock, with a weighted average exercise price of approximately $11.01 per share.

Stock Plans

The Company maintains two share-based employee compensation plans: the 2009 Stock Option Plan (2009 Plan) and the 2015 Equity Incentive Plan (2015 Plan). The 2015 Plan serves as the successor to its 2009 Plan. The 2015 Plan became effective as of November 17, 2015. Outstanding awards under the 2009 Plan continue to be subject to the terms and conditions of the 2009 Plan.

Under the 2015 Plan, shares of common stock are reserved for the issuance of incentive stock options (ISOs), non-statutory stock options (NSOs), restricted stock awards, RSUs, performance shares and stock bonuses to qualified employees, directors and consultants. The shares may be granted at a price per share not less than the fair market value at the date of grant. Initially, 30,000,000 shares were reserved under the 2015 Plan and any shares subject to options or other similar awards granted under the 2009 Plan that expire, are forfeited, are repurchased by the Company or otherwise terminate unexercised will become available under the 2015 Plan. The number of shares available for issuance under the 2015 Plan will be increased on the first day of each fiscal year, in an amount equal to the least of (i) 40,000,000 shares, (ii) 5% of the outstanding shares on the last day of the immediately preceding fiscal year, or (iii) such number of shares determined by the Company's board of directors. As of December 31, 2016, the total number of options and RSUs outstanding under the 2015 Plan was 19,295,512 million shares, and 36,282,753 million shares were available for future issuance.

Under the 2009 Plan, shares of common stock are reserved for the issuance of ISOs or NSOs to eligible participants. The options may be granted at a price per share not less than the fair market value at the date of grant. Options granted generally vest over a four-year term from the date of grant, at a rate of 25% after one year, then monthly on a straight-line basis thereafter. Generally, options granted are exercisable for up to 10 years from the date of grant. The Plan allows for early exercise of employee stock options whereby the option holder is allowed to exercise prior to vesting. Any unvested shares are subject to repurchase by the Company at their original exercise prices. As of December 31, 2016, the total number of options and RSUs outstanding under the 2009 Plan was 69,409,441 million shares. No additional shares will be issued under 2009 Plan, effective November 17, 2015.
In January 2015, the Company's Chief Executive Officer contributed 5,068,238 shares of common stock back to the Company for no consideration. The purpose of the contribution was to retire such shares in order to offset stock ownership dilution to existing investors in connection with future issuances under the 2009 Plan.
A summary of stock option activity for the year ended December 31, 2016 is as follows (in thousands, except share and per share data):

	Number of stock options outstanding	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Balance at December 31, 2015	107,515,554	$ 6.99	7.87	$ 656,194
Granted	1,767,320	13.49		
Exercised	(24,328,414)	3.39		
Forfeited and canceled	(11,692,898)	10.98		
Balance at December 31, 2016	73,261,562	$ 7.70	7.28	$ 443,711
Options vested and expected to vest at December 31, 2016	69,467,073	$ 7.51	6.95	$ 433,756
Options exercisable at December 31, 2016	69,936,089	$ 7.54	7.19	$ 434,962

Aggregate intrinsic value represents the difference between the Company's estimated fair value of its common stock and the exercise price of outstanding, "in-the-money" options. Aggregate intrinsic value for stock options exercised through December 31, 2016, 2015 and 2014 was $202.6 million, $49.8 million and $47.8 million, respectively.
The total weighted average grant-date fair value of options granted was $5.80, $5.87 and $3.84 per share for the years ended December 31, 2016, 2015 and 2014, respectively.

Restricted Stock Activity

The Company issues restricted stock units (RSUs) under the 2015 Plan, which typically vest over a term of four years. On December 18, 2015, the Company granted an aggregate of 1,854,145 RSUs, which vested within one year of their grant date.

Activity related to RSUs during the year ended December 31, 2016 is set forth below:

	Number of RSUs	Weighted average grant date fair value
Unvested at December 31, 2015	3,632,765	$ 13.14
Granted	17,060,055	12.08
Vested	(3,392,726)	12.58
Forfeited	(1,856,703)	13.15
Unvested at December 31, 2016	15,443,391	$ 12.09

Employee Stock Purchase Plan

On November 17, 2015, the Company's 2015 Employee Stock Purchase Plan (ESPP) became effective. The ESPP allows eligible employees to purchase shares of the Company's common stock at a discount through payroll deductions of up to 15% of their eligible compensation, subject to any plan limitations. The ESPP provides for 12-month offering periods. The offering periods are scheduled to start on the first trading day on or after May 15 and November 15 of each year, except for the first offering period, which commenced on November 19, 2015 and ended on November 15, 2016. Each offering period includes two purchase periods, which begin on the first trading day on or after November 15 and May 15, and ending on the last trading day on or before May 15 and November 15, respectively. Employees are able to purchase shares at 85% of the lower of the fair market value of the Company's common stock on the first trading day of the offering period or the last trading day of the purchase period. The number of shares available for sale under the ESPP will be increased annually on the first day of each fiscal year, equal to the least of (i) 8,400,000 million shares, (ii) 1% of the outstanding shares of the Company's common stock as of the last day of the immediately preceding fiscal year, or (iii) such other amount as determined by the administrator.

As of December 31, 2016, 1,852,900 shares had been purchased under the ESPP and 5,696,594 shares were available for future issuance under the ESPP. The Company recorded $5.1 million and $0.7 million of share-based compensation expense related to the ESPP during the year ended December 31, 2016 and 2015, respectively.

Share-Based Compensation

The fair value of RSUs is based on the market value of the Company's common stock on grant date. The fair value of stock options and employee stock purchase plan shares granted to employees is estimated on the date of grant using the Black-Scholes-Merton option valuation model. This share-based compensation expense valuation model requires the Company to make assumptions and judgments regarding the variables used in the calculation. These variables include the expected term (weighted average period of time that the options granted are expected to be outstanding), the expected volatility of the Company's stock, expected risk-free interest rate, expected dividends, and the estimated forfeitures of unvested stock options. To the extent actual forfeiture results differ from the estimates, the difference will be recorded as a cumulative adjustment in the period estimates are revised. The Company uses the simplified calculation of expected term, as the Company does not have sufficient historical data to use any other method to estimate expected term. Expected volatility is based on an average of the historical volatilities of the common stock of several entities with characteristics similar to those of the Company. The expected risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. Expected forfeitures are based on the Company's historical experience. Share-based compensation expense is recorded net of estimated forfeitures on a straight-line basis over the requisite service period.
The fair value of stock options granted to non-employees, including consultants, is initially measured upon the date of grant and remeasured over the vesting period using the same methodology described above. These non-employees

provide service to the Company on an ongoing basis, therefore, the performance commitment for each non-employee grant is not considered probable until the award is earned over time. The expected term for non-employee grants is the contractual term and share-based compensation expense is recognized on a straight-line basis over this term. Share-based compensation expense related to non-employees has not been material for any of the periods presented. Effective August 31, 2015, the Company modified all of its nonstatutory stock option grants to extend the exercise term for terminated employees who have completed two years of service. During the year ended December 31, 2016 and 2015, share-based compensation expense includes $2.6 million and $3.3 million, respectively, related to the vested portion of the impacted

options as a result of the modification. The Company will incur an additional $4.2 million of share-based compensation expense over the remaining vesting periods of the impacted options.
The fair value of stock options was estimated using the following weighted-average assumptions:

	Year Ended December 31,					
	2016		2015		2014	
Fair value of common stock	$8.37 - $15.48		$10.06 - $15.39		$7.25 - $10.06	
Dividend yield	—	%	—	%	—	%
Risk-free interest rate	1.54	%	1.73	%	1.85	%
Expected volatility	42.74	%	47.68	%	46.95	%
Expected term (years)	6.08		6.02		6.06	

The following table summarizes the effects of share-based compensation on the Company's consolidated statements of operations (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Product development	$91,404	$54,738	$24,758
Sales and marketing	14,122	7,360	3,738
General and administrative	33,260	20,194	7,604
Total	$138,786	$82,292	$36,100

The Company capitalized $2.8 million of share-based compensation expense related to capitalized software during the year ended December 31, 2016. There was no similar activity during the year ended December 31, 2015 .

As of December 31, 2016, there was $257.6 million of total unrecognized compensation cost related to outstanding stock options and restricted stock awards that is expected to be recognized over a weighted average period of 2.82 years.

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NOTE 15 - NET LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss attributable to common stockholders by the weighted-average number of shares of common stock outstanding during the period. For the year ended December 31, 2015, net loss attributable to common stockholders includes the impact of the issuance of 10,299,696 shares of the Company's common stock to certain holders of Series E preferred stock, in the form of a deemed stock dividend of $32.2 million. Diluted loss per share is the same as basic loss per share for all years presented because the effects of potentially dilutive items were anti-dilutive given the Company’s net loss attributable to common stockholders.
The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share data):

	Year Ended December 31,		
	2016	2015	2014
Net loss	$(171,590)	$(179,817)	$(154,093)
Deemed dividend on Series E preferred stock	—	(32,200)	—
Net loss attributable to common stockholders	$(171,590)	$(212,017)	$(154,093)
Basic shares:			
Weighted-average common shares outstanding	344,393	175,139	148,876
Weighted-average unvested shares	(2,838)	(4,641)	(6,834)
Weighted-average shares used to compute basic net loss per share	341,555	170,498	142,042
Diluted shares:			
Weighted-average shares used to compute diluted net loss per share	341,555	170,498	142,042
Loss per share attributable to common stockholders:			
Basic	$(0.50)	$(1.24)	$(1.08)
Diluted	$(0.50)	$(1.24)	$(1.08)

The following potential common shares were excluded from the calculation of diluted net loss per share attributable to common stockholders because their effect would have been anti-dilutive for the periods presented (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Stock options and restricted stock units	88,705	111,148	87,471
Common stock warrants	9,457	9,544	15,762
Preferred stock warrants	—	—	87
Convertible preferred stock	—	—	135,253
Unvested shares	1,892	3,420	6,443
Employee stock purchase plan	216	172	—
Total anti-dilutive securities	100,270	124,284	245,016

NOTE 16 - COMMITMENTS AND CONTINGENCIES

Operating and Capital Leases

The Company has entered into various non-cancelable operating leases for certain offices with contractual lease periods expiring between 2017 and 2025. The Company recognized total rental expenses under operating leases of $11.3 million, $12.8 million, and $11.4 million during the years ended December 31, 2016, 2015, and 2014, respectively.

Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2016 are as follows (in thousands):

	Capital	Operating
Year:		
2017	$694	$16,639
2018	651	16,519
2019	536	15,673
2020	1	15,757
2021	—	16,172
Thereafter	—	35,943
Total	$1,882	$116,703
Less amount representing interest	(4)	
Present value of capital lease obligations	1,878	
Less current portion of capital lease obligation	(691)	
Non-current portion of capital lease obligation	$1,187	

The Company recognized sublease income of $3.1 million and $0.6 million during the years ended December 31, 2016 and 2015, respectively, under non-cancelable sublease arrangements expiring in 2018.

Litigation

The Company is currently a party to, and may in the future be involved in, various litigation matters (including intellectual property litigation), legal claims, and government investigations.

The Company is involved in a class action lawsuit concerning independent contractors in connection with the Company’s Caviar business. On March 19, 2015, Jeffry Levin, on behalf of a putative nationwide class, filed a lawsuit in the United States District Court for the Northern District of California against the Company’s wholly owned subsidiary, Caviar, Inc., which, as amended, alleges that Caviar misclassified Mr. Levin and other similarly situated couriers as independent contractors and, in doing so, violated various provisions of the California Labor Code and California Business and Professions Code by requiring them to pay various business expenses that should have been borne by Caviar. The Court compelled arbitration of Mr. Levin’s individual claims on November 16, 2015 and dismissed the lawsuit in its entirety with prejudice on May 2, 2016. On June 1, 2016, Mr. Levin filed a Notice of Appeal of the Court’s order compelling arbitration with the United States Court of Appeals for the Ninth Circuit. Mr. Levin filed his opening appellate brief regarding the order compelling arbitration of his individual claims on October 7, 2016. The Company filed its answering brief on December 7, 2016, and Mr. Levin filed his reply on December 21, 2016. The parties now await notice of a hearing date from the Ninth Circuit. Mr. Levin also sought an award of penalties pursuant to the Labor Code Private Attorneys General Act of 2004 (PAGA). The parties stipulated that Mr. Levin would no longer pursue this PAGA claim but that it may instead be pursued by a different courier. Subsequently, couriers Nadezhda Rosen and La’Dell Brewster filed a new PAGA-only claim in California state court on November 7, 2016. Plaintiffs claim that Caviar misclassified its couriers as independent contractors resulting in numerous violations of the California Labor Code, pursuant to which plaintiffs seek statutory penalties for those violations. The parties have stipulated to extend the time for Caviar to respond to the complaint until March 17, 2017. In February 2017, the Company participated in a mediation with the parties in these Caviar misclassification suits to explore resolution of the matters at hand; however, an agreement on all the material terms has not been reached.

In addition, from time to time, the Company is involved in various other litigation matters and disputes arising in the ordinary course of business. The Company cannot at this time fairly estimate a reasonable range of exposure, if any, of the potential liability with respect to these other matters. While the Company does not believe, at this time, that any ultimate liability resulting from any of these other matters will have a material adverse effect on the Company's results of operations, financial position, or liquidity, the Company cannot give any assurance regarding the ultimate outcome of these other matters, and their resolution could be material to the Company's operating results for any particular period, depending on the level of income for the period.

NOTE 17 - SEGMENT AND GEOGRAPHICAL INFORMATION

Operating segments are defined as components of an enterprise for which discrete financial information is available that is evaluated regularly by the chief operating decision maker (CODM) for purposes of allocating resources and evaluating financial performance. The Company’s CODM reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. As such, the Company’s operations constitute a single operating segment and one reportable segment.

Revenue

Revenue by geography is based on the billing addresses of the merchants. The following table sets forth revenue by geographic area (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Revenue			
United States	$1,643,852	$1,224,566	$825,578
International	64,869	42,552	24,614
Total net revenue	$1,708,721	$1,267,118	$850,192

No individual country from the international markets contributed in excess of 10% of total revenue for the years ended December 31, 2016, 2015 and 2014.

Long-Lived Assets

The following table sets forth long-lived assets by geographic area (in thousands):

	December 31,	
	2016	2015
Long-lived assets		
United States	$162,118	$168,583
International	2,675	2,114
Total long-lived assets	$164,793	$170,697

NOTE 18 - SUPPLEMENTAL CASH FLOW INFORMATION

The supplemental disclosures of cash flow information consist of the following (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Supplemental Cash Flow Data:			
Cash paid for interest	$570	$ 981	$ 940
Cash paid for income taxes	395	1,916	2,442
Supplemental disclosures of non-cash investing and financing activities:			
Purchases of property and equipment in accounts payable and accrued expenses	2,554	5,593	—
Unpaid business acquisition purchase price	240	—	—
Conversion of Series A, B, C, D & E preferred stock upon initial public offering to common stock	—	544,897	—
Unpaid offering costs related to initial public offering	—	5,530	—
Deemed dividend on Series E preferred stock	—	32,200	—
Fair value of shares issued related to acquisitions	—	35,776	59,576

NOTE 19 - SUBSEQUENT EVENTS

On February 24, 2017, the Company and Starbucks entered into a Warrant Cancellation and Payment Agreement pursuant to which the Company is to pay Starbucks a cash consideration of approximately $54.8 million in return for the termination of the Warrant to Purchase Stock dated August 7, 2012, as amended, that provides for the right to purchase an aggregate of 9,456,955 shares of the Company's common stock.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Our management conducted an assessment of the effectiveness of our internal control over financial reporting based on the criteria established in “Internal Control - Integrated Framework” (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2016. The effectiveness of the Company’s internal control over financial reporting as of December 31, 2016 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item will be set forth in our definitive proxy statement to be filed with the Securities and Exchange Commission not later than 120 days after the end of our fiscal year ended December 31, 2016 in connection with our 2017 annual meeting of stockholders (the Proxy Statement), and is incorporated herein by reference.

Item 11. EXECUTIVE COMPENSATION

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

PART IV
Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as a part of this Annual Report on Form 10-K:
(1)Consolidated Financial Statements:

Our Consolidated Financial Statements are listed in the “Index to Consolidated Financial Statements” under Part II, Item 8 of this Annual Report on Form 10-K.
(2)Financial Statement Schedules:

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes herein.
(3)Exhibits

The documents listed in the Exhibit Index of this Annual Report on Form 10-K are incorporated by reference or are filed with this Annual Report on Form 10-K, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: February 24, 2017

SQUARE, INC.

By: /s/ Jack Dorsey

Jack Dorsey

President, Chief Executive Officer, and Chairman

POWER OF ATTORNEY

Each person whose signature appears below hereby constitutes and appoints Jack Dorsey, Sarah Friar and Hillary Smith, and each of them, as his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully for all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their, his or her substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Jack Dorsey Jack Dorsey	President, Chief Executive Officer, and Chairman(Principal Executive Officer)	February 24, 2017
/s/ Sarah Friar Sarah Friar	Chief Financial Officer (Principal Financial Officer)	February 24, 2017
/s/ Ajmere Dale Ajmere Dale	Chief Accounting Officer (Principal Accounting Officer)	February 24, 2017
/s/ Roelof Botha Roelof Botha	Director	February 24, 2017
/s/ Paul Deighton Paul Deighton	Director	February 24, 2017
/s/ Jim McKelvey Jim McKelvey	Director	February 24, 2017
/s/ Mary Meeker Mary Meeker	Director	February 24, 2017
/s/ Ruth Simmons Ruth Simmons	Director	February 24, 2017
/s/ Lawrence Summers Lawrence Summers	Director	February 24, 2017
/s/ David Viniar David Viniar	Director	February 24, 2017

EXHIBIT INDEX

Exhibit Number	Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	8-K	001-37622	3.1	November 24, 2015
3.2	Amended and Restated Bylaws of the Registrant.	8-K	001-37622	3.2	November 24, 2015
4.1	Form of Class A common stock certificate of the Registrant.	S-1/A	333-207411	4.1	November 6, 2015
4.2	Fifth Amended and Restated Investors' Rights Agreement among the Registrant and certain holders of its capital stock, dated as of September 9, 2014.	S-1	333-207411	4.2	October 14, 2015
4.3	Warrant to purchase shares of common stock issued to Starbucks Corporation, dated as of August 7, 2012, as amended on September 30, 2013.	S-1	333-207411	4.4	October 14, 2015
10.1+	Form of Indemnification Agreement between the Registrant and each of its directors and executive officers.	S-1/A	333-207411	10.1	November 6, 2015
10.2+	Square, Inc. 2015 Equity Incentive Plan, as amended and restated, and related form agreements.	10-Q	001-37622	10.1	August 4, 2016
10.3+	Square, Inc. 2015 Employee Stock Purchase Plan, as amended and restated, and related form agreements.	10-K	001-37622	10.3	March 10, 2016
10.4+	Square, Inc. 2009 Stock Plan and related form agreements.	S-1	333-207411	10.4	October 14, 2015
10.5+	Square, Inc. Executive Incentive Compensation Plan.	S-1	333-207411	10.5	October 14, 2015
10.6+	Square, Inc. Outside Director Compensation Policy, as amended and restated.				
10.7+	Form of Change of Control and Severance Agreement between the Registrant and certain of its executive officers.	S-1	333-207411	10.7	October 14, 2015
10.8+	Offer Letter between the Registrant and Jack Dorsey, dated as of March 7, 2016.	10-K	001-37622	10.8	March 10, 2016
10.9+	Offer Letter between the Registrant and Sarah Friar, dated as of October 1, 2015.	S-1/A	333-207411	10.9	November 6, 2015
10.10+	Offer Letter between the Registrant and Dana R. Wagner, dated as of October 1, 2015.	S-1/A	333-207411	10.10	November 6, 2015
10.11+	Offer Letter between the Registrant and Françoise Brougher, dated as of October 1, 2015.	S-1/A	333-207411	10.11	November 6, 2015
10.12+	Offer Letter between the Registrant and Alyssa Henry, dated as of October 1, 2015.	S-1/A	333-207411	10.12	November 6, 2015
10.13+	Offer Letter between the Registrant and Hillary Smith, dated as of October 27, 2016.				
10.14	Office Lease by and between the Registrant and Hudson 1455 Market, LLC, dated as of October 17, 2012, as amended on March 22, 2013, January 22, 2014, and June 6, 2014.	S-1	333-207411	10.13	October 14, 2015
10.15	Revolving Credit Agreement dated as of November 2, 2015 among the Registrant, the Lenders Party Thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent.	S-1/A	333-207411	10.14	November 6, 2015
10.16	Commitment Letter dated October 30, 2015 by Goldman Sachs Lending Partners LLC.	S-1/A	333-207411	10.14A	November 16, 2015

10.17#	Master Development and Supply Agreement by and between the Registrant and TDK Corporation, dated as of October 1, 2013.	S-1	333-207411	10.15	October 14, 2015
10.18#	Master Manufacturing Agreement by and between the Registrant and Cheng Uei Precision Industry Co., Ltd., dated as of June 27, 2012.	S-1	333-207411	10.16	October 14, 2015
10.19#	ASIC Development and Supply Agreement by and between the Registrant, Semiconductor Components Industries, LLC (d/b/a ON Semiconductor) and ON Semiconductor Trading, Ltd., dated as of March 25, 2013.	S-1	333-207411	10.17	October 14, 2015
21.1	List of subsidiaries of the Registrant.				
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm.				
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				

32.1†	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

+ Indicates management contract or compensatory plan.

The Registrant has omitted portions of the relevant exhibit and filed such exhibit separately with the Securities and Exchange Commission pursuant to a request for confidential treatment under Rule 406 of the Securities Act of 1933, as amended.

† The certifications attached as Exhibit 32.1 that accompany this Annual Report on Form 10-K are deemed furnished and not filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of the Registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Annual Report on Form 10-K, irrespective of any general incorporation language contained in such filing.

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