Square, Inc.
Form 10-K
February 27, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number 001-37622

SQUARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	80-0429876
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1455 Market Street, Suite 600
San Francisco, CA 94103
(Address of principal executive offices, including zip code)
(415) 375-3176
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of each exchange on which registered
Class A Common Stock, $0.0000001 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ý NO o
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. YES o NO ý
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 ý NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter

period that the registrant was required to submit and post such files). YES ý NO o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b 2 of the Exchange Act. (Check one):

Large accelerated filer ý	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO ý

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant, based on the closing price of a share of the registrant’s Class A common stock on June 30, 2016 as reported by the New York Stock Exchange on such date was approximately $1.4 billion. Shares of the registrant’s Class A common stock and Class B common stock held by each executive officer, director and holder of 5% or more of the outstanding Class A common stock and Class B common stock have been excluded in that such persons may be deemed to be affiliates. This calculation does not reflect a determination that certain persons are affiliates of the registrant for any other purpose.

As of February 17, 2017, the number of shares of the registrant’s Class A common stock outstanding was 208,288,497 and the number of shares of the registrant's Class B common stock outstanding was 158,902,579.

Portions of the registrant’s Definitive Proxy Statement relating to the Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after the end of the registrant’s fiscal year ended December 31, 2016.

TABLE OF CONTENTS

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve substantial risks and uncertainties. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “appears,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “c “believes,” “estimates,” “predicts,” “potential,” or “continue,” or the negative of these words or other similar terms or expressions that concern our expectations, strategy, plans, or intentions. Forward-looking statements contained in this Annual Report on Form 10-K include, but are not limited to, statements about our future financial performance, our anticipated growth and growth strategies and our ability to effectively manage that growth, our ability to invest in and develop our products and services to operate with changing technology, our anticipated expansion and growth in Gross Payment Volume (GPV) and revenue, our plans for international expansion, our plans with respect to patents and other intellectual property, our expectations regarding litigation, and the sufficiency of our cash and cash equivalents and cash generated from operations to meet our working capital and capital expenditure requirements. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties, and other factors described in the section titled “Risk Factors” and elsewhere in this Annual Report on Form 10-K.
We undertake no obligation to update any forward-looking statements made in this Annual Report on Form 10-K to reflect events or circumstances after the date of this Annual Report on Form 10-K or to reflect new information or the occurrence of unanticipated events, except as required by law.

PART I
Item 1. BUSINESS

Our Business

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. This approach aligns with our purpose of economic empowerment, as everything we do should give sellers accessible, affordable tools to grow their businesses and participate in the economy.

Square is a cohesive commerce ecosystem that helps our sellers start, run, and grow their businesses. We combine sophisticated software with affordable hardware to enable sellers to turn mobile devices and computing devices into powerful payment and point-of-sale solutions. We have high seller acceptance rates and fast onboarding, while maintaining low risk and fraud losses as a result of our approach to risk management that emphasizes data science and machine learning. We focus on technology and design to create products and services that are cohesive, fast, self-serve, and dependable. These attributes differentiate us in a fragmented industry that forces sellers to stitch together hardware, software, and payments services from multiple vendors.

The foundation of our ecosystem is a full service, managed payments offering. Once a seller downloads the Square Point of Sale mobile app, they can quickly and easily take their first payment, because we can typically bring them onto our system in minutes. 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 Payment Card Industry (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.

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. We monetize these features through either a per transaction fee, a subscription fee, or a service fee. Some of these advanced point-of-sale features are broadly applicable to our seller base and include Employee Management and Customer Engagement. With our Square Capital service, 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 have also extended our ecosystem to serve sellers with more specific needs. Our Build with Square developer platform (APIs) allows businesses with individualized needs to customize their business solutions while processing payments on Square and taking advantage of all the services in our ecosystem, including integration with third-party applications. In addition, certain verticals, such as service and retail sellers, benefit from specific features such as Invoices, Appointments, and Square Inventory. We also serve sellers through Caviar, a food ordering service that helps restaurants reach new customers and increase sales without additional overhead.

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. We believe the diversity of our sellers underscores the accessibility and flexibility of our offerings. In the year ended December 31, 2016, we processed $49.7 billion of Gross Payment Volume (GPV), which was generated by 1 billion card payments from approximately 245 million payment cards. We processed $35.6 billion and $23.8 billion of GPV in 2015 and 2014, respectively.

Our ability to add new sellers efficiently, and help them grow their business after they join our platform, has led to continued and sustained growth. Our existing sellers also represent a sizable opportunity to up-sell and cross-sell products and services with little incremental sales and marketing expense. Additionally, we are increasingly serving larger sellers, which we define as those that generate more than $125,000 in annualized GPV. GPV from larger sellers represented 42% of our GPV in the fourth quarter of 2016, an increase from 39% in the fourth quarter of 2015.

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
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)		

Our Products and Services

Managed Payments Solutions

The foundation of our ecosystem is a full service, managed payments offering. As previously mentioned, sellers can onboard to Square in minutes, and once onboarded, a seller can accept payments in person via the swipe, dip, or tap of a card; online via Square Invoices, Square Virtual Terminal, or the seller's website; or through Square Cash, our personal finance app. By paying one transparent transaction fee, sellers receive technology and features that allow them to manage the entire payment lifecycle including reporting and analytics, next-day settlements (or instant settlement for an additional transaction fee via Instant Deposit), digital receipts, payment dispute management and chargeback protection, and PCI compliance. Transaction-based revenue as a percentage of GPV was 2.93%, 2.95%, and 2.98% in the years ended December 31, 2016, 2015, and 2014, respectively.

In-person/card present (CP) payments

For in-person payments, our affordable, custom-designed hardware can process all card payment forms, including magnetic stripe, EMV chip, and NFC technology. Sellers can accept Visa, MasterCard, American Express, or Discover for one transaction fee. Our hardware includes the following products:

- Magstripe reader: Our free magstripe reader enables swiped transactions of magnetic stripe cards by connecting with an iOS or Android smartphone or tablet.

- Contactless and chip reader: This reader accepts EMV chip cards and NFC payments, enabling acceptance via Apple Pay, Android Pay, and other mobile wallets. The reader connects wirelessly or via USB.

- Chip card reader: Our chip card reader accepts EMV chip cards and enables swiped transactions of magnetic stripe cards by connecting with an iOS or Android smartphone or tablet.

- Square Stand: This hardware transforms an iPad into a full point-of-sale terminal. It features an integrated magnetic stripe reader, provides power to a connected iPad, and can connect to the contactless and chip reader wirelessly or via USB. Square Stand also connects to various peripheral devices that brick-and-mortar businesses need, such as barcode scanners and receipt printers.

Online/card not present (CNP) payments

Sellers can also accept online or card not present payments with Square by manually entering card information into the Square Point of Sale mobile app or into Square Virtual Terminal via a web browser. Additionally, Square Invoices allows a seller to collect payments securely by creating a custom digital invoice from Square Point of Sale or from Square Dashboard, our reporting and analytics tool, which is then emailed directly to the customer.

Square Cash

Square Cash is an easy-to-use personal finance app that allows anyone to send and receive money electronically. Individuals and businesses can sign up for a Square Cash account using just a debit card, bank account, or credit card and an email address or a phone number. Square Cash is free for individuals sending peer-to-peer payments with a debit card or bank account, or for a per transaction fee for all businesses and individuals sending peer-to-peer payments with a credit card. Individuals have multiple ways to access the money in their Square Cash account. Peer-to-peer payments users can deposit funds into their bank account within 1-3 business days for free, or instantly for a per transaction fee. Alternatively, users can store the money in Square Cash, which can be linked to a virtual Visa debit card that can be used for online purchases or in-person payments where Apple Pay is accepted.

Square Point of Sale

Square Point of Sale is our powerful point-of-sale software that can be downloaded to any iOS or Android device and is designed to get a seller (and their employees) up and running quickly. It consists of managed payments solutions and advanced software products, all of which are integrated with one another to provide both sellers and their buyers with a cohesive experience that is fast, self-serve, and dependable. Square Point of Sale also includes Square Dashboard, our cloud-based reporting and analytics tool that provides sellers with real-time data and insights about sales, items, customers, and employees. This enables sellers to make informed decisions about their business. We monetize these features through either a per transaction fee, a subscription fee, or a service fee.

Our advanced point-of-sale features are ideal for a seller with a more complex business or for a seller who has multiple employees and/or locations. Location and employee management allows a seller to track sales by location, device, or employee; customize employee permissions; and create employee timecards. Square Payroll empowers sellers to grow by making it easy to hire, onboard, and pay employees and the associated taxes. Square Point of Sale also provides customer engagement tools that help sellers grow their business through digital customer feedback, marketing, and loyalty programs. By linking customer data with point-of-sale and transaction data, we can offer targeted marketing campaigns and a closed-loop system that allows sellers to easily assess the return on investment of their marketing efforts.

Additionally, we continue to add features to Square Point of Sale to better meet the needs of specific industries, such as services, retail, and food-related sellers. Sellers in the services industry can enable their customers to easily schedule appointments with their preferred time, service, and staff member. Sellers can also send invoices to their customer's email address, creating a seamless experience from booking to payment. And sellers in food-related industries, like bars and restaurants, can easily create, save, add to, split, and close tickets (with tip).

We recently launched Square for Retail, our first industry-specific point of sale that is purpose-built for retailers with sophisticated management needs. Square for Retail is an end-to-end solution that fully integrates with our managed payments solutions and hardware. It has a search-based user interface and fast barcode scanning; advanced inventory management that supports tens of thousands of items, cost of goods sold, purchase orders; and employee management and advanced clientèling capabilities that allow retail sellers to better understand their customers' habits.

Developer platform

We have opened Square to reach sellers who want access to our ecosystem but also want flexibility in their solutions to meet their individualized business needs. Build with Square is our developer platform, consisting of various application program interfaces (APIs) that allow sellers and their developers to customize business solutions. Our Point-of-Sale API allows sellers to integrate any iOS or Android point of sale with Square to accept payments and access all other services in the ecosystem. This is particularly useful for sellers with highly-individualized point-of-sale needs. With our e-commerce API, sellers can integrate Square with their e-commerce website, giving them the ability to track, manage, and grow both their online and offline businesses in a single dashboard.

Build with Square also has APIs for sellers to integrate Square with business solutions such as item and inventory management, sales reporting and analytics, and employee management. Through the Square App Marketplace, sellers can also integrate Square with third-party apps, such as QuickBooks or BigCommerce, that create extensions to our point-of-sale functionality and other back office solutions, and enables sellers to integrate all of their business data.

Square Capital

Square Capital, through a partnership with a Utah-chartered, member FDIC industrial bank, facilitates loans to pre-qualified sellers based on real-time payment and point-of-sale data. These customized loan offers eliminate the lengthy (and often unsuccessful) loan application process for the seller, while facilitating prudent risk management. The terms are straightforward for sellers, and once approved, they get their funds quickly, often the next business day. Sellers can use these funds to make investments in their business, such as purchasing inventory or equipment, hiring additional employees, expanding their stores, or opening new locations.

Generally, loan repayment occurs automatically through a fixed percentage of every card transaction a seller takes. By simply running their business, sellers repay their loan within an average of nine months. We currently fund a majority of these loans from arrangements with institutional third-party investors who purchase these loans on a forward-flow basis. This funding significantly increases the speed with which we can scale Square Capital services and allows us to mitigate our balance sheet and liquidity risk.

Since its public launch in May 2014, Square Capital has facilitated over 200,000 loans and merchant cash advances (MCAs), representing $1.3 billion.

Caviar

Caviar is another service we offer that helps sellers grow and provides a differentiated way to service restaurants, a large target market for managed payments and point-of-sale solutions. This service makes it easy for restaurants to offer food delivery to their customers, enabling them to expand their sales and grow revenue without additional overhead. Individuals can order food from local restaurants through the Caviar website or mobile app, which is purpose-built to make delivery fast and easy. Caviar is currently available in many U.S. markets, including but not limited to New York, San Francisco, and Philadelphia, with thousands of partner restaurants. Caviar charges consumers a delivery and service fee per order. We also charge our partner restaurants a seller fee as a percentage of total food order value.

Our Sellers

Our sellers represent a diverse range of industries, including retail, services, and food-related businesses. We serve sellers of various 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, with further international expansion planned. We believe the diversity of our sellers underscores the accessibility and flexibility of our offerings.

We are increasingly serving larger sellers, which we define as sellers that generate more than $125,000 in annualized GPV. GPV from larger sellers represented 42% of total GPV in the fourth quarter of 2016, up from 39% in the fourth quarter of 2015 and 33% in the fourth quarter of 2014. For the year ended December 31, 2016, we had no customer who accounted for greater than 10% of our GPV or our net revenue.

The chart below shows the mix of our GPV by seller size and industry:

8

Sales and Marketing

We have a strong brand and continue to increase awareness of Square among sellers by enhancing our services and fostering rapid adoption through brand affinity, direct marketing, public relations, and strategic partnerships. Our Net Promoter Score (NPS) has averaged nearly 70 over the past four quarters, which is double the average score for banking providers. Our high NPS means our sellers recommend our services to others, strengthening our brand and helping to drive efficient customer acquisition.

Direct marketing, online and offline, has also been an effective customer acquisition channel. This includes online display advertising, online search engine optimization and marketing, social media, direct mail campaigns, seller referral programs, television advertising, and trade shows and events. Additionally, Square hardware products, such as our contactless and chip reader or Square Stand, are available at over 36,000 retail stores (including Apple, Amazon, Best Buy, Staples, Target, and Walgreens). Our direct sales and account management teams also contribute to the acquisition and support of larger sellers. In addition to direct channels, we work with third-party partners and developers who offer our solutions to their customers.

Our direct, ongoing interactions with our sellers help us tailor offerings to them, at scale, and in the context of their usage. We use various scalable communication channels, such as email marketing, in-app notifications and messaging, dashboard alerts, and Square Communities, our online forum for sellers, to increase the awareness and usage of our products and services with little incremental sales and marketing expense.

Product Development and Technology

We design our products and services to be cohesive, fast, self-serve, and dependable, and we organize our product teams accordingly, combining individuals from product management, development and engineering, data science, and design. Our products and services are mobile-first and platform-agnostic, and we are able to continuously optimize them because our hardware, software, and payments processing are integrated. We frequently update our software products and have a regular software release schedule with improvements deployed generally twice a month, ensuring our sellers get immediate access to the latest features. Our services are built on a scalable technology platform, and we place a strong emphasis on data analytics and machine learning to maximize the efficacy, efficiency, and scalability of our services. This enables us to capture and analyze over a billion transactions per year and automate risk assessment for more than 99.95% of all transactions. Our hardware is designed and developed in-house, and we contract with third-party manufacturers for production. Our product development expenses were $268.5 million, $199.6 million and $144.6 million for the years ended December 31, 2016, 2015, and 2014, respectively.

Transaction Processing Overview

Processing card transactions requires close coordination among a number of industry participants that provide the services and infrastructure required to enable such transactions. These participants consist of payment service providers, acquiring processors, card networks, and issuing banks. Within this landscape, Square serves as a payment service provider, acting as the touch point for the seller to the rest of the payment chain. The definitions and graphic below outline this payment chain and the typical flow of a Square transaction, along with the types of fees typically paid and received at each stage.

Payment Service Provider (PSP): Provider of the payment services that holds the direct relationship with the seller and facilitates the rest of the transaction on behalf of the seller. A PSP is also the merchant of record for the transaction. The merchant of record is liable for the settlement of transactions processed.

Acquiring Processor: Provider of the back-end technology that facilitates the flow of payment information through the Card Networks to the Issuing Bank. Our agreements with acquiring processors typically have terms of two to four years.

Card Networks (e.g. Visa, MasterCard): Provider of the infrastructure for card payment information to flow from the Acquiring Bank to the Acquiring Processor.

Issuing Bank: The financial institution that issues the buyer’s payment card.

Acquiring Bank: The financial institution associated with the Acquiring Processor.

1. Once the buyer is ready to make a purchase, the seller inputs the transaction into the Square Point of Sale and presents the buyer with the amount owed.

2. For in-person transactions, the buyer pays by swiping or dipping their payment card, or by tapping their NFC-enabled payment card or mobile device on a Square Reader or Square Stand, which captures the buyer’s account information. For card not present transactions, card information is keyed in manually by either the buyer or seller into the Square Point of Sale app, Square Invoices, Square Virtual Terminal, or the seller's e-commerce website.

3. The Square Point of Sale sends the transaction information to Square, which acts as the PSP.

4. Square passes the transaction information to the Acquiring Processor via an internet connection. Square pays a small fixed fee per transaction to the Acquiring Processor.

5. The Acquiring Processor routes the transaction to the appropriate Card Network affiliated with the buyer’s card such as Visa, Mastercard, Discover, or American Express. Square pays a variety of fees to the Card Network, the most significant of which are assessment fees that are typically less than 0.15% of the transaction amount.

6. The Acquiring Processor then routes the transaction through the Card Network to the Issuing Bank, which authorizes or declines the transaction for the buyer’s payment card.

7. Upon authorization, the Issuing Bank sends a notification back through the Card Network to the Square Point of Sale to inform the seller that the transaction has been successfully authorized.

8. The Square Point of Sale sends a digital receipt for the transaction to the buyer, enabling a persistent communication channel between the seller and the buyer. For example, this is how the buyer can send feedback to the seller about the service provided.

9. The Issuing Bank then triggers a disbursement of funds to the Acquiring Bank through the Card Network for the transaction amount. Square will ultimately pay the Issuing Bank an interchange fee as a percentage of the amount of the transaction plus a fixed fee per transaction, which together average between 1.5% to 2.0% of the transaction amount. However, this percentage can vary significantly based on the card type, transaction type, and transaction size.

10. Square transfers the funds to the seller’s bank account, net of the fee charged by Square. Square provides sellers with fast access to funds, typically settling with them by the business day after the date of the transaction via Automated Clearing House (ACH) transfers, or the same day via its Instant Deposit service for an additional transaction fee. Square pays a very small fee for each ACH transfer.

11. The funds are settled from the Acquiring Bank to Square, typically in one to two business days after the date of the transaction.

12. At the end of the month, the Issuing Bank sends a statement to the buyer showing their monthly charges. The statement includes a reference to Square as the merchant of record on the billing statement as a prefix to the seller name (denoted as SQ).

Our Competition

The markets in which we operate are competitive and evolving. Our competitors range from large, well-established vendors to smaller, earlier-stage companies.

We seek to differentiate ourselves from competitors primarily on the basis of our commerce ecosystem and our focus on building products and services that are cohesive, fast, self-serve, and dependable. With respect to each of these factors, we believe that we compare favorably to our competitors.

For payments and point-of-sale services, we compete primarily with traditional acquiring processors and payment processors who sell costly card terminal and point-of-sale systems, often tied to long-term contracts, through direct sales or Independent Sales Organization (ISO) channels. Many competitors offer payments and point-of-sale services that have features tailored to particular industries or business types but require sellers to stitch together technology from multiple hardware, software, and payments vendors.

Some sellers may elect to use individual point-of-sale solutions from other companies that overlap with certain functions and features that we provide, including:

- Business software providers such as those that provide inventory management, analytics, customer management and marketing, e-commerce, and appointment solutions;

- Established or new alternative lenders;
- Delivery service providers; and
- Peer-to-peer payment providers.

Intellectual Property

We seek to protect our intellectual property rights by relying on a combination of federal, state, and common law rights in the United States and other countries, as well as on contractual measures. It is our practice to enter into confidentiality, non-disclosure, and invention assignment agreements with our employees and contractors, and into confidentiality and non-disclosure agreements with other third parties, in order to limit access to, and disclosure and use of, our confidential information and proprietary technology. In addition to these contractual measures, we also rely on a combination of trademarks, trade dress, copyrights, registered domain names, trade secrets, and patent rights to help protect our brand and our other intellectual property.

We have developed a patent program and strategy to identify, apply for, and secure patents for innovative aspects of our products, services, and technologies where appropriate. As of December 31, 2016, we had 229 issued patents and 588 filed patent applications in the United States and in foreign jurisdictions relating to a variety of aspects of our technology. Our issued patents will expire between 2022 and 2035. We intend to file additional patent applications as we continue to innovate through our research and development efforts and to pursue additional patent protection to the extent we deem it beneficial and cost-effective.

We actively pursue registration of our trademarks, logos, service marks, trade dress, and domain names in the United States and in other jurisdictions. We are the registered holder of a variety of U.S. and international domain names that include the term “Square” and variations thereof.

From time to time, we also incorporate certain intellectual property licensed from third parties, including under certain open source licenses. Even if any such third-party technology did not continue to be available to us on commercially reasonable terms, we believe that alternative technologies would be available as needed in every case.

Government Regulation

Foreign and domestic laws and regulations apply to many key aspects of our business. Failure to comply with these requirements may result in, among other things, revocation of required licenses or registrations, loss of approved status, private litigation, regulatory or governmental investigations, administrative enforcement actions, sanctions, civil and criminal liability, and constraints on our ability to continue to operate.

Payments Regulation

Various laws and regulations govern the payments industry in the United States and globally. For example, certain jurisdictions in the United States require a license to offer money transmission services, such as our peer-to-peer payments product, Square Cash, and we maintain a license in each of those jurisdictions and comply with new license requirements as they arise. We are also registered as a “Money Services Business” with the U.S. Department of Treasury’s Financial Crimes Enforcement Network. These licenses and registrations subject us, among other things, to record-keeping requirements, reporting requirements, bonding requirements, limitations on the investment of customer funds, and inspection by state and federal regulatory agencies.

Outside the United States, we provide localized versions of some of our services to customers, including through various foreign subsidiaries. For example, in Canada, Japan, and Australia, Square Point of Sale is the sole payments service we offer. The activities of those non-U.S. entities are, or may be, supervised by regulatory authorities in the jurisdictions in which they operate. For instance, we are registered with the Australian Transaction Reports and Analysis Centre (AUSTRAC), as required by anti-money laundering rules, to provide payments services in Australia.

Our payments services may be or become subject to regulation by other authorities, and the laws and regulations applicable to the payments industry in any given jurisdiction are always subject to interpretation and change.

Consumer Financial Protection

The Consumer Financial Protection Bureau and other federal, local, state, and foreign regulatory agencies regulate financial products, including credit, deposit, and payments services, and other similar services. These agencies have broad consumer protection mandates, and they promulgate, interpret, and enforce rules and regulations that affect our business.

Anti-Money Laundering

We are subject to anti-money laundering (AML) laws and regulations in the United States and other jurisdictions. We have implemented an AML program designed to prevent our payments network from being used to facilitate money laundering, terrorist financing, and other illicit activity. Our program is also designed to prevent our network from being used to facilitate business in countries, or with persons or entities, included on designated lists promulgated by the U.S. Department of the Treasury's Office of Foreign Assets Controls and equivalent foreign authorities. Our AML compliance program includes policies, procedures, reporting protocols, and internal controls, including the designation of an AML compliance officer, and is designed to address these legal and regulatory requirements and to assist in managing risk associated with money laundering and terrorist financing.

Protection and Use of Information

We collect and use a wide variety of information to help ensure the integrity of our services and to provide features and functionality to our customers. This aspect of our business, including the collection, use, and protection of the information we acquire from our own services as well as from third-party sources, is subject to laws and regulations in the United States and elsewhere. Accordingly, we publish our privacy policies and terms of service, which describe our practices concerning the use, transmission, and disclosure of information. As our business continues to expand in the United States and worldwide, and as laws and regulations continue to be passed and their interpretations continue to evolve, additional laws and regulations may become relevant to us.

Communications Regulation

We send texts, emails, and other communications in a variety of contexts, such as when providing digital receipts. Communications laws, including those promulgated by the Federal Communications Commission, apply to certain aspects of this activity in the United States and elsewhere.

Additional Developments

Various regulatory agencies in the United States and elsewhere continue to examine a wide variety of issues that could impact our business, including products liability, import and export compliance, accessibility for the disabled, insurance, marketing, privacy, and labor and employment matters. As our business continues to develop and expand, additional rules and regulations may become relevant. For example, if we choose to offer Square Payroll in more jurisdictions, additional regulations, including tax rules, will apply.

Our Employees

As of December 31, 2016, we had 1,853 full-time employees. We also engage temporary employees and consultants as needed to support our operations. None of our employees are either represented by a labor union or subject to a collective bargaining agreement. We have not experienced any work stoppages, and we consider our relations with our employees to be good.

Corporate Information

Square was incorporated in Delaware in June 2009. Our headquarters are located at 1455 Market Street, Suite 600, San Francisco, California 94103. Our telephone number is (415) 375-3176. Our website is located at www.squareup.com, and our investor relations website is located at www.squareup.com/about/investors. The information contained in, or accessible through, our website is not part of, and is not incorporated into, this Annual Report on Form 10-K.

We use various trademarks and trade names in our business, including “Square” and Square®, which we have registered in the United States and in various other countries. This Annual Report on Form 10-K also contains trademarks and trade names of other businesses that are the property of their respective holders. We have omitted the ® and ™ designations, as applicable, for the trademarks we name in this Annual Report on Form 10-K.

Available Information

13

Copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), are available, free of charge, on our investor relations website as soon as reasonably practicable after we file such material electronically with or furnish it to the Securities and Exchange Commission (SEC). The SEC also maintains a website that contains our SEC filings. The address of the site is www.sec.gov. Further, a copy of this Annual Report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

We webcast our earnings calls and certain events we participate in or host with members of the investment community on our investor relations website. Additionally, we provide notifications of news or announcements regarding our financial performance, including SEC filings, investor events, press and earnings releases, and blogs as part of our investor relations website. We have used, and intend to continue to use, our investor relations website, as well as the Twitter accounts @Square and @SquareIR, as means of disclosing material non-public information and for complying with our disclosure obligations under Regulation FD. Further corporate governance information, including our board committee charters, code of business conduct and ethics and corporate governance guidelines, is also available on our investor relations website under the heading "Governance Documents." The contents of our websites are not intended to be incorporated by reference into this Annual Report on Form 10-K or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

Item 1A. RISK FACTORS

Investing in our securities involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information in this Annual Report on Form 10-K, including the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes, before making any investment decision with respect to our securities. The risks and uncertainties described below may not be the only ones we face. If any of the risks actually occur, our business could be materially and adversely affected. In that event, the market price of our Class A common stock could decline, and you could lose part or all of your investment.

Risks Related to Our Business and Our Industry

Our business depends on a strong and trusted brand, and any failure to maintain, protect, and enhance our brand would hurt our business.

We have developed a strong and trusted brand that has contributed significantly to the success of our business. Our brand is predicated on the idea that sellers and buyers will trust us and find value in building and growing their businesses with our products and services. Maintaining, protecting, and enhancing our brand is critical to expanding our base of sellers, buyers, and other third-party partners, as well as increasing engagement with our products and services. This will depend largely on our ability to maintain trust, be a technology leader, and continue to provide high-quality and secure products and services. Any negative publicity about our industry or our company, the quality and reliability of our products and services, our risk management processes, changes to our products and services, our ability to effectively manage and resolve seller and buyer complaints, our privacy and security practices, litigation, regulatory activity, and the experience of sellers and buyers with our products or services, could adversely affect our reputation and the confidence in and use of our products and services. Harm to our brand can arise from many sources, including failure by us or our partners to satisfy expectations of service and quality; inadequate protection of sensitive information; compliance failures and claims; litigation and other claims; employee misconduct; and misconduct by our partners, service providers, or other counterparties. If we do not successfully maintain a strong and trusted brand, our business could be materially and adversely affected.

Our growth may not be sustainable and depends on our ability to retain existing sellers, attract new sellers, and increase sales to both new and existing sellers.

Our total net revenue grew from $850.2 million in 2014 to $1,267.1 million in 2015 and to $1,708.7 million in 2016. We expect our rate of revenue growth will decline, and it may decline more quickly than we expect for a variety of reasons, including the risks described in this Annual Report on Form 10-K. Our sellers and other users of our services have no obligation to continue to use our services, and we cannot assure you that they will. We generally do not have long-term contracts with our sellers, and the difficulty and costs associated with switching to a competitor may not be significant for many of our services. Our sellers’ payment processing activity with us may decrease for a variety of reasons, including sellers’ level of satisfaction with our products and services, the effectiveness of our support services, our pricing, the pricing and quality of competing products or services, the effects of global economic conditions, or reductions in our sellers’ customer spending levels. In addition, the growth of our business depends in part on existing sellers expanding their use of our products and services. If we are unable to encourage sellers to broaden their use of our services, our growth may slow or stop, and our business may be materially and adversely affected. The growth of our business also depends on our ability to attract new sellers, to encourage larger sellers to use our products and services, and to introduce successful new products and services. We have invested in new products and services, including Square Cash, Caviar, Instant Deposit, and Invoices and will continue to invest in new products and services, but if those products and services fail to be successful, our growth may slow or decline.

Our business has generated net losses, and we intend to continue to invest substantially in our business. Thus, we may not be able to achieve or maintain profitability.

We generated net losses of $171.6 million, $212.0 million, and $154.1 million for the years ended December 31, 2016, 2015 and 2014, respectively.

As of December 31, 2016, we had an accumulated deficit of $779.2 million. We intend to continue to make significant investments in our business, including with respect to our employee base; sales and marketing, including expenses relating to increased direct marketing efforts, referral programs, and free hardware and subsidized services; development of new products, services, and features; expansion of office space and other infrastructure; expansion of international operations; and general administration, including legal, finance, and other compliance expenses related to being a public company. If the costs associated with acquiring and supporting new or larger sellers materially rise in the future, including the fees we pay to third parties to advertise our products and services, our expenses may rise significantly. In addition, increases in our seller base could cause us to incur increased losses because costs associated with new sellers are generally incurred up front, while revenue is recognized thereafter as sellers utilize our services. If we are unable to generate adequate revenue growth and manage our expenses, we may continue to incur significant losses and may not achieve or maintain profitability.

We frequently make decisions that may reduce our short-term operating results if we believe those decisions will improve the experiences of our sellers, their customers, and other users of our products and services, which we believe will improve our operating results over the long term. These decisions may not be consistent with the expectations of investors and may not produce the long-term benefits that we expect, in which case our business may be materially and adversely affected.

We, our sellers, our partners, and others who use our services obtain and process a large amount of sensitive data. Any real or perceived improper use of, disclosure of, or access to such data could harm our reputation as a trusted brand, as well as have a material and adverse effect on our business.

We, our sellers, and our partners, including third-party data centers that we use, obtain and process large amounts of sensitive data, including data related to our sellers, their customers, and their transactions. This is also true of other users of our services, such as Square Cash and Square Payroll. We face risks, including to our reputation as a trusted brand, in the handling and protection of this data, and these risks will increase as our business continues to expand. Our operations involve the storage and transmission of sensitive information of individuals using our services, including their names, addresses, social security numbers (or their foreign equivalents), payment card numbers and expiration dates, bank account information, and data regarding the performance of our sellers' businesses. We also obtain sensitive information regarding our sellers' customers, including their contact information, payment card numbers and expiration dates, and purchase histories. Additionally, certain of our products and services are subject to the Health Insurance Portability and Accountability Act of 1996 (and the rules and regulations thereunder, as amended, including with respect to the HITECH Act) (HIPAA), and therefore we are required to take measures to safeguard protected health information of our sellers and their customers. We have administrative, technical, and physical security measures in place, and we have policies and procedures in place to contractually require third parties to whom we transfer data to implement and maintain appropriate security measures. However, if our security measures or those of the previously mentioned third parties are inadequate or are breached as a result of third-party action, employee error, malfeasance, malware, phishing, hacking attacks, system error, trickery, or otherwise, and, as a result, someone obtains unauthorized access to sensitive information, including personally identifiable information or protected health information, on our systems or our partners' systems, our reputation and business could be damaged. If the sensitive information is lost or improperly disclosed or threatened to be disclosed, we could incur significant liability and be subject to regulatory scrutiny and penalties, including costs associated with remediation. Under payment card rules and our contracts with our card processors, if there is a breach of payment card information that we store or that is stored by our sellers or other third parties with which we do business, we could be liable to the payment card issuing banks for their cost of issuing new cards and other related expenses. Additionally, if our own confidential business information were improperly disclosed, our business could be materially and adversely affected. A core aspect of our business is the reliability and security of our payments platform. Any perceived or actual breach of security could have a significant impact on our reputation as a trusted brand, cause us to lose existing sellers, prevent us from obtaining new sellers, require us to expend significant funds to remedy problems caused by breaches and to implement measures to prevent further breaches, and expose us to legal risk and potential liability including those resulting from governmental or regulatory investigations, class action litigation and costs associated with remediation, such as fraud monitoring. Any security breach at a company providing services to us, our sellers, or other users of our services could have similar effects.

Our risk management efforts may not be effective, which could expose us to losses and liability and otherwise harm our business.

We offer managed payments and other products and services to a large number of customers, and we are responsible for vetting and monitoring these customers and determining whether the transactions we process for them are legitimate. When our products and services are used to process illegitimate transactions, and we settle those funds to sellers and are unable to recover them, we suffer losses and liability. These types of illegitimate transactions can also expose us to governmental and regulatory sanctions as well as potentially prevent us from satisfying our contractual obligations to our third party partners, which may cause us to be in breach of our obligations. The highly automated nature of, and liquidity offered by, our payments services make us a target for illegal or improper uses, including fraudulent or illegal sales of goods or services, money laundering, and terrorist financing. Identity thieves and those committing fraud using stolen or fabricated credit card or bank account numbers, or other deceptive or malicious practices, potentially can steal significant amounts of money from businesses like ours. In configuring our payments services, we face an inherent trade-off between security and customer convenience. Our risk management policies, procedures, techniques, and processes may not be sufficient to identify all of the risks to which we are exposed, to enable us to mitigate the risks we have identified, or to identify additional risks to which we may become subject in the future. As a greater number of larger sellers use our services, our exposure to material risk losses from a single seller, or from a small number of sellers, will increase. Our current business and anticipated domestic and international growth will continue to place significant demands on our risk management efforts, and we will need to continue developing and improving our existing risk management infrastructure, techniques, and processes. In addition, when we introduce new services, expand existing services, focus on new business types, or begin to operate in markets where we have a limited history of fraud loss, we may be less able to forecast and reserve accurately for those losses. Furthermore, if our risk management policies and processes contain errors or are otherwise ineffective, we may suffer large financial losses, we may be subject to civil and criminal liability, and our business may be materially and adversely affected.

We are currently, and will continue to be, exposed to risks associated with chargebacks and refunds in connection with payment card fraud or relating to the goods or services provided by our sellers. In the event that a billing dispute between a cardholder and a seller is not resolved in favor of the seller, including in situations where the seller engaged in fraud, the transaction is typically "charged back" to the seller and the purchase price is credited or otherwise refunded to the cardholder. If we are unable to collect chargebacks or refunds from the seller's account, or if the seller refuses to or is unable to reimburse us for chargebacks or refunds due to closure, bankruptcy, or other reasons, we may bear the loss for the amounts paid to the cardholder. Since October 2015, businesses that cannot process EMV chip cards are held financially responsible for certain fraudulent transactions conducted using chip-enabled cards. This has shifted an increased amount of the risk for certain fraudulent transactions from the issuing banks to these sellers, which has resulted in our having to seek an increased level of reimbursement for chargebacks from our sellers that do not deploy EMV-compliant card readers. Not all of the readers we offer to merchants are EMV-compliant. Our financial results would be adversely affected to the extent sellers do not fully reimburse us for the related chargebacks. We do not collect and maintain reserves from our sellers to cover these potential losses, and for customer relations purposes we sometimes decline to seek reimbursement for certain chargebacks. The risk of chargebacks is typically greater with those of our sellers that promise future delivery of goods and services, which we allow on our service. If we are unable to maintain our losses from chargebacks at acceptable levels, the payment card networks could fine us, increase our transaction-based fees, or terminate our ability to process payment cards. Any increase in our transaction-based fees could damage our business, and if we were unable to accept payment cards, our business would be materially and adversely affected.

We derive substantially all of our revenue from managed payments services. Our efforts to expand our product portfolio and market reach may not succeed and may reduce our revenue growth.

We derive substantially all of our revenue from transaction-based fees we collect in connection with managed payments services. While we intend to continue to broaden the scope of products and services we offer, we may not be successful in deriving any significant revenue from these products and services. Failure to broaden the scope of products and services that are attractive may inhibit the growth of repeat business and harm our business, as well as increase the vulnerability of our core payments business to competitors offering a full suite of products and services. Furthermore, we may have limited or no experience in our newer markets. For example, we cannot assure you that any of our products or services outside of managed payments services will be as widely accepted or that they will continue to grow in revenue. These offerings may present new and difficult technological, operational, and other challenges, and if we experience service disruptions, failures, or other issues, our business may be materially and adversely affected. Our newer activities may not recoup our investments in a timely manner or at all. If any of this were to occur, it could damage our reputation, limit our growth, and materially and adversely affect our business.

Our success depends on our ability to develop products and services to address the rapidly evolving market for payments and point-of-sale, financial, and marketing services, and, if we are not able to implement successful enhancements and new features for our products and services, our business could be materially and adversely affected.

We expect that new services and technologies applicable to the industries in which we operate will continue to emerge and evolve. Rapid and significant technological changes continue to confront the industries in which we operate, including developments in e-commerce, mobile commerce, and proximity payment devices (including contactless payments via NFC technology). Other potential changes are on the horizon as well, such as developments in crypto-currencies and in tokenization, which replaces sensitive data (e.g., payment card information) with symbols (tokens) to keep the data safe in the event that it ends up in the wrong hands. Similarly, there is rapid innovation in the provision of other products and services to businesses, including in financial services and marketing services.

These new services and technologies may be superior to, impair, or render obsolete the products and services we currently offer or the technologies we currently use to provide them. Incorporating new technologies into our products and services may require substantial expenditures and take considerable time, and we may not be successful in realizing a return on these development efforts in a timely manner or at all. There can be no assurance that any new products or services we develop and offer to our sellers will achieve significant commercial acceptance. Our ability to develop new products and services may be inhibited by industry-wide standards, payment card networks, laws and regulations, resistance to change from buyers or sellers, or third parties' intellectual property rights. Our success will depend on our ability to develop new technologies and to adapt to technological changes and evolving industry standards. If we are unable to provide enhancements and new features for our products and services or to develop new products and services that achieve market acceptance or that keep pace with rapid technological developments and evolving industry standards, our business would be materially and adversely affected.

The success of enhancements, new features, and products and services depends on several factors, including the timely completion, introduction, and market acceptance of the enhancements or new features or services. We often rely not only on our own initiatives and innovations, but also on third parties, including some of our competitors, for the development of and access to new technologies. Failure to accurately predict or to respond effectively to developments in our industry may significantly impair our business.

In addition, because our products and services are designed to operate with a variety of systems, infrastructures, and devices, we need to continuously modify and enhance our products and services to keep pace with changes in mobile, software, communication, and database technologies. We may not be successful in either developing these modifications and enhancements or in bringing them to market in a timely and cost-effective manner. Any failure of our products and services to continue to operate effectively with third-party infrastructures and technologies could reduce the demand for our products and services, result in dissatisfaction of our sellers or their customers, and materially and adversely affect our business.

Substantial and increasingly intense competition in our industry may harm our business.

We compete in markets characterized by vigorous competition, changing technology, changing seller and buyer needs, evolving industry standards, and frequent introductions of new products and services. We expect competition to intensify in the future as existing and new competitors introduce new services or enhance existing services. We compete against many companies to attract customers, and some of these companies have greater financial resources and substantially larger bases of customers than we do, which may provide them with significant competitive advantages. These companies may devote greater resources to the development, promotion, and sale of products and services, and they may offer lower prices or more effectively introduce their own innovative products and services that adversely impact our growth. Mergers and acquisitions by these companies may lead to even larger competitors with more resources. We also expect new entrants to offer competitive products and services. Certain sellers have long-standing exclusive, or nearly exclusive, relationships with our competitors to accept payment cards and other services that we offer. These relationships may make it difficult or cost-prohibitive for us to conduct material amounts of business with them. Competing services tied to established brands may engender greater confidence in the safety and efficacy of their services. If we are unable to differentiate ourselves from and successfully compete with our competitors, our business will be materially and adversely affected.

We may also face pricing pressures from competitors. Some potential competitors are able to offer lower prices to sellers for similar services by cross-subsidizing their payments services through other services they offer. Such competition may result in the need for us to alter the pricing we offer to our sellers and could reduce our gross profit. In addition, as we grow, sellers may demand more customized and favorable pricing from us, and competitive pressures may require us to agree to such pricing, further reducing our gross profit. We currently negotiate pricing discounts and other incentive arrangements with certain large sellers to increase acceptance and usage of our products and services. If we continue this practice and if an increasing proportion of our sellers are large sellers, we may have to increase the discounts or incentives we provide, which could also reduce our gross profit.

We are dependent on payment card networks and acquiring processors, and any changes to their rules or practices could harm our business.

Our business depends on our ability to accept credit and debit cards, and this ability is provided by the payment card networks, including Visa, MasterCard, American Express, and Discover. Other than American Express, we do not directly access the payment card networks that enable our acceptance of payment cards. As a result, we must rely on banks and acquiring processors to process transactions on our behalf. Our acquiring processor agreements have terms ranging from two to six years. Our three largest such agreements expire between the third quarter of 2017 and the first quarter of 2020, and two of these agreements, including the one expiring in 2017, provide for automatic renewal. These banks and acquiring processors may fail or refuse to process transactions adequately, may breach their agreements with us, or may refuse to renew these agreements on commercially reasonable terms. They might also take actions that degrade the functionality of our services, impose additional costs or requirements on us, or give preferential treatment to competitive services, including their own services. If we are unsuccessful in establishing or maintaining mutually beneficial relationships with these payment card networks, banks, and acquiring processors, our business may be harmed.

The payment card networks and our acquiring processors require us to comply with payment card network operating rules, including special operating rules that apply to us as a “payment service provider” providing payment processing services to merchants. The payment card networks set these network rules and have discretion to interpret them and change them. Any changes to or interpretations of the network rules that are inconsistent with the way we or our acquiring processors currently operate may require us to make changes to our business that could be costly or difficult to implement. If we fail to make such changes or otherwise resolve the issue with the payment card networks, the networks could fine us or prohibit us from processing payment cards. In addition, violations of the network rules or any failure to maintain good relationships with the payment card networks could impact our ability to receive incentives from them, could increase our costs, or could otherwise harm our business. If we were unable to accept payment cards or were limited in our ability to do so, our business would be materially and adversely affected.

We are required to pay interchange fees and assessments to the payment card networks, as well as fees to our acquiring processors, to process transactions. From time to time, payment card networks have increased, and may increase in the future, the interchange fees and assessments that they charge for each transaction processed using their networks. In addition, our acquiring processors and payment card networks may refuse to renew our agreements with them on commercially reasonable terms or at all. Interchange fees or assessments are also subject to change from time to time due to government regulation. Because we generally charge our sellers a flat rate for our managed payments services, rather than passing through interchange fees and assessments to our sellers directly, any increase or decrease in interchange fees or assessments or in the fees we pay to our acquiring processors could make our pricing look less competitive, lead us to change our pricing model, or adversely affect our margins.

We could be, and in the past have been, subject to penalties from payment card networks if we fail to detect that sellers are engaging in activities that are illegal, contrary to the payment card network operating rules, or considered “high risk.” We must either prevent high-risk sellers from using our products and services or register such sellers with the payment card networks and conduct additional monitoring with respect to such sellers. Although the amount of these penalties has not been material to date, any additional penalties in the future could become material and could result in termination of our ability to accept payment cards or could require changes in our process for registering new sellers. This could materially and adversely affect our business.

Our quarterly results of operations and operating metrics fluctuate significantly and are unpredictable and subject to seasonality, which could result in the trading price of our Class A common stock being unpredictable or declining.

Our quarterly results of operations may vary significantly and are not necessarily an indication of future performance. These fluctuations may be due to a variety of factors, some of which are outside of our control and may not fully reflect the underlying performance of our business. Our limited operating history combined with the rapidly evolving markets in which we operate also contributes to these fluctuations. Fluctuations in quarterly results may materially and adversely affect the predictability of our business and the price of our Class A common stock.

Factors that may cause fluctuations in our quarterly financial results include our ability to attract and retain new customers; the timing, effectiveness, and costs of expansion and upgrades of our systems and infrastructure, as well as the success of those expansions and upgrades; the outcomes of legal proceedings and claims; our ability to maintain or increase revenue, gross margins, and operating margins; our ability to continue introducing new services and to continue convincing customers to adopt additional offerings; increases in and timing of expenses that we may incur to grow and expand our operations and to remain competitive; period-to-period volatility related to fraud and risk losses; system failures resulting in the inaccessibility of our products and services; changes in the regulatory environment, including with respect to security, privacy, or enforcement of laws and regulations by regulators, including fines, orders, or consent decrees; changes in global business or macroeconomic conditions; unusual weather conditions; general retail buying patterns; and the other risks described in this Annual Report on Form 10-K.

We depend on key management, as well as our experienced and capable employees, and any failure to attract, motivate, and retain our employees could harm our ability to maintain and grow our business.

Our future success is significantly dependent upon the continued service of our executives and other key employees. If we lose the services of any member of management or any key personnel, we may not be able to locate a suitable or qualified replacement, and we may incur additional expenses to recruit and train a replacement, which could severely disrupt our business and growth. Jack Dorsey, our co-founder, President, and Chief Executive Officer, also serves as Chief Executive Officer of Twitter, Inc. This may at times adversely affect his ability to devote time, attention, and effort to Square.

To maintain and grow our business, we will need to identify, hire, develop, motivate, and retain highly skilled employees. Identifying, recruiting, training, integrating, and retaining qualified individuals requires significant time, expense, and attention. In addition, from time to time, there may be changes in our management team that may be disruptive to our business. If our management team, including any new hires that we make, fails to work together effectively and to execute our plans and strategies on a timely basis, our business could be harmed. Competition for highly skilled personnel is intense, particularly in the San Francisco Bay Area where our headquarters are located. We may need to invest significant amounts of cash and equity to attract and retain new employees, and we may never realize returns on these investments. If we are not able to add and retain employees effectively, our ability to achieve our strategic objectives will be adversely affected, and our business and growth prospects will be harmed.

In addition, a number of employees, including many members of management, may be able to receive significant proceeds from sales of our equity in the public markets. As a result, it may be difficult for us to continue to retain and motivate these employees, and, if we are unable to do so, our business may be materially and adversely affected.

If we do not continue to improve our operational, financial and other internal controls and systems to manage growth effectively, our business could be harmed.

Our current business and anticipated growth will continue to place significant demands on our management and other resources. In order to manage our growth effectively, we must continue to strengthen our existing infrastructure and operational procedures, enhance our internal controls and reporting systems, and ensure we timely and accurately address issues as they arise. In particular, our continued growth will increase the challenges involved in:

- improving and implementing existing and developing new internal administrative infrastructure, particularly our operational, financial, communications and other internal systems and procedures;
- installing enhanced management information and control system; and
- preserving our core values, strategies, and goals and effectively communicating these to our employees worldwide.

If we are not successful in developing and implementing the right processes and tools to manage our enterprise, our ability to compete successfully and achieve our business objectives could be impaired.

These efforts may require substantial financial expenditures, commitments of resources, developments of our processes, and other investments and innovations. As we grow, we may not be able to develop and launch new features for our products and services as quickly as a smaller, more efficient organization. If we do not successfully manage our growth, our business will suffer.

A deterioration of general macroeconomic conditions could materially and adversely affect our business and financial results.

Our performance is subject to economic conditions and their impact on levels of spending by businesses and their customers. Most of the sellers that use our services are small businesses, many of which are in the early stages of their development, and these businesses may be disproportionately adversely affected by economic downturns and may fail at a higher rate than larger or more established businesses. If spending by their customers declines, these businesses would experience reduced sales and process fewer payments with us or, if they cease to operate, stop using our products and services altogether. Small businesses frequently have limited budgets and limited access to capital, and they may choose to allocate their spending to items other than our financial or marketing services, especially in times of economic uncertainty or in recessions. In addition, if more of our sellers cease to operate, this may have an adverse impact not only on the growth of our payments services but also on our transaction and advance loss rates, and the success of our other services. For example, if sellers processing payments with us receive chargebacks after they cease to operate, we may incur additional losses. Additionally, the growth in the number of sellers qualifying for participation in the Square Capital program may slow, the receivables related to the Square Capital MCAs may decline, or business loans may be paid more slowly, or not at all. Furthermore, our investment portfolio, which includes U.S. government and corporate securities, is subject to general credit, liquidity, market, and interest rate risks, which may be exacerbated by certain events that affect the global financial markets. If global credit and equity markets decline for extended periods, or if there is a downgrade of the securities within our portfolio, the investment portfolio may be adversely affected and we could determine that our investments have experienced an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our financial results. Thus, if general macroeconomic conditions deteriorate, our business and financial results could be materially and adversely affected.

If we are unable to maintain, promote, and grow our brand through effective marketing and communications strategies, our brand and business may be harmed.

We believe that maintaining and promoting our brand in a cost-effective manner is critical to achieving widespread acceptance of our products and services and to expanding our base of customers. Maintaining and promoting our brand will depend largely on our ability to continue to provide useful, reliable, and innovative products and services, which we may not do successfully. We may introduce, or make changes to, features, products, services, or terms of service that customers do not like, which may materially and adversely affect our brand. Our brand promotion activities may not generate customer awareness or increase revenue, and even if they do, any increase in revenue may not offset the expenses we incur in building our brand. If we fail to successfully promote and maintain our brand or if we incur excessive expenses in this effort, our business could be materially and adversely affected.

The introduction and promotion of new services, as well as the promotion of existing services, may be partly dependent on our visibility on third-party advertising platforms, such as Google, Twitter, or Facebook. Changes in the way these platforms operate or changes in their advertising prices or other terms could make the maintenance and promotion of our products and services and our brand more expensive or more difficult. If we are unable to market and promote our brand on third-party platforms effectively, our ability to acquire new sellers would be materially harmed.

We have received a significant amount of media coverage since our formation. We have also been from time to time in the past, and may in the future be, the target of incomplete, inaccurate, and misleading or false statements about our company, our business, and our products and services that could damage our brand and materially deter people from adopting our services. Negative publicity about our company or our management, including about our product quality and reliability, changes to our products and services, privacy and security practices, litigation, regulatory enforcement, and other actions, as well as the actions of our customers and other users of our services, even if inaccurate, could cause a loss of confidence in us. Our ability to respond to negative statements about us may be limited by legal prohibitions on permissible public communications by us during future periods.

Expanding our business globally could subject us to new challenges and risks.

We currently offer our services and products in multiple countries and plan to continue expanding our business further globally. Additional expansion, whether in our existing or new global markets, will require additional resources and controls, and offering our services in new geographic regions often requires substantial expenditures and takes considerable time, and we may not be successful enough in these new geographies to recoup our investments in a timely manner or at all. Such expansion could also subject our business to substantial risks, including:

- difficulty in attracting a sufficient number of sellers;
- failure to anticipate competitive conditions;
- conformity with applicable business customs, including translation into foreign languages and associated expenses;
- increased costs and difficulty in protecting intellectual property and sensitive data;

changes to the way we do business as compared with our current operations or a lack of acceptance of our products and services;

the ability to support and integrate with local third-party service providers;

competition with service providers or other entrenched market-players that have greater experience in the local markets than we do;
difficulties in staffing and managing foreign operations in an environment of diverse culture, laws and customs, challenges caused by distance, language, and cultural differences, and the increased travel, infrastructure and legal and compliance costs associated with global operations;
difficulties in recruiting and retaining qualified employees;
difficulty in gaining acceptance from industry self-regulatory bodies;
compliance with multiple, potentially conflicting and changing governmental laws and regulations, including with respect to data privacy and security;
compliance with U.S. and foreign anti-bribery laws;
potential tariffs, sanctions, or other trade barriers including fines;
exchange rate risk;
compliance with potentially conflicting and changing laws of taxing jurisdictions where we conduct business and applicable U.S. tax laws, the complexity and adverse consequences of such tax laws and potentially adverse tax consequences due to changes in such tax laws; and
regional economic and political instability.

As a result of these risks, our efforts to expand our global operations may not be successful, which could limit our ability to grow our business.

We rely on third parties and their systems for a variety of services, including the processing of transaction data and settlement of funds to us and our sellers, and these third parties' failure to perform these services adequately could materially and adversely affect our business.

To provide our managed payments solution and other products and services, we rely on third parties that we do not control, such as the payment card networks, our acquiring processors, the payment card issuers, various financial institution partners (including those for Square Capital and Square Cash), systems like the Federal Reserve Automated Clearing House, and other partners. We rely on these third parties for a variety of services, including the transmission of transaction data, processing of chargebacks and refunds, settlement of funds to our sellers, and the provision information and other elements of our services. For example, we currently rely on three acquiring processors in the United States and two for each of Canada, Japan, and Australia. While we believe there are other acquiring processors that could meet our needs, adding or transitioning to new providers may significantly disrupt our business and increase our costs. In the event these third parties fail to provide these services adequately, including as a result of errors in their systems or events beyond their control, or refuse to provide these services on terms acceptable to us or at all, and we are not able to find suitable alternatives, our business may be materially and adversely affected.

Our services must integrate with a variety of operating systems, and the hardware that enables merchants to accept payment cards must interoperate with third-party mobile devices utilizing those operating systems. If we are unable to ensure that our services or hardware interoperate with such operating systems and devices, our business may be materially and adversely affected.

We are dependent on the ability of our products and services to integrate with a variety of operating systems, as well as web browsers that we do not control. Any changes in these systems that degrade the functionality of our products and services, impose additional costs or requirements on us, or give preferential treatment to competitive services, including their own services, could materially and adversely affect usage of our products and services. In addition, we rely on app marketplaces, such as the Apple App Store and Google Play, to drive downloads of our mobile app. Apple, Google, or other operators of app marketplaces regularly make changes to their marketplaces, and those changes may make access to our products and services more difficult. In the event that it is difficult for our sellers to access and use our products and services, our business may be materially and

adversely affected. Furthermore, Apple, Google, or other operators of app marketplaces regularly provide software updates, and such software updates may not operate effectively with our products and services, which may reduce the demand for our products and services, result in dissatisfaction by our sellers or their customers, and may materially and adversely affect our business.

In addition, our hardware interoperates with mobile devices developed by third parties. For example, the current version of our magstripe reader plugs into the audio jack of most smartphones and tablets. In September 2016, Apple introduced the iPhone 7, which does not have an audio jack, and instead Apple provided an adapter that can be inserted into a connectivity port. This change and other potential changes in the design of future mobile devices may limit the interoperability of our hardware with such devices and require modifications to our hardware. If we are unable to ensure that our hardware continues to interoperate effectively with such devices, if doing so is costly, or if existing merchants decide not to utilize additional parts necessary for interoperability, our business may be materially and adversely affected.

Many of our key components are procured from a single or limited number of suppliers. Thus, we are at risk of shortage, price increases, changes, delay, or discontinuation of key components, which could disrupt and materially and adversely affect our business.

Many of the key components used to manufacture our products, such as the custom parts of our magstripe reader, including its magnetic stripe-reading element, its plastic cover, and its application-specific integrated circuits, come from limited or single sources of supply, as do the plastic cover, connector, and security cage of our contactless and chip reader. In addition, in some cases, we rely only on one manufacturer to fabricate, test, and assemble our products. For example, a single manufacturer assembles our magstripe reader and our contactless and chip reader, as well as manufactures those products' plastic parts with custom tools that we own but that they maintain on their premises. The term of the agreement with that manufacturer automatically renews for consecutive one-year periods unless either party provides notice of non-renewal. In general, our contract manufacturers fabricate or procure components on our behalf, subject to certain approved procedures or supplier lists, and we do not have firm commitments from all of these manufacturers to provide all components, or to provide them in quantities and on timelines that we may require. For example, pursuant to a development and supply agreement, a component supplier provides design, development, customization, and related services for components of the magnetic stripe-reading element in some of our products. The term of the agreement renews for successive two-year terms unless either party provides notice of non-renewal. Similarly, a component provider develops certain application-specific integrated circuits for our products pursuant to our designs and specifications. The term of our agreement with this provider renews for consecutive one-year periods unless either party provides notice of non-renewal.

Due to our reliance on the components or products produced by suppliers such as these, we are subject to the risk of shortages and long lead times in the supply of certain components or products. We are still in the process of identifying alternative manufacturers for the assembly of our products and for most of the single-sourced components used in our products. In the case of off-the-shelf components, we are subject to the risk that our suppliers may discontinue or modify them, or that the components may cease to be available on commercially reasonable terms. We have in the past experienced, and may in the future experience, component shortages or delays or other problems in product assembly, and the availability of these components or products may be difficult to predict. For example, our manufacturers may experience disruptions in their manufacturing operations due to equipment breakdowns, labor strikes or shortages, natural disasters, component or material shortages, cost increases, or other similar problems.

Additionally, various sources of supply-chain risk, including strikes or shutdowns at delivery ports or loss of or damage to our products while they are in transit or storage, intellectual property theft, losses due to tampering, or other similar problems could limit the supply of our products. In the event of a shortage or supply interruption from suppliers of these components, we may not be able to develop alternate sources quickly, cost-effectively, or at all. Any interruption or delay in manufacturing, component supply, any increases in component costs, or the inability to obtain these parts or components from alternate sources at acceptable prices and within a reasonable amount of time, would harm our ability to provide our products to sellers on a timely basis. This could harm our relationships with our sellers, prevent us from acquiring new sellers, and materially and adversely affect our business.

Our business could be harmed if we are unable to accurately forecast demand for our products and to adequately manage our product inventory.

We invest broadly in our business, and such investments are driven by our expectations of the future success of a product. Our products, such as the Square Reader, often require investments with long lead times. An inability to correctly forecast the success of a particular product could harm our business. We must forecast inventory needs and expenses and place orders sufficiently in advance with our third-party suppliers and contract manufacturers based on our estimates of future demand for particular products. Our ability to accurately forecast demand for our products could be affected by many factors, including an increase or decrease in demand for our products or for our competitors' products, unanticipated changes in general market conditions, and the change in economic conditions.

If we underestimate demand for a particular product, our contract manufacturers and suppliers may not be able to deliver sufficient quantities of that product to meet our requirements, and we may experience a shortage of that product available for sale or distribution. The shortage of a popular product could materially and adversely affect our brand, our seller relationships, and the acquisition of additional sellers. If we overestimate demand for a particular product, we may experience excess inventory levels for that product and the excess inventory may become obsolete or out-of-date. Inventory levels in excess of demand may result in inventory write-downs or write-offs and the sale of excess inventory at further discounted prices, which could negatively impact our gross profit and our business.

Our products and services may not function as intended due to errors in our software, hardware, and systems, product defects, or due to security breaches or human error in administering these systems, which could materially and adversely affect our business.

Our software, hardware, and systems may contain undetected errors that could have a material adverse effect on our business, particularly to the extent such errors are not detected and remedied quickly. We have from time to time found defects in our customer-facing software and hardware, internal systems, and technical integrations with third-party systems, and new errors may be introduced in the future. We rely on a limited number of component and product suppliers located outside of the U.S. to manufacture our products. As a result, our direct control over production and distribution is limited and it is uncertain what effect such diminished control will have on the quality of our products. If there are defects in the manufacture of our hardware products, we may face negative publicity, government investigations, and litigation, and we may not be fully compensated by our suppliers for any financial or other liability that we suffer as a result.

In addition, we provide frequent incremental releases of product and service updates and functional enhancements, which increases the possibility of errors. The electronic payments products and services we provide are designed to process complex transactions and deliver reports and other information related to those transactions, all at high volumes and processing speeds. Since customers use our services for important aspects of their businesses, any errors, defects, third-party security breaches such as cyber-attacks or identify theft, malfeasance, disruptions in services, or other performance problems with our services could hurt our reputation and damage our customers' businesses. Software and system errors, or human error, could delay or inhibit settlement of payments, result in oversettlement, cause reporting errors, or prevent us from collecting transaction-based fees, all of which have occurred in the past. Similarly, third-party security breaches such as cyber-attacks or identity theft could disrupt the proper functioning of our software products or services, cause errors, allow unauthorized access to sensitive, proprietary or confidential information of ours or our sellers, and other destructive outcomes. Moreover, third-party security breaches or errors in our hardware design or manufacture could cause product safety issues typical of consumer electronics devices. Such issues could lead to product recalls and inventory shortages, result in costly and time-consuming efforts to redesign and redistribute our products, give rise to regulatory inquiries and investigations, and result in lawsuits and other liabilities and losses, which could have a material and adverse effect on our business.

Additionally, electronic payment products and services, including ours, have been and could continue to be in the future, specifically targeted and penetrated or disrupted by hackers, and our data encryption may be unable to prevent unauthorized use. Because the techniques used to obtain unauthorized access to data, products and services, and disable, alter, degrade, or sabotage them, change frequently and may be difficult to detect or remediate for long periods of time, we and our customers may be unable to anticipate these techniques or implement adequate preventative measures to stop them. If we or our sellers are unable to anticipate or prevent these attacks, our sellers' businesses may be harmed, our reputation could be damaged, and we could incur significant liability.

Systems failures, interruptions, delays in service, catastrophic events, and resulting interruptions in the availability of our products or services, or those of our sellers, could harm our business and our brand, and subject us to substantial liability.

Our systems and those of our third-party data center facilities may experience service interruptions, denial-of-service and other cyber-attacks, human error, earthquakes, hurricanes, floods, fires, natural disasters, power losses, disruptions in telecommunications services, fraud, military or political conflicts, terrorist attacks and other geopolitical unrest, computer viruses, or other events. Our systems are also subject to break-ins, sabotage, and acts of vandalism. Some of our systems are not fully redundant, and our disaster-recovery planning is not sufficient for all eventualities. In addition, as a provider of payments solutions, we are subject to increased scrutiny by regulators that may require specific business continuity and disaster recovery plans and more rigorous testing of such plans. This increased scrutiny may be costly and time-consuming and may divert our resources from other business priorities.

We have experienced and will likely continue to experience denial-of-service attacks, system failures, and other events or conditions that interrupt the availability or reduce the speed or functionality of our products and services. These events have resulted and likely will result in loss of revenue. In addition, they could result in significant expense to repair or replace damaged equipment and remedy resultant data loss or corruption. A prolonged interruption in the availability or reduction in the speed or other functionality of our products or services could materially harm our reputation and business. Frequent or persistent interruptions in our products and services could cause sellers to believe that our products and services are unreliable, leading them to switch to our competitors or to avoid our products and services, and could permanently harm our reputation and business. Moreover, to the extent that any system failure or similar event results in damages to customers or their businesses, these customers could seek compensation from us for their losses, and those claims, even if unsuccessful, would likely be time-consuming and costly for us to address.

A significant natural disaster could have a material and adverse impact on our business. Our headquarters and certain of our data center facilities are located in the San Francisco Bay Area, a region known for seismic activity. Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problems at our headquarters or data centers could result in lengthy interruptions in our services or could result in related liabilities. We have implemented a disaster recovery program, which enables us to move production to a back-up data center in the event of a catastrophe.

Although this program is functional, it may prove to be inadequate, increasing the risk of interruptions in our services, which could have a material and adverse impact on our business. We do not maintain insurance sufficient to compensate us for the potentially significant losses that could result from disruptions to our services.

Significant natural or other disasters could also have a material and adverse impact on our sellers, which, in the aggregate, could in turn adversely affect our results of operations.

Square Capital is subject to additional risks relating to the availability of capital, seller receivables payments, availability and structure of its bank partnership and general macroeconomic conditions.

Square Capital, which includes our wholly owned subsidiary Square Capital, LLC, is subject to risks in addition to those described elsewhere in this Annual Report on Form 10-K. Maintaining and growing Square Capital is dependent on institutional third-party investors purchasing the loans originated by our bank partner. If such third parties fail to continue to purchase such loans or reduce the amount of future loans they purchase, then our bank partner may need to reduce originations, or we would need to fund the purchase of additional loans from our own resources. We then may have to reduce the scale of Square Capital, which could have a direct impact on our continued growth. If third parties reduce the price they are willing to pay for these loans or reduce the servicing fees they pay us in exchange for servicing the loans on their behalf, then the financial performance of Square Capital would be harmed.

Adverse changes in macroeconomic conditions could cause some Square sellers who utilize Square Capital to cease operating or to experience a decline in their payment processing volume, thereby rendering them unable to make payment on the receivables, unable to make repayment of loans and/or extend the repayment period beyond the contractual repayment terms on the loan. Sellers are contractually obligated to use Square as their only card payment processing service until the agreed-upon fixed amount of receivables or repayment of loans is made. To the extent a seller breaches this obligation, the seller would be liable for the balance of the receivables in respect of an MCA or an accelerated loan repayment, where Square Capital's recourse is to the business and not to any individual or other asset.

In addition, adverse changes in macroeconomic conditions could lead to a decrease in the number of sellers eligible for Square Capital facilitated loans and strain our ability to correctly identify such sellers on behalf of our bank partner or manage the risk of non-payment or fraud as servicer of the loans. Similarly, if we fail to correctly predict or price the loans to sellers utilizing Square Capital, our business may be materially and adversely affected.

We have partnered with a Utah-chartered, member FDIC industrial bank to originate the loans. There has been, and may continue to be, regulatory interest in and/or litigation challenging partnered lending arrangements where a bank makes loans and then sells and assigns such loans to a non-bank entity that is engaged in assisting with the origination and servicing of the loan. If our bank partner ceases to partner with us, ceases to abide by the terms of our agreement with them, or cannot partner with us on commercially reasonable terms, and we are not able to find suitable alternatives and/or obtain licenses to make loans ourselves, Square Capital may need to enter into a new partnership with another qualified financial institution, or revert to the MCA model, both of which may be time-consuming and costly, and as a result Square Capital may be materially and adversely affected.

We intend to continue to explore other models and structures for Square Capital, including other forms of credit. Some of those models or structures may require, or be deemed to require, additional procedures, partnerships, licenses, or capabilities that we have not yet obtained or developed. Should we fail to expand and evolve Square Capital in this manner, or should these new models or structures, or new regulations or interpretations of existing regulations, impose requirements on us that are impractical or that we cannot satisfy, the future growth and success of Square Capital may be materially and adversely affected.

Our business is subject to extensive regulation and oversight in a variety of areas, all of which are subject to change and uncertain interpretation.

We are subject to a wide variety of local, state, federal, and international laws, regulations, and industry standards in the United States and in other countries in which we operate. These laws and regulations govern numerous areas that are important to our business, including consumer protection, privacy, fair lending, financial services, labor and employment, immigration, import and export practices, product labeling, competition, data protection, and marketing and communications practices, to name a few. Such laws and regulations are subject to changes and evolving interpretations and application, including by means of legislative changes and/or executive orders, and it can be difficult to predict how they may be applied to our business and the way we conduct our operations, particularly as we introduce new products and services and expand into new jurisdictions. Any perceived or actual breach of laws and regulations could result in investigations, regulatory inquiries, litigation, fines, or otherwise negatively impact our business. It is possible that these laws and regulations could be interpreted or applied in a manner that would prohibit, alter, or impair our existing or planned products and services; that could cause us to be subject to audits, inquiries, or investigations; that could result in fines, injunctive relief, or other penalties; or that could require costly, time-consuming, or otherwise burdensome compliance measures from us.

In particular, as we seek to build a trusted and secure platform for commerce, and as we expand our network of sellers and buyers and facilitate their transactions and interactions with one another, we will increasingly be subject to laws and regulations relating to the collection, use, retention, security, and transfer of information, including the personally identifiable information of our employees and sellers and their customers. As with the other laws and regulations noted above, these laws and regulations may change or be interpreted and applied differently over time and from jurisdiction to jurisdiction, and it is possible they will be interpreted and applied in ways that will materially and adversely affect our business. Moreover, we may not be able to respond quickly to regulatory, legislative and other developments, and these changes may in turn increase our cost of doing business. In addition, if our practices are not consistent or viewed as not consistent with changes in laws and regulations or new interpretations of existing laws and regulations, we may become subject to lawsuits, penalties, and other liabilities that did not previously apply.

We have incurred, and may continue to incur, significant expenses to comply with mandatory privacy and security standards and protocols imposed by law, regulation, industry standards or contractual obligations. We post on our website our privacy policies and practices concerning the collection, use, and disclosure of information. Any failure, real or perceived, by us to comply with our posted privacy policies or with any regulatory requirements or orders or other local, state, federal, or international privacy or consumer protection-related laws and regulations could cause sellers or their customers to reduce their use of our products and services and could materially and adversely affect our business.

Our business is subject to complex and evolving regulations and oversight related to our provision of payments services and other financial services.

The laws, rules, regulations, and licensing schemes that govern our business include or may in the future include those relating to banking, lending, deposit-taking, cross-border and domestic money transmission, foreign exchange, payments services

26

(such as payment processing and settlement services), consumer financial protection, anti-money laundering, escheatment, and compliance with the Payment Card Industry Data Security Standard, a set of requirements designed to ensure that all companies that process, store, or transmit payment card information maintain a secure environment to protect cardholder data. These laws, rules, and regulations are enforced by multiple authorities and governing bodies in the United States, including the Department of the Treasury, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, and numerous state and local agencies. Outside of the United States, we are subject to additional laws, rules, and regulations related to the provision of payments and financial services, including those enforced by the Ministry of Economy, Trade, and Industry in Japan, and those enforced by the Australian Transaction Reports and Analysis Centre. As we expand into new jurisdictions, the number of foreign regulations and regulators governing our business will expand as well. Square Capital has shifted from offering MCAs to facilitating loans through a partnership with a Utah-chartered, member FDIC industrial bank. In this transition, additional state and federal lending requirements have become applicable. In addition, as our business continues to develop and expand, we may become subject to additional rules and regulations. Similarly, if we choose to offer Square Payroll in more jurisdictions, additional regulations, including tax rules, will apply.

Although we have a compliance program focused on applicable laws, rules, and regulations and are continually investing more in this program, we may still be subject to fines or other penalties in one or more jurisdictions levied by federal, state or local regulators, including state Attorneys General and private plaintiffs who may be acting as private attorneys general pursuant to various applicable federal, state and local laws, as well as those levied by foreign regulators. In addition to fines, penalties for failing to comply with applicable rules and regulations could include significant criminal and civil lawsuits, forfeiture of significant assets, increased licensure requirements, or other enforcement actions. We could also be required to make changes to our business practices or compliance programs as a result of regulatory scrutiny. In addition, any perceived or actual breach of compliance by us with respect to applicable laws, rules, and regulations could have a significant impact on our reputation as a trusted brand and could cause us to lose existing customers, prevent us from obtaining new customers, require us to expend significant funds to remedy problems caused by breaches and to avert further breaches, and expose us to legal risk and potential liability.

We have obtained licenses to operate as a money transmitter (or its equivalent) in the United States and in the states where this is required. As a licensed money transmitter, we are subject to obligations and restrictions with respect to the investment of customer funds, reporting requirements, bonding requirements, and inspection by state regulatory agencies concerning those aspects of our business considered money transmission. Evaluation of our compliance efforts, as well as the questions of whether and to what extent our products and services are considered money transmission, are matters of regulatory interpretation and could change over time. In the past, we have been subject to fines and other penalties by regulatory authorities due to their interpretations and applications to our business of their respective state money transmission laws. In the future, as a result of the regulations applicable to our business, we could be subject to investigations and resulting liability, including governmental fines, restrictions on our business, or other sanctions, and we could be forced to cease conducting certain aspects of our business with residents of certain jurisdictions, be forced to otherwise change our business practices in certain jurisdictions, or be required to obtain additional licenses or regulatory approvals. There can be no assurance that we will be able to obtain any such licenses, and, even if we were able to do so, there could be substantial costs and potential product changes involved in maintaining such licenses, which could have a material and adverse effect on our business.

We are subject to risks related to litigation, including intellectual property claims and regulatory disputes.

We may be, and have been, subject to claims, lawsuits (including class actions and individual lawsuits), government investigations, and other proceedings involving intellectual property, consumer protection, privacy, labor and employment, immigration, import and export practices, product labeling, competition, accessibility, securities, tax, marketing and communications practices, commercial disputes, and other matters. For example, we are involved in putative class action lawsuits concerning independent contractors in connection with our Caviar business, alleging that the couriers have been improperly denied reimbursement for business expenses due to their classification as independent contractors.

The number and significance of our legal disputes and inquiries have increased as we have grown larger, as our business has expanded in scope and geographic reach, and as our products and services have increased in complexity.

Becoming a public company has raised our public profile, which could result in increased litigation. In addition, some of the laws and regulations affecting the internet, mobile commerce, payment processing, business financing, and employment did not anticipate businesses like ours, and many of the laws and regulations affecting us have been enacted relatively recently. As a result, there is substantial uncertainty regarding the scope and application of many of the laws and regulations to which

27

we are subject, which increases the risk that we will be subject to claims alleging violations of those laws and regulations. We may also be accused of having, or be found to have, infringed or violated third-party intellectual property rights.

Regardless of the outcome, legal proceedings can have a material and adverse impact on us due to their costs, diversion of our resources, and other factors. Plaintiffs may seek, and we may become subject to, preliminary or provisional rulings in the course of litigation, including preliminary injunctions requiring us to cease some or all of our operations. We may decide to settle legal disputes on terms that are unfavorable to us. Furthermore, if any litigation to which we are a party is resolved adversely, we may be subject to an unfavorable judgment that we may not choose to appeal or that may not be reversed upon appeal. We may have to seek a license to continue practices found to be in violation of a third party's rights. If we are required, or choose to enter into, royalty or licensing arrangements, such arrangements may not be available on reasonable terms or at all and may significantly increase our operating costs and expenses. As a result, we may also be required to develop or procure alternative non-infringing technology or discontinue use of technology, and doing so could require significant effort and expense or may not be feasible. In addition, the terms of any settlement or judgment in connection with any legal claims, lawsuits, or proceedings may require us to cease some or all of our operations or pay substantial amounts to the other party and could materially and adversely affect our business.

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

Our trade secrets, trademarks, copyrights, patents, and other intellectual property rights are critical to our success. We rely on, and expect to continue to rely on, a combination of confidentiality, invention assignment, and license agreements with our employees, consultants, and third parties with whom we have relationships, as well as trademark, trade dress, domain name, copyright, trade secret, and patent rights, to protect our brand and other intellectual property rights. However, various events outside of our control may pose a threat to our intellectual property rights, as well as to our products and services. Effective protection of trademarks, copyrights, domain names, patent rights, and other intellectual property rights is expensive and difficult to maintain, both in terms of application and maintenance costs, as well as the costs of defending and enforcing those rights. The efforts we have taken to protect our intellectual property rights may not be sufficient or effective. Our intellectual property rights may be infringed, misappropriated, or challenged, which could result in them being narrowed in scope or declared invalid or unenforceable. Similarly, our reliance on unpatented proprietary information and technology, such as trade secrets and confidential information, depends in part on agreements we have in place with employees and third parties that place restrictions on the use and disclosure of this intellectual property. These agreements may be insufficient or may be breached, or we may not enter into sufficient agreements with such individuals in the first instance, in either case potentially resulting in the unauthorized use or disclosure of our trade secrets and other intellectual property, including to our competitors, which could cause us to lose any competitive advantage resulting from this intellectual property. Individuals not subject to invention assignment agreements may make adverse ownership claims to our current and future intellectual property. There can be no assurance that our intellectual property rights will be sufficient to protect against others offering products or services that are substantially similar to ours and that compete with our business.

As of December 31, 2016, we had 229 patents issued in the United States and abroad and 588 patent applications on file in the United States and abroad, though there can be no assurance that any or all of these applications will ultimately be issued as patents. We also pursue registration of copyrights, trademarks, and domain names in the United States and in certain jurisdictions outside of the United States, but doing so may not always be successful or cost-effective. In general, we may be unable or, in some instances, choose not to obtain legal protection for our intellectual property, and our existing and future intellectual property rights may not provide us with competitive advantages or distinguish our products and services from those of our competitors. The laws of some foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States, and effective intellectual property protection and mechanisms may not be available in those jurisdictions. We may need to expend additional resources to defend our intellectual property in these countries, and the inability to do so could impair our business or adversely affect our international expansion. Our intellectual property rights may be contested, circumvented, or found unenforceable or invalid, and we may not be able to prevent third parties from infringing, diluting, or otherwise violating them.

Significant impairments of our intellectual property rights, and limitations on our ability to assert our intellectual property rights against others, could have a material and adverse effect on our business.

We may not be able to secure financing on favorable terms, or at all, to meet our future capital needs.

We have funded our operations since inception primarily through equity financings, bank credit facilities, and capital lease arrangements. We have just begun to generate sufficient cash to fund our ongoing operations, and there is no guarantee that we will be able to continue to do so in the future. In the future, we may require additional capital to respond to business opportunities, refinancing needs, challenges, regulatory surety bond requirements, acquisitions, or unforeseen circumstances and may decide to engage in equity or debt financings or enter into credit facilities for other reasons, and we may not be able to secure any such additional debt or equity financing or refinancing on favorable terms, in a timely manner, or at all. Any debt financing obtained by us in the future could also involve restrictive covenants relating to our capital-raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. Our credit facility contains operating covenants, including customary limitations on the incurrence of certain indebtedness and liens, restrictions on certain inter-company transactions, and limitations on the amount of dividends and stock repurchases. Our ability to comply with these covenants may be affected by events beyond our control, and breaches of these covenants could result in a default under the credit facility and any future financial agreements into which we may enter. If not waived, defaults could cause our outstanding indebtedness under our credit facility and any future financing agreements that we may enter into to become immediately due and payable.

If we raise additional funds through further issuances of equity, convertible debt securities, or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences, and privileges senior to those of holders of our Class A common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to grow or support our business and to respond to business challenges could be significantly limited.

Any acquisitions, strategic investments, entries into new businesses, divestitures, and other transactions could fail to achieve strategic objectives, disrupt our ongoing operations, and harm our business.

In pursuing our business strategy, we routinely conduct discussions and evaluate opportunities for possible acquisitions, strategic investments, entries into new businesses, divestitures, and other transactions. We continue to seek to acquire or invest in businesses, apps, or technologies that we believe could complement or expand our products and services, enhance our technical capabilities, or otherwise offer growth opportunities. The identification, evaluation, and negotiation of potential acquisitions or divestitures may divert the attention of management and entail various expenses, whether or not such transactions are ultimately completed. We also have limited experience in acquiring other businesses. In addition to opportunity costs, these transactions involve large challenges and risks, whether or not such transactions are completed, including risks that:

- the transaction may not advance our business strategy;
- we may be unable to identify opportunities on terms acceptable to us;
- we may not realize a satisfactory return or increase our revenue;
- we may experience disruptions on our ongoing operations and divert management's attention;
- we may be unable to retain key personnel;
- we may experience difficulty in integrating technologies, IT systems, accounting systems, culture, or personnel;
- acquired businesses may not have adequate controls, processes and procedures to ensure compliance with laws and regulations, and our due diligence process may not identify compliance issues or other liabilities;
- we may assume additional financial or legal exposure, including exposure that is known to us;
- we may have difficulty entering new market segments;
- we may be unable to retain the customers and partners of acquired businesses;
- there may be unknown, underestimated, or undisclosed commitments or liabilities, including actual or threatened litigation;

29

- there may be regulatory constraints, particularly competition regulations that may affect the extent to which we can maximize the value of our acquisitions or investments; and
- acquisitions could result in dilutive issuances of equity securities or the incurrence of debt.

We may also choose to divest certain businesses or product lines that no longer fit with our strategic objectives. If we decide to sell assets or a business, we may have difficulty obtaining financing or selling on acceptable terms in a timely manner. Additionally, we may experience difficulty separating out portions of or entire businesses, incur potential loss of revenue or experience negative impact on margins. Such potential transactions may also delay achievement of our strategic objectives, cause us to incur additional expenses, potentially disrupt seller relationships, and expose us to unanticipated or ongoing obligations and liabilities.

Our reported financial results may be materially and adversely affected by changes in accounting principles generally accepted in the United States.

Generally accepted accounting principles in the United States are subject to interpretation by the Financial Accounting Standards Board (FASB), the SEC, and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results and could materially and adversely affect the transactions completed before the announcement of a change.

We may have exposure to greater-than-anticipated tax liabilities, which may materially and adversely affect our business.

We are subject to income taxes and non-income taxes in the United States and other countries in which we conduct business, and such laws and rates vary by jurisdiction. We are subject to review and audit by U.S. federal, state, local and foreign tax authorities. Such tax authorities may disagree with tax positions we take and if any such tax authority were to successfully challenge any such position, our financial results and operations could be materially and adversely affected. In addition, our future tax liability could be adversely affected by changes in tax laws, rates, and regulations. The determination of our worldwide provision for income and other taxes is highly complex and requires significant judgment, and there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our estimates are reasonable, the amount ultimately payable may differ from amounts recorded in our financial statements and may materially affect our financial results in the period or periods for which such determination is made.

Risks Related to Ownership of Our Common Stock

The dual class structure of our common stock has the effect of concentrating voting control within our stockholders who held our stock prior to our initial public offering, including many of our employees and directors and their affiliates; this will limit or preclude your ability to influence corporate matters.

Our Class B common stock has ten votes per share, and our Class A common stock has one vote per share. Stockholders who hold shares of Class B common stock, including many of our executive officers, employees, and directors and their affiliates, held approximately 89.3% of the voting power of our combined outstanding capital stock as of December 31, 2016. Our executive officers and directors and their affiliates held approximately 60.8% of the voting power of our combined outstanding capital stock as of December 31, 2016. Because of the ten-to-one voting ratio between our Class B and Class A common stock, the holders of our Class B common stock collectively hold more than a majority of the combined voting power of our common stock, and therefore such holders are able to control all matters submitted to our stockholders for approval. When the shares of our Class B common stock represent less than 5% of the combined voting power of our Class A common stock and Class B common stock, the then-outstanding shares of Class B common stock will automatically convert into shares of Class A common stock.

Transfers by holders of Class B common stock will generally result in those shares converting to Class A common stock, subject to limited exceptions, such as certain transfers to entities, including certain charities and foundations, to the extent the transferor retains sole dispositive power and exclusive voting control with respect to the shares of Class B common stock. Such conversions of Class B common stock to Class A common stock upon transfer will have the effect, over time, of increasing the relative voting power of those holders of Class B common stock who retain their shares in the long term. If, for example, our stockholders who held our stock prior to our initial public offering retain a significant portion of their holdings of Class B common stock for an extended period of time, they could, in the future, continue to control a majority of the combined voting power of our outstanding capital stock.

We will continue to incur significantly increased costs and devote substantial management time as a result of operating as a public company.

As a public company, we incur significant legal, financial, and other expenses that we did not incur as a private company. We are subject to the reporting requirements of the Exchange Act and are required to comply with the applicable requirements of the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as the rules and regulations subsequently implemented by the SEC and the listing standards of the New York Stock Exchange, including changes in corporate governance practices and the establishment and maintenance of effective disclosure and financial controls. Continuing to comply with these requirements may increase our legal and financial compliance costs and may make some activities more time consuming and costly. In addition, our management and other personnel must divert attention from operational and other business matters to devote substantial time to these requirements. If we are unable to continue to meet these requirements, we may not be able to remain listed on the NYSE, which could result in potential loss of confidence by our sellers and employees, loss of institutional investor interest, fewer business development opportunities, class action or shareholder derivative lawsuits, depressed stock price, limited liquidity of our Class A common stock, and other material adverse consequences. Moreover, we could incur additional compensation costs in the event that we decide to pay cash compensation closer to that of other public technology companies, which would increase our general and administrative expenses and could materially and adversely affect our profitability.

If we are unable to maintain effective disclosure controls and internal controls over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports, and the market price of our Class A common stock may be materially and adversely affected.

We are continuing to develop and refine our disclosure controls and improve our internal controls over financial reporting. We have expended, and anticipate that we will continue to expend, significant resources in order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting.

Our current controls and any new controls that we develop may become inadequate because of changes in conditions in our business. If we identify material weaknesses in our disclosure controls or internal control over financial reporting in the future, we will be unable to assert that our internal controls are effective. If we are unable to do so, or if our auditors are unable to attest to management's report on the effectiveness of our internal controls, we could lose investor confidence in the accuracy and completeness of our financial reports, which could cause the price of our Class A common stock to decline. We have identified significant deficiencies in our internal control over financial reporting in the past and have taken steps to remediate such deficiencies. However, our efforts to remediate them may not be effective or prevent any future deficiency in our internal controls. We are required to disclose material changes made in our internal controls and procedures on a quarterly basis.

Any failure to maintain effective disclosure controls and internal control over financial reporting could have a material and adverse effect on our business and operating results, and cause a decline in the market price of our Class A common stock.

The market price of our Class A common stock has been and will likely continue to be volatile, and you could lose all or part of your investment.

The market price of our Class A common stock has been and may continue to be subject to wide fluctuations in response to various factors, some of which are beyond our control and may not be related to our operating performance. In addition to the factors discussed in this "Risk Factors" section and elsewhere in this Annual Report on Form 10-K, factors that could cause fluctuations in the market price of our Class A common stock include the following:

- price and volume fluctuations in the overall stock market from time to time;
- volatility in the market prices and trading volumes of companies in our industry or companies that investors consider comparable;
- changes in operating performance and stock market valuations of other companies generally or of those in our industry in particular;

- sales of shares of our common stock by us or our stockholders;
- failure of securities analysts to maintain coverage and/or to provide accurate consensus results of us, changes in financial estimates by securities analysts who follow us, or our failure to meet these estimates or the expectations of investors;
- the financial or other projections we may provide to the public, any changes in those projections, or our failure to meet those projections;
- announcements by us or our competitors of new products or services;
- public reaction to our press releases, other public announcements, and filings with the SEC;
- rumors and market speculation involving us or other companies in our industry;
- actual or anticipated changes in our results of operations;
- changes in the regulatory environment;
- actual or anticipated developments in our business, our competitors' businesses, or the competitive landscape generally;
- litigation involving us, our industry, or both, or investigations by regulators into our operations or those of our competitors;
- announced or completed acquisitions of businesses or technologies by us or our competitors;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidelines, interpretations, or principles;
- any significant change in our management; and
- general economic conditions and slow or negative growth of our markets.

In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. This litigation, if instituted against us, could result in substantial costs and a diversion of our management's attention and resources.

Anti-takeover provisions contained in our amended and restated certificate of incorporation, our amended and restated bylaws, and provisions of Delaware law, could impair a takeover attempt.

Our amended and restated certificate of incorporation, our amended and restated bylaws, and Delaware law contain provisions which could have the effect of rendering more difficult, delaying, or preventing an acquisition deemed undesirable by our board of directors and therefore depress the trading price of our Class A common stock.

Among other things, our amended and restated certificate of incorporation and amended and restated bylaws include provisions (i) creating a classified board of directors whose members serve staggered three-year terms; (ii) authorizing "blank check" preferred stock, which could be issued by our board of directors without stockholder approval and may contain voting, liquidation, dividend, and other rights superior to our common stock; (iii) limiting the ability of our stockholders to call special meetings; (iv) eliminating the ability of our stockholders to act by written consent without a meeting or to remove directors without cause; and (v) requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors. These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents certain stockholders holding more than 15% of our outstanding capital stock from

engaging in certain business combinations without the approval of our board of directors or the holders of at least two-thirds of our outstanding capital stock not held by such stockholder.

Any provision of our amended and restated certificate of incorporation, amended and restated bylaws, or Delaware law that has the effect of delaying or preventing a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our capital stock and could also affect the price that some investors are willing to pay for our Class A common stock.

Our amended and restated bylaws provide that the Court of Chancery of the State of Delaware will be the sole and exclusive forum for substantially all disputes between us and our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers, or employees.

Our amended and restated bylaws provide that, unless we consent to the selection of an alternative forum, the Court of Chancery of the State of Delaware is the sole and exclusive forum for (i) any derivative action or proceeding brought on our behalf; (ii) any action asserting a claim of breach of fiduciary duty owed by any of our directors, officers, or other employees to us or to our stockholders; (iii) any action asserting a claim arising pursuant to the Delaware General Corporation Law; or (iv) any action asserting a claim governed by the internal affairs doctrine. The choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers, or other employees, which may discourage such lawsuits against us and our directors, officers, and other employees. Alternatively, if a court were to find the choice of forum provision contained in our amended and restated bylaws to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could have a material and adverse impact on our business.

If securities or industry analysts publish reports that are interpreted negatively by the investment community, publish negative research reports about our business, or cease coverage of our company or fail to regularly publish reports on us, our share price and trading volume could decline.

The trading market for our Class A common stock depends, to some extent, on the research and reports that securities or industry analysts publish about us, our business, our market, or our competitors. We do not have any control over these analysts or the information contained in their reports. If one or more analysts publish research reports that are interpreted negatively by the investment community, or have a negative tone regarding our business, financial or operating performance, industry or end-markets, our share price could decline. In addition, if a majority of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

We do not intend to pay dividends for the foreseeable future.

We currently intend to retain any future earnings to finance the operation and expansion of our business, and we do not expect to declare or pay any dividends in the foreseeable future. As a result, you may only receive a return on your investment in our common stock if the trading price of our common stock increases. Investors seeking cash dividends should not purchase shares of our common stock.

Additional stock issuances could result in significant dilution to our stockholders.

We may issue additional equity securities to raise capital, make acquisitions, or for a variety of other purposes. Additional issuances of our stock may be made pursuant to the exercise or conversion of new or existing convertible debt securities, warrants, stock options, or other equity incentive awards to new and existing service providers. Any such issuances will result in dilution to existing holders of our stock. We rely on equity-based compensation as an important tool in recruiting and retaining employees. The amount of dilution due to equity-based compensation of our employees and other additional issuances could be substantial.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our corporate headquarters, which include product development, sales, marketing, and business operations, are located in San Francisco, California. It consists of 338,910 square feet of space under a lease that expires in 2023. We also lease 43,689 square feet in New York, New York for a product development, sales, and business operations office under a lease that expires in 2025. We have offices in several other locations and believe our facilities are sufficient for our current needs.

Item 3. LEGAL PROCEEDINGS

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

We are involved in a class action lawsuit concerning independent contractors in connection with our 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 our 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. We filed our 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, we 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, we are involved in various other litigation matters and disputes arising in the ordinary course of business. We cannot at this time fairly estimate a reasonable range of exposure, if any, of the potential liability with respect to these other matters. While we do not believe, at this time, that any ultimate liability resulting from any of these other matters will have a material adverse effect on our results of operations, financial position, or liquidity, we cannot give any assurance regarding the ultimate outcome of these other matters, and their resolution could be material to our operating results for any particular period, depending on the level of income for the period.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information for Common Stock

Our Class A common stock began trading on the New York Stock Exchange under the symbol "SQ" on November 19, 2015. Prior to that date, there was no public trading market for our Class A common stock. The following table sets forth the high and low sales price per share of our Class A common stock as reported on the New York Stock Exchange for the period indicated:

Year Ended December 31, 2016	High	Low
First Quarter	$15.91	$8.06
Second Quarter	$15.87	$8.42
Third Quarter	$12.54	$8.78
Fourth Quarter	$14.82	$10.88
Year Ended December 31, 2015		
Fourth Quarter (from November 19, 2015)	$14.78	$9.00

Holders of Record

As of February 17, 2017, there were 46 holders of record of our Class A common stock and 168 holders of record of our Class B common stock. Because many of our shares of Class A common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of beneficial owners of our Class A common stock represented by these record holders.

Dividend Policy

We have never declared nor paid any cash dividends on our capital stock. We currently intend to retain all available funds and any future earnings for use in the operation of our business and do not expect to pay any dividends on our capital stock in the foreseeable future. Any future determination relating to our dividend policy will be at the discretion of our board of directors, subject to applicable laws, and will depend on our financial condition, results of operations, capital requirements, general business conditions, and other factors that our board of directors considers relevant.

Unregistered Sales of Equity Securities

None.

Issuer Purchases of Equity Securities
None.

Performance Graph

This performance graph shall not be deemed “soliciting material” or to be “filed” with the SEC for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act), or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Square, Inc. under the Securities Act of 1933, as amended, or the Exchange Act.
The following graph compares the cumulative total return to stockholders on our common stock relative to the cumulative total returns of the Standard & Poor’s 500 Index, or S&P 500, and the S&P North American Technology Index. An investment of $100 (with reinvestment of all dividends) is assumed to have been made in our Class A common stock and in each index on November 19, 2015, the date our Class A common stock began trading on the NYSE, and its relative performance is tracked through December 31, 2016. The returns shown are based on historical results and are not intended to suggest future performance.

Company/Index	11/19/2015	12/31/2015	12/31/2016
Square, Inc.	100	100.15	104.28
S&P 500	100	98.72	110.52
S&P North American Technology	100	99.20	111.15

Item 6. SELECTED FINANCIAL DATA

The following selected consolidated statement of operations data for the years ended December 31, 2016, 2015, and 2014, and the consolidated balance sheet data as of December 31, 2016, and 2015, have been derived from our audited consolidated financial statements and should be read in conjunction with the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. The following selected consolidated statement of operations data for the years ended December 31, 2013, and 2012, and the consolidated balance sheet data as of December 31, 2014, and 2013, are derived from our audited consolidated financial statements which are not included in this Annual Report on Form 10-K.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenue:					
Transaction-based revenue	$1,456,160	$1,050,445	$707,799	$433,737	$193,978
Starbucks transaction-based revenue	78,903	142,283	123,024	114,456	9,471
Subscription and services-based revenue	129,351	58,013	12,046	—	—
Hardware revenue	44,307	16,377	7,323	4,240	—
Total net revenue	1,708,721	1,267,118	850,192	552,433	203,449
Cost of revenue:					
Transaction-based costs	943,200	672,667	450,858	277,833	126,351
Starbucks transaction-based costs	69,761	165,438	150,955	139,803	12,547
Subscription and services-based costs	43,132	22,470	2,973	—	—
Hardware costs	68,562	30,874	18,330	6,012	—
Amortization of acquired technology	8,028	5,639	1,002	—	—
Total cost of revenue	1,132,683	897,088	624,118	423,648	138,898
Gross profit	576,038	370,030	226,074	128,785	64,551
Operating expenses:				—	
Product development	268,537	199,638	144,637	82,864	46,568
Sales and marketing	173,876	145,618	112,577	64,162	56,648
General and administrative	251,993	143,466	94,220	68,942	36,184
Transaction, loan and advance losses	51,235	54,009	24,081	15,329	10,512
Amortization of acquired customer assets	850	1,757	1,050	—	—
Impairment of intangible assets	—	—	—	2,430	—
Total operating expenses	746,491	544,488	376,565	233,727	149,912
Operating loss	(170,453)	(174,458)	(150,491)	(104,942)	(85,361)
Interest and other (income) expense, net	(780)	1,613	2,162	(962)	(162)
Loss before income tax	(169,673)	(176,071)	(152,653)	(103,980)	(85,199)
Provision for income taxes	1,917	3,746	1,440	513	—
Net loss	(171,590)	(179,817)	(154,093)	(104,493)	(85,199)
Deemed dividend on Series E preferred stock	—	(32,200)	—	—	—
Net loss attributable to common stockholders	$(171,590)	$(212,017)	$(154,093)	$(104,493)	$(85,199)
Net loss per share attributable to common stockholders:					
Basic	$(0.50)	$(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

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.

42

- 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)

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.

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

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

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 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	2014 to 2015
	2016	2015	2014	% Change	% Change
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. T