TEVA PHARMACEUTICAL INDUSTRIES LTD
Form 10-Q
November 01, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 001-16174

TEVA PHARMACEUTICAL INDUSTRIES LIMITED

(Exact name of registrant as specified in its charter)

Israel	**Not Applicable**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification Number)**
5 Basel Street, Petach Tikva, ISRAEL	**4951033**
(Address of principal executive offices)	**(Zip code)**

+972 (3) 914-8171

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 30, 2018, the registrant had 1,018,711,443 ordinary shares outstanding.

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

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INTRODUCTION AND USE OF CERTAIN TERMS

Unless otherwise indicated, all references to the Company, we, our and Teva refer to Teva Pharmaceutical Industrie Limited and its subsidiaries, and references to revenues refer to net revenues. References to U.S. dollars, dollars, U.S $ and $ are to the lawful currency of the United States of America, and references to NIS are to new Israeli shekels. References to MS are to multiple sclerosis. Market data, including both sales and share data, is based on information provided by IQVIA (formerly IMS Health Inc.), a provider of market research to the pharmaceutical industry (IQVIA), unless otherwise stated. References to Actavis Generics are to the generic pharmaceuticals business we purchased from Allergan plc (Allergan) on August 2, 2016. References to R&D are to Research and Development, references to IPR&D are to in-process R&D, references to S&M are to Selling and Marketing and references to G&A are to General and Administrative. Some amounts in this report may not add up due to rounding. All percentages have been calculated using unrounded amounts.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

In addition to historical information, this Quarterly Report on Form 10-Q, and the reports and documents incorporated by reference in this Quarterly Report on Form 10-Q, may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are based on management s current beliefs and expectations and are subject to substantial risks and uncertainties, both known and unknown, that could cause our future results, performance or achievements to differ significantly

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from that expressed or implied by such forward-looking statements. You can identify these forward-looking statements by the use of words such as should, expect, anticipate, estimate, target, may, project, guidance plan, believe and other words and terms of similar meaning and expression in connection with any discussion of future operating or financial performance. Important factors that could cause or contribute to such differences include risks relating to:

- our ability to successfully compete in the marketplace, including: that we are substantially dependent on our generic products; competition for our specialty products, especially COPAXONE®, our leading medicine, which faces competition from existing and potential additional generic versions and orally-administered alternatives; competition from companies with greater resources and capabilities; efforts of pharmaceutical companies to limit the use of generics, including through legislation and regulations; consolidation of our customer base and commercial alliances among our customers; the increase in the number of competitors targeting generic opportunities and seeking U.S. market exclusivity for generic versions of significant products; price erosion relating to our products, both from competing products and increased regulation; delays in launches of new products and our ability to achieve expected results from investments in our product pipeline; our ability to take advantage of high-value opportunities; the difficulty and expense of obtaining licenses to proprietary technologies; and the effectiveness of our patents and other measures to protect our intellectual property rights;

- our substantial indebtedness, which may limit our ability to incur additional indebtedness, engage in additional transactions or make new investments, may result in a further downgrade of our credit ratings; and our inability to raise debt or borrow funds in amounts or on terms that are favorable to us;

- our business and operations in general, including: failure to effectively execute our restructuring plan announced in December 2017; uncertainties related to, and failure to achieve, the potential benefits and success of our new senior management team and organizational structure; harm to our pipeline of future products due to the ongoing review of our R&D programs; our ability to develop and commercialize additional pharmaceutical products; potential additional adverse consequences following our resolution with the U.S. government of our FCPA investigation; compliance with sanctions and other trade control laws; manufacturing or quality control problems, which may damage our reputation for quality production and require costly remediation; interruptions in our supply chain; disruptions of our or third party information technology systems or breaches of our data security; the failure to recruit or retain key personnel; variations in intellectual property laws that may adversely affect our ability to manufacture our products; challenges associated with conducting business globally, including adverse effects of political or economic instability, major hostilities or terrorism; significant sales to a limited number of customers in our U.S. market; our ability to successfully bid for suitable acquisition targets or licensing opportunities, or to consummate and integrate acquisitions; and our prospects and opportunities for growth if we sell assets;

- compliance, regulatory and litigation matters, including: costs and delays resulting from the extensive governmental regulation to which we are subject; the effects of reforms in healthcare regulation and reductions in pharmaceutical pricing, reimbursement and coverage; governmental investigations into S&M practices; potential liability for patent infringement; product liability claims; increased government scrutiny of our patent settlement agreements; failure to comply with complex Medicare and Medicaid reporting and

payment obligations; and environmental risks;

other financial and economic risks, including: our exposure to currency fluctuations and restrictions as well as credit risks; potential impairments of our intangible assets; potential significant increases in tax liabilities; and the effect on our overall effective tax rate of the termination or expiration of governmental programs or tax benefits, or of a change in our business;

and other factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2017, including the sections thereof captioned Risk Factors and Forward Looking Statements, and in our subsequent quarterly reports on Form 10-Q and other filings with the Securities and Exchange Commission, which are available at www.sec.gov and www.tevapharm.com. Forward-looking statements speak only as of the date on which they are made, and we assume no obligation to update or revise any forward-looking statements or other information contained herein, whether as a result of new information, future events or otherwise. You are cautioned not to put undue reliance on these forward-looking statements.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED BALANCE SHEETS

(U.S. dollars in millions)

(Unaudited)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,875	$ 963
Trade receivables	5,665	7,128
Inventories	4,866	4,924
Prepaid expenses	911	1,100
Other current assets	483	701
Assets held for sale	81	566
Total current assets	13,881	15,382
Deferred income taxes	427	574
Other non-current assets	722	932
Property, plant and equipment, net	7,101	7,673
Identifiable intangible assets, net	15,345	17,640
Goodwill	27,585	28,414
Total assets	$ 65,061	$ 70,615
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	$ 2,673	$ 3,646
Sales reserves and allowances	6,701	7,881
Trade payables	1,626	2,069
Employee-related obligations	712	549
Accrued expenses	2,232	3,014
Other current liabilities	886	724
Liabilities held for sale		38
Total current liabilities	14,830	17,921
Long-term liabilities:		
Deferred income taxes	2,478	3,277

Other taxes and long-term liabilities	1,803	1,843
Senior notes and loans	26,816	28,829
Total long-term liabilities	31,097	33,949
Commitments and contingencies, see note 16		
Total liabilities	45,927	51,870
Equity:		
Teva shareholders equity:		
Preferred shares of NIS 0.10 par value per mandatory convertible preferred share; September 30, 2018 and December 31, 2017: authorized 5.0 million shares; issued 3.7 million shares	3,825	3,631
Ordinary shares of NIS 0.10 par value per share; September 30, 2018 and December 31, 2017: authorized 2,495 million shares; issued 1,125 million shares and 1,124 million shares, respectively	54	54
Additional paid-in capital	23,404	23,479
Accumulated deficit	(3,072)	(3,808)
Accumulated other comprehensive loss	(2,335)	(1,848)
Treasury shares as of September 30, 2018 and December 31, 2017 106 million ordinary shares and 107 million ordinary shares, respectively	(4,146)	(4,149)
	17,730	17,359
Non-controlling interests	1,404	1,386
Total equity	19,134	18,745
Total liabilities and equity	$ 65,061	$ 70,615

The accompanying notes are an integral part of the financial statements.

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(U.S. dollars in millions, except share and per share data)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net revenues	$ 4,529	$ 5,617	$ 14,295	$ 16,987
Cost of sales	2,508	2,967	7,865	8,643
Gross profit	2,021	2,650	6,430	8,344
Research and development expenses	311	531	918	1,432
Selling and marketing expenses	743	843	2,224	2,745
General and administrative expenses	309	372	954	1,101
Other asset impairments, restructuring and other items	658	550	2,080	1,209
Goodwill impairment			300	6,100
Legal settlements and loss contingencies	19	(20)	(1,239)	324
Other income	(35)	(4)	(334)	(100)
Operating income (loss)	16	378	1,527	(4,467)
Financial expenses, net	229	259	736	704
Income (loss) before income taxes	(213)	119	791	(5,171)
Tax benefits	(26)	(494)	(56)	(462)
Share in losses of associated companies, net	10	3	76	10
Net income (loss)	(197)	610	771	(4,719)
Net income attributable to non-controlling interests	11	15	35	11
Net income (loss) attributable to Teva	(208)	595	736	(4,730)
Dividends on preferred shares	65	65	195	195
Net income (loss) attributable to ordinary shareholders	$ (273)	$ 530	$ 541	$ (4,925)
Earnings (loss) per share attributable to ordinary shareholders:				
Basic	$ (0.27)	$ 0.52	$ 0.53	$ (4.85)
Diluted	$ (0.27)	$ 0.52	$ 0.53	$ (4.85)
Weighted average number of shares (in millions):				

Basic	1,018	1,017	1,018	1,016
Diluted	1,018	1,017	1,020	1,016

The accompanying notes are an integral part of the financial statements.

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(U.S. dollars in millions)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net income (loss)	$ (197)	$ 610	$ 771	$ (4,719)
Other comprehensive income (loss), net of tax:				
Currency translation adjustment	(105)	264	(577)	1,136
Unrealized gain (loss) from derivative financial instruments	19	(49)	75	(118)
Unrealized gain (loss) from available-for-sale securities	1	(17)		20
Unrealized gain (loss) on defined benefit plans	1	1		(12)
Total other comprehensive income (loss)	(84)	199	(502)	1,026
Total comprehensive income (loss)	(281)	809	269	(3,693)
Comprehensive income (loss) attributable to non-controlling interests	(26)	11	20	75
Comprehensive income (loss) attributable to Teva	$ (255)	$ 798	$ 249	$ (3,768)

The accompanying notes are an integral part of the financial statements.

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS

(U.S. dollars in millions)

(Unaudited)

	Nine months ended September 30,	
	2018	**2017**
Operating activities:		
Net income (loss)	$ 771	$ (4,719)
Adjustments to reconcile net income (loss) to net cash provided by operations:		
Net change in operating assets and liabilities	(1,521)	(1,717)
Depreciation and amortization	1,460	1,584
Impairment of long-lived assets	1,501	564
Deferred income taxes, net and uncertain tax positions	(650)	(733)
Goodwill impairment	300	6,100
Stock-based compensation	122	106
Impairment of equity investment	103	
Research and development in process	54	175
Net gain from sale of long-lived assets and investments	(53)	(48)
Other items	(8)	9
Venezuela impairment of net monetary assets		45
Net cash provided by operating activities	2,079	1,366
Investing activities:		
Beneficial interest collected in exchange for securitized trade receivables	1,372	962
Proceeds from sales of business, investments and long-lived assets	880	1,607
Purchases of property, plant and equipment	(438)	(607)
Purchases of investments and other assets	(56)	(194)
Other investing activities	34	(277)
Acquisitions of subsidiaries, net of cash acquired		43
Net cash provided by investing activities	1,792	1,534
Financing activities:		
Repayment of senior notes and loans and other long-term liabilities	(6,989)	(1,005)
Proceeds from senior notes and loans, net of issuance costs	4,434	507
Net change in short-term debt	(262)	(1,630)
Other financing activities	(13)	(69)
Dividends paid on ordinary shares	(12)	(814)
Dividends paid on preferred shares	(10)	(195)

Dividends paid to non-controlling interests		(38)
Net cash used in financing activities	(2,852)	(3,244)
Translation adjustment on cash and cash equivalents	(107)	36
Net change in cash and cash equivalents	912	(308)
Balance of cash and cash equivalents at beginning of period	963	988
Balance of cash and cash equivalents at end of period	$ 1,875	$ 680
Non-cash financing and investing activities:		
Beneficial interest obtained in exchange for securitized trade receivables	$ 1,345	$ 911

The accompanying notes are an integral part of the financial statements.

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TEVA PHARMACEUTICAL INDUSTRIES LIMITED

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 Basis of presentation:

The accompanying unaudited consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements. In the opinion of management, the financial statements reflect all recurring adjustments necessary to fairly state the financial position and results of operations of Teva. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company s Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission (SEC). Amounts as of December 31, 2017 were derived from the audited balance sheet at that date, but not all disclosures required by generally accepted accounting principles in the United States (U.S. GAAP) are included. Certain comparative figures have been reclassified to conform to current presentation. The results of operations for the nine months ended September 30, 2018 are not necessarily indicative of results that could be expected for the entire fiscal year.

Note 2 Significant accounting policies:

Recently adopted accounting pronouncements

On January 1, 2018, Teva adopted the new accounting standard ASC 606, Revenue from Contracts with Customers, and all the related amendments (new revenue standard) to all contracts using the modified retrospective method. The cumulative effect of initially applying the new revenue standard was immaterial. See note 9 for further discussion.

In May 2017, the FASB issued guidance on changes to terms and conditions of share-based payment awards. The amendment provides guidance about which changes to terms or conditions of a share-based payment award require an entity to apply modification accounting. The guidance is effective for the fiscal year beginning on January 1, 2018, including interim periods within that year. Teva adopted the provisions of this update in the first quarter of 2018. The impact that this new standard has on Teva s financial statements after adoption will depend on any future modification of share-based compensation.

In February 2017, the FASB issued guidance on de-recognition of nonfinancial assets. The amendments address the recognition of gains and losses on the transfer (i.e., sale) of nonfinancial assets to counterparties other than customers. The guidance conforms de-recognition on nonfinancial assets with the model for transactions in the new revenue standard. Teva adopted the provisions of this update in the first quarter of 2018 with no material impact on its consolidated financial statements.

In August 2016, the FASB issued guidance on statements of cash flows. The guidance addresses eight specific issues: debt prepayment or debt extinguishment costs; settlement of certain debt instruments; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies; distributions received from equity method investees; beneficial interest in securitization transactions; and separately identifiable cash flows and application of predominance principle. The amendments should be applied retrospectively. Teva adopted the provisions of this update in the first quarter of 2018. This resulted in the reclassification of $962 million of beneficial interest in securitization transactions from operating activities to investing activities for the nine month period ended September 30, 2017.

In January 2016, the FASB issued guidance which updates certain aspects of recognition, measurement, presentation and disclosure of equity investments. The guidance requires entities to recognize changes in fair value in net income rather than in accumulated other comprehensive income. Teva adopted the provisions of this update in the first quarter of 2018. Following the adoption, the Company recorded a $5 million opening balance reclassification from accumulated other comprehensive loss to retained earnings. See note 10.

Recently issued accounting pronouncements, not yet adopted

In August 2018, the FASB issued guidance that aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The guidance will be effective for fiscal years beginning after December 15, 2019, although early adoption is permitted. The Company is currently evaluating this guidance to determine the impact it may have on its consolidated financial statements.

In August 2018, the FASB issued guidance that removes certain disclosure requirements related to the fair value hierarchy, modifies existing disclosure requirements related to measurement uncertainty and adds new disclosure requirements. The new disclosure requirements include disclosing the changes in unrealized gains and losses for the period included in other comprehensive

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income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. Certain disclosures required by this guidance will need to be applied on a retrospective basis and others on a prospective basis. The guidance will be effective for fiscal years beginning after December 15, 2019, although early adoption is permitted. The Company is currently evaluating this guidance to determine the impact it may have on its consolidated financial statements.

In July 2018, the FASB issued a codification improvement, which does not prescribe any new accounting guidance, but instead provides minor improvements and clarifications to various FASB accounting guidance. Certain updates are applicable immediately while others provide for a transition period until the next fiscal year beginning after December 15, 2018. The Company is currently evaluating this guidance to determine the impact it may have on its consolidated financial statements.

In June 2018, the FASB issued guidance which simplifies the accounting for non-employee share-based payment transactions. The amendments specify that ASC 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor s own operations by issuing share-based payment awards. The guidance will be effective for fiscal years beginning after December 31, 2018, although early adoption is permitted. The Company does not expect that the adoption of this guidance will have a significant impact on its consolidated financial statements.

In February 2018, the FASB issued guidance on the reclassification of certain tax effects from accumulated other comprehensive income. The guidance allows reclassification of stranded tax effects resulting from the Tax Cuts and Jobs Act from accumulated other comprehensive income to retained earnings. This guidance is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company does not expect that the adoption of this guidance will have a significant impact on its consolidated financial statements.

In August 2017, the FASB issued guidance on derivatives and hedging, which expands and refines hedge accounting for both non-financial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The guidance will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years (early adoption is permitted for any interim and annual financial statements that have not yet been issued). Teva is currently evaluating the potential effect of the guidance on its consolidated financial statements.

In June 2016, the FASB issued guidance on financial instruments. The guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The guidance will be effective for the fiscal year beginning on January 1, 2020, including interim periods within that year. Teva is currently evaluating the potential effect of the guidance on its consolidated financial statements.

In February 2016, the FASB issued guidance on leases. The guidance requires entities to record lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. In September 2017, the FASB issued additional amendments providing clarification and implementation guidance. The guidance will become effective for interim and annual periods beginning on January 1, 2019 (early adoption is permitted). In January 2018, the FASB issued an update that permits an entity to elect an optional transition practical expedient to not evaluate land easements that existed or expired before the entity s adoption of the new standard and that were not previously accounted for as leases. In July 2018, the FASB issued both codification improvements, which clarify how to apply certain aspects of the new lease standard and an update. The update provided to either adopt at the earliest period presented using a modified retrospective approach, or to continue applying the guidance under the current lease

standard in the comparative periods presented in the consolidated financial statements. Companies that elect this option would record a cumulative-effect adjustment to the opening balance of retained earnings on the date of adoption. The Company expects to apply the guidance using the cumulative-effect approach, thereby applying the new guidance at the effective date, without adjusting the comparative periods and, if necessary, recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption.

The Company is performing a comprehensive evaluation of the impact of the adoption of this guidance, which includes assessing the Company s lease portfolio, implementation of a new enterprise-wide lease management system to meet reporting requirements, assessing the impact to business processes and implementation of internal controls over financial reporting and related disclosure requirements. The Company is working closely with the software system developer, as the timely readiness of the lease software system is critical to ensure an efficient and effective adoption of the standard. Although the Company has not finalized its process of evaluating the impact of adoption of the ASU on its consolidated financial statements, the Company expects there will be a material increase to assets and liabilities related to the recognition of new right-of-use assets and lease liabilities on the Company s consolidated balance sheet for leases currently classified as operating leases. The Company does not, however, expect a material impact to its consolidated statements of income.

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NOTE 3 Certain transactions:

Business acquisitions:

Actavis Generics and Anda acquisitions

On August 2, 2016, Teva consummated its acquisition of Allergan plc s (Allergan) worldwide generic pharmaceuticals business (Actavis Generics). At closing, Teva transferred to Allergan consideration of approximately $33.4 billion in cash and approximately 100.3 million Teva shares.

On October 3, 2016, Teva consummated the acquisition of Anda Inc. (Anda), the fourth largest distributor of generic pharmaceuticals in the United States, from Allergan, for cash consideration of $500 million. The purchase is a transaction related to the Actavis Generics acquisition and as such the purchase price accounting and related disclosures were treated on a combined basis.

The final cash consideration for the Actavis Generics acquisition was subject to certain net working capital adjustments. Following the terms of the agreement, Teva submitted an adjustment for $1.4 billion with regards to a working capital true up as well as potential recoveries of purchase price related to certain tax items. On January 31, 2018, Teva and Allergan entered into a settlement agreement and mutual releases for which Allergan made a one-time payment of $703 million to Teva. The Agreement also provides that Teva and Allergan will jointly dismiss the working capital dispute arbitration, as well as actual or potential claims under the Master Purchase Agreement, dated July 26, 2015, by and between Teva and Allergan, for breach of any representation, warranty or covenant (other than any breach of a post-closing covenant not known as of the date of the settlement agreement). As the measurement period has ended, this amount was recorded as a gain under legal settlements and loss contingencies in the first quarter of 2018.

Rimsa

On March 3, 2016, Teva completed the acquisition of Representaciones e Investigaciones Médicas, S.A. de C.V. (Rimsa), a pharmaceutical manufacturing and distribution company in Mexico, for $2.3 billion, in a cash free, debt free set of transactions. Teva financed the transaction using cash on hand.

Following the closing of the acquisition, Teva identified issues concerning Rimsa s pre-acquisition quality, manufacturing and other practices, at which point Teva began an assessment of the extent and cost of remediation required to return its products to the market. In September 2016, two lawsuits were filed: a pre-emptive suit by the Rimsa sellers against Teva and Teva s lawsuit alleging fraud and breach of contract against the Rimsa sellers. The Rimsa sellers subsequently dismissed their lawsuit and the dismissal was approved by court order on December 20, 2016.

On February 15, 2018, Teva and the Rimsa sellers entered into a settlement agreement and mutual releases on the breach of contract claim for which the sellers made a one-time payment to Teva. As the measurement period has ended, this was recorded as a gain under legal settlements and loss contingencies in the first quarter of 2018. This settlement was approved by the court and Teva s breach of contract claim was subsequently dismissed.

Assets and Liabilities Held For Sale:

Certain Women s Health and Other Specialty Products

On September 17, 2017, Teva entered into a definitive agreement under which CVC Capital Partners Fund VI would acquire a portfolio of products for $703 million in cash. The portfolio of products, which is marketed and sold outside of the United States, includes the women s health products OVALEAP®, ZOELY®, SEASONIQUE®, COLPOTROPHINE® and other specialty products such as ACTONEL®.

As of December 31, 2017, the Company accounted for this transaction as assets and liabilities held for sale and determined that the fair value less cost to sell exceeded the carrying value of the business. The Company disposed $329 million of goodwill associated with the divested business.

On January 31, 2018, Teva completed the sale of the portfolio of products to CVC Capital Partners Fund VI. As a result of these transactions, the Company recognized a net gain on sale of approximately $93 million in the first quarter of 2018 within other income in the consolidated statement of income. The transaction expenses for these divestitures of approximately $2 million were recognized concurrently and included as a reduction to the net gain on sale.

The Company determined that the sale of its global women s health businesses did not constitute a strategic shift and that it did not, and will not, have a major effect on its operations and financial results. Accordingly, the operations associated with the transactions are not reported as discontinued operations.

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The table below summarizes the major classes of assets and liabilities included as held for sale as of September 30, 2018 and December 31, 2017:

	September 30, 2018	December 31, 2017
	(U.S. $ in millions)	
Inventories		39
Property, plant and equipment, net (*)	41	16
Identifiable intangible assets, net		236
Goodwill (*)	40	275
Total assets of the disposal group classified as held for sale in the consolidated balance sheets	$ 81	$ 566
Other taxes and long-term liabilities		38
Total liabilities of the disposal group classified as held for sale in the consolidated balance sheets	$	$ 38

(*) Mainly comprised of certain facilities in Israel.

Other significant agreements:

The Company has entered into alliances and other arrangements with third parties to acquire rights to products it does not have, to access markets it does not operate in and to otherwise share development costs or business risks. The Company s most significant agreements of this nature are summarized below.

PGT Healthcare Partnership

In April 2018, Teva signed a separation agreement with the Procter & Gamble Company (P&G) to terminate Teva s joint venture with P&G, PGT Healthcare partnership (PGT) which the two companies established in 2011 to market over-the-counter (OTC) medicines. Teva will continue to maintain its OTC business on an independent basis.

The separation became effective on July 1, 2018. As part of the separation, Teva transferred to P&G the shares it held in New Chapter Inc. and ownership rights in an OTC plant located in India. Teva will continue to provide certain services to P&G after the separation for a transition period.

During the first quarter of 2018, Teva classified the plant in India as an asset held for sale and recorded an impairment of $64 million under other asset impairments, restructuring and other items. In addition, Teva recorded a write-down of $94 million of its investment in New Chapter Inc. under share in losses of associated companies.

During September 2018, Teva and P&G completed the final net asset distribution as part of the dissolution and Teva recorded a gain of $50 million to reflect the cash payment received from P&G to settle the dissolution.

Alder BioPharmaceuticals

On January 8, 2018, Teva signed a global license agreement with Alder BioPharmaceuticals (Alder). The agreement validates Teva s IP and resolves Alder s opposition to Teva s European patent with respect to anti-calcitonin gene-related peptide (CGRP) antibodies, including the withdrawal of Alder s appeal before the European Patent Office. Under the terms of the agreement, Alder will receive a non-exclusive license to Teva s anti-CGRP antibodies patent portfolio to develop, manufacture and commercialize eptinezumab in the U.S. and worldwide, excluding Japan and Korea. Teva received a $25 million upfront payment during the first quarter of 2018, which was recognized as revenue. The agreement stipulates additional milestone payments to Teva of up to $175 million, as well as future royalties.

AUSTEDO®

On September, 19, 2017, Teva entered into a partnership agreement with Nuvelution Pharma, Inc. (Nuvelution) for development of AUSTEDO for the treatment of Tourette syndrome in pediatric patients in the United States. Nuvelution will fund and manage clinical development, driving all operational aspects of the phase 3 program, and Teva will lead the regulatory process and be responsible for commercialization. Upon and subject to FDA approval of AUSTEDO for the treatment of Tourette syndrome, Teva will pay Nuvelution a pre-agreed amount as compensation for their contribution to the partnership.

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Otsuka

On May 12, 2017, Teva entered into a license and collaboration agreement with Otsuka Pharmaceutical Co. Ltd. (Otsuka), providing Otsuka with an exclusive license to conduct phase 2 and 3 clinical trials for fremanezumab in Japan and, if approved, to commercialize the product in Japan. Otsuka paid Teva an upfront payment of $50 million in consideration for the transaction. Teva may receive additional milestone payments upon filing with Japanese regulatory authorities, receipt of regulatory approval and achievement of certain revenue targets. Otsuka will also pay Teva royalties on fremanezumab sales in Japan.

Attenukine™

In December 2016, Teva entered into a license agreement for research, development, manufacture and commercializing of Attenukine™ with a subsidiary of Takeda Pharmaceutical Company Ltd. (Takeda). Teva received a $30 million upfront payment. The agreement stipulates additional milestone payments to Teva of up to $280 million, as well as future royalties.

Ninlaro®

In November 2016, Teva entered into an agreement to sell its royalties and other rights in Ninlaro® (ixazomib) to a subsidiary of Takeda, for a $150 million upfront payment to Teva and an additional $150 million payment based on sales during 2017. Teva was entitled to these royalties pursuant to an agreement from 2014 assigning the Ninlaro® patents to an affiliate of Takeda in consideration of milestone payments and sales royalties. In the first six months of 2017, Teva received payments in the amount of $150 million, which were recognized as revenue for the period.

Celltrion

In October 2016, Teva and Celltrion, Inc. (Celltrion) entered into a collaborative agreement to commercialize two of Celltrion s biosimilar products in development for the U.S. and Canadian markets. Teva paid Celltrion $160 million, of which up to $60 million is refundable or creditable under certain circumstances. Teva and Celltrion will share the profit from the commercialization of these products.

Regeneron

In September 2016, Teva and Regeneron Pharmaceuticals, Inc. (Regeneron) entered into a collaborative agreement to develop and commercialize Regeneron s pain medication product, fasinumab. Teva and Regeneron share equally in the global commercial rights to this product, as well as ongoing associated R&D costs of approximately $1 billion. Teva made an upfront payment of $250 million to Regeneron in the third quarter of 2016 as part of the agreement. Milestone payments of $25 million and $35 million were paid in the second quarter of 2017 and the first quarter of 2018, respectively, and a provision of $60 million was recorded in the third quarter of 2018.

NOTE 4 Inventories:

Inventories, net of reserves, consisted of the following:

	September 30, 2018	December 31, 2017

	(U.S. $ in millions)	
Finished products	$ 2,679	$ 2,689
Raw and packaging materials	1,395	1,454
Products in process	609	597
Materials in transit and payments on account	183	184
	$ 4,866	$ 4,924

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NOTE 5 Property, plant and equipment:

Property, plant and equipment, net, consisted of the following:

	September 30, 2018	December 31, 2017
	(U.S. $ in millions)	
Machinery and equipment	$ 5,783	$ 5,809
Buildings	3,179	3,329
Computer equipment and other assets	2,115	2,016
Payments on account	538	634
Land [1]	361	390
	11,976	12,178
Less accumulated depreciation	4,875	4,505
	$ 7,101	$ 7,673

(1) Land includes long-term leasehold rights in various locations, with useful lives between 30 and 99 years.

NOTE 6 Identifiable intangible assets:

Identifiable intangible assets consisted of the following:

	Gross carrying amount net of impairment		Accumulated amortization		Net carrying amount	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
	(U.S. $ in millions)					
Product rights	$ 21,094	$ 21,011	$ 9,132	$ 8,276	$ 11,962	$ 12,735
Trade names	610	617	82	55	528	562
Research and development in process	2,855	4,343			2,855	4,343
Total	$ 24,559	$ 25,971	$ 9,214	$ 8,331	$ 15,345	$ 17,640

Product rights and trade names are assets presented at amortized cost. These assets represent a portfolio of pharmaceutical products from various categories with a weighted average amortization life of approximately 11 years. Amortization of intangible assets was $297 million and $357 million for the three months ended September 30, 2018 and 2017, respectively and $909 million and $1,088 million for the nine months ended September 30, 2018 and 2017, respectively. Amortization is recorded under cost of sales or S&M expenses, depending on the nature of the asset.

The fair value of acquired identifiable intangible assets is generally determined using an income approach. This method starts with a forecast of all expected future net cash flows associated with the asset and then adjusts the forecast to present value by applying an appropriate discount rate that reflects the risk factors associated with the cash flow streams.

Whenever impairment indicators are identified for definite life intangible assets, Teva reconsiders the asset s estimated life, calculates the undiscounted value of the asset s or asset group s cash flows and then calculates, if required, the discounted value of cash flow by applying an appropriate discount rate to the undiscounted cash flow streams. Teva then compares such value against the asset s or asset group s carrying amount. If the carrying amount is greater, Teva records an impairment loss for the excess of carrying value over fair value based on the discounted cash flows.

The more significant estimates and assumptions inherent in the estimate of the fair value of identifiable intangible assets include all assumptions associated with forecasting product profitability, including sales and cost to sell projections, R&D expenditure for ongoing support of product rights or continued development of IPR&D, estimated useful lives and IPR&D expected launch dates. Additionally, for IPR&D assets the risk of failure has been factored into the fair value measure.

Impairment of identifiable intangible assets of $519 million and $355 million for the three months ended September 30, 2018 and 2017, respectively and $1,246 million and $409 million for the nine months ended September 30, 2018 and 2017, respectively. Impairments of identifiable intangible assets are recorded in earnings under other asset impairments, restructuring and other items. See note 14.

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Additional reductions to IPR&D intangibles relate to reclassification to product rights following regulatory approvals of generic products and impairments of assets due to development status, changes in projected launch date or changes in commercial projections related to products under development.

In the first nine months of 2018, Teva reclassified approximately $553 million relating to certain products from IPR&D to product rights following regulatory approval, mainly $444 million in connection with AJOVY (fremanezumab) and $103 million in connection with mesalamine.

NOTE 7 Goodwill:

The changes in the carrying amount of goodwill for the period ended September 30, 2018 were as follows:

	Generics	Specialty	Other	Total	North America	International Europe	International Market	International Other	International Total
	(U.S. $ in millions)				(U.S. $ in millions)				
Balance as of December 31, 2017 [1]	$ 18,864	$ 8,464	$ 1,086	$ 28,414	$	$	$	$	$
Relative fair value allocation	(18,864)	(8,464)	(1,086)	(28,414)	11,144	9,001	5,404	2,865	28,414
Balance as of January 1, 2018					11,144	9,001	5,404	2,865	28,414
Goodwill impairment [3]							(300)		(300)
Goodwill disposal [2]						(65)	(14)		(79)
Goodwill reclassified as assets to held for sale								(40)	(40)
Translation differences					(21)	(338)	(50)	(1)	(410)
Balance as of September 30, 2018 [1]	$	$	$	$	$ 11,123	$ 8,598	$ 5,040	$ 2,824	$ 27,585

(1) Accumulated goodwill impairment as of September 30, 2018 and December 31, 2017 was approximately $18.3 billion and $18.0 billion, respectively.
(2) Due to the divestment of the women s health business, the sale of Actavis Brazil and other activity.
(3) Due to the goodwill impairment related to the Rimsa and/or Mexico reporting unit.

In November 2017, Teva announced a new organizational structure and leadership changes to enable strategic alignment across its portfolios, regions and functions. Teva now operates its business through three segments: North America, Europe and International Markets. The purpose of the new structure is to enable stronger alignment and integration between operations, commercial regions, R&D and Teva s global marketing and portfolio function, in order to optimize its product lifecycle across the therapeutic areas. Teva began reporting its financial results under this structure in the first quarter of 2018.

In addition to these three segments, Teva has other activities, primarily the sale of active pharmaceutical ingredients (API) to third parties and certain contract manufacturing services. See note 17.

Following the announcement of its new organizational structure and leadership changes in November 2017, Teva conducted an analysis of its business segments, which led to changes in Teva s identified reporting units, operating and reporting segments. As a result, on January 1, 2018, Teva reallocated its goodwill to the adjusted reporting units using a relative fair value allocation. In conjunction with the goodwill reallocation, Teva performed a goodwill impairment test for the balances in its adjusted reporting units, utilizing the same annual operating plan (AOP) and long range plan model that were used in its 2017 annual impairment test; the Company concluded that the fair value of each reporting unit was in excess of its carrying value.

During the first quarter of 2018, Teva identified an increase in certain components of the weighted average cost of capital (WACC), such as an increase in the risk free interest and the unlevered beta. The Company addressed these changes in rates as an indication for impairment and performed an additional impairment test as of March 31, 2018.

Based on its revised analysis, Teva recorded a goodwill impairment of $180 million related to its Rimsa reporting unit in the first quarter of 2018. The remaining goodwill allocated to this reporting unit was $706 million as of March 31, 2018. This impairment was driven by the change in fair value, including the discount rate updated for the WACC change noted above, and the change in allocated net assets to the reporting unit. See note 3.

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In the second quarter of 2018, the Company completed its long-range planning (LRP) process. The LRP is part of Teva s internal financial planning and budgeting processes and is discussed and reviewed by Teva s management and its board of directors. Certain events and changes in circumstances, reflected in the LRP, indicated that it was more likely than not that the carrying value of certain reporting units exceeded their fair value:

Historically, Rimsa had been carved out as a separate reporting unit due to the significant operational challenges. Teva wanted to ensure that any impairment related to Rimsa would be recorded, by separating it from the International Markets reporting unit. During the second quarter of 2018, Rimsa and Teva Mexico substantially completed the integration process and as a result Teva decided to utilize the combined Mexico reporting unit for goodwill impairment testing, as opposed to Rimsa only in prior periods.

Following the integration, and although the remediation plan is progressing in connection with Rimsa legacy products, Teva estimates that the recovery time will be longer than initially planned, specifically in connection with the time to regain lost market share. As a result, the Company recorded an additional goodwill impairment charge of $120 million related to its Mexico reporting unit in the second quarter of 2018.

Additionally, the Company identified further developments with respect to legislation proposed by the Russian Ministry of Health. The draft legislation includes, among other items, amendments in the mechanism of regulating prices for vital and essential medicines. The suggested amendments triggered a public discussion between authorities and pharmaceutical companies, which ended in the second quarter of 2018, followed by an internal discussion by the relevant authorities. The estimated impact of developments and uncertainties with respect to the final legislation in Russia were reflected in the LRP and triggered an impairment test for the International Markets reporting unit and related intangible assets, significantly decreasing the difference between the estimated fair value and estimated carrying value of the reporting unit, from 6% to 2%; however no impairment was recorded.

After assessing the totality of relevant events and circumstances, Teva determined that, as of the second quarter of 2018, it is not more likely than not that the fair value of its remaining reporting units is less than their carrying amount.

In light of the integration and the progress toward operational remediation in Rimsa as discussed above, Teva concluded that commencing July 1, 2018, it would no longer view Mexico separately from the International Markets reporting unit and accordingly will no longer perform impairment testing on Mexico as a separate reporting unit.

During the third quarter of 2018, Teva identified an increase in the risk free interest rate, which caused an increase in WACC. In addition, certain currencies in countries included in Teva s International Markets reporting unit experienced significant devaluations. Teva addressed these events as an indication for impairment and performed an additional impairment test for the International Markets and Europe reporting units as of September 30, 2018. Teva assumed that the currency devaluations would cause price increases of its imported goods to those countries which would not be completely offset by corresponding price adjustments to the selling price of Teva s goods. These changes decreased the difference between the estimated fair value and estimated carrying value of the International Markets reporting unit from 2% to 1% and of the Europe reporting unit from 6% to 4%, however, no impairment charge was recorded for either reporting unit.

In the third quarter of 2018, the fair value exceeded the estimated carrying value by 36% and 43% for North America and Other reporting units, respectively.

Based on current macro-economic developments and capital markets assumptions and holding all other assumptions constant, an increase in the risk free interest rate of 0.5% would result in an increase to Teva s WACC by approximately the same amount and consequently in a change in fair value of the International Markets reporting unit of $653 million, resulting in an impairment of $605 million. In addition, the same change in the Europe reporting unit would result in a change in fair value of $871 million, resulting in an impairment of $243 million.

Teva determines the fair value of its reporting units using a weighting of fair values derived from the income approach. The income approach is a forward-looking approach for estimating fair value and utilizes the 2018 remaining year forecast, projections for growth off that base with an associated price erosion, as well as terminal growth rate. Within the income approach, the method that was used is the discounted cash flow method. Teva started with a forecast of all the expected net cash flows associated with the reporting unit, which includes the application of a terminal value, and then applied a discount rate to arrive at a net present value amount. Cash flow projections are based on Teva s estimates of revenue growth rates and operating margins, taking into consideration industry and market conditions. The discount rate used is based on the WACC, adjusted for the relevant risk associated with country-specific characteristics. If any of these expectations were to vary materially from Teva s assumptions, Teva could face impairment of goodwill allocated to these reporting units in the future.

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NOTE 8 Earnings (Loss) per share:

Basic earnings and loss per share are computed by dividing net results attributable to Teva s ordinary shareholders by the weighted average number of ordinary shares outstanding (including fully vested restricted share units (RSUs)) during the period, net of treasury shares.

In computing the diluted loss per share for the three months ended September 30, 2018, no account was taken of the potential dilution by the assumed exercise of employee stock options and non-vested RSUs granted under employee stock compensation plans, and convertible senior debentures, since they had an anti-dilutive effect on loss per share. Diluted earnings per share for the three months ended September 30, 2017 take into account the potential dilution that could occur upon the exercise of options and non-vested RSUs granted under employee stock compensation plans, using the treasury stock method.

Additionally, no account was taken of the potential dilution by the mandatory convertible preferred shares, amounting to 66 million (including shares that may be issued due to unpaid dividends to date) for the three months ended September 30, 2018 and 59 million for the three months ended September 30, 2017, as well as for the convertible senior debentures for the respective periods, since both had an anti-dilutive effect on earnings (loss) per share.

Diluted earnings per share for the nine months ended September 30, 2018 take into account the potential dilution that could occur upon the exercise of options and non-vested RSUs granted under employee stock compensation plans, using the treasury stock method. In computing loss per share for the nine months ended September 30, 2017, no account was taken of the potential dilution by the assumed exercise of employee stock options and non-vested RSUs granted under employee stock compensation plans, and convertible senior debentures, since they had an anti-dilutive effect on loss per share.

Additionally, no account was taken of the potential dilution by the mandatory convertible preferred shares, amounting to 68 million (including shares that may be issued due to unpaid dividends to date) for the nine months ended September 30, 2018 and 59 million for the nine months ended September 30, 2017, as well as for the convertible senior debentures for the respective periods, since both had an anti-dilutive effect on earnings (loss) per share.

NOTE 9 Revenue from contracts with customers:

On January 1, 2018, Teva adopted the new revenue standard to all contracts using the modified retrospective method. The cumulative effect of initially applying the new revenue standard was immaterial.

Revenue recognition prior to the adoption of the new revenue standard

Please refer to note 1 to the consolidated financial statements and critical accounting policies included in Teva s Annual Report on Form 10-K for the year ended December 31, 2017 for a summary of the significant accounting policies.

Revenue recognition following the adoption of the new revenue standard

A contract with a customer exists only when: the parties to the contract have approved it and are committed to perform their respective obligations, the Company can identify each party s rights regarding the distinct goods or services to be transferred (performance obligations), the Company can determine the transaction price for the goods or services to be transferred, the contract has commercial substance and it is probable that the Company will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

Revenues are recorded in the amount of consideration to which the Company expects to be entitled in exchange for performance obligations upon transfer of control to the customer, excluding amounts collected on behalf of other third parties and sales taxes.

The amount of consideration to which Teva expects to be entitled varies as a result of rebates, chargebacks, returns and other sales reserve and allowances (SR&A) the Company offers its customers and their customers, as well as the occurrence or nonoccurrence of future events, including milestone events. A minimum amount of variable consideration is recorded concurrently with the satisfaction of performance obligations to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Estimates of variable consideration are based on historical experience and the specific terms in the individual agreements (which the Company believes approximates expected value). Rebates and chargebacks are the largest components of SR&A. For further description of SR&A components and how they are estimated, see Variable Consideration below.

Shipping and handling costs after control over a product has transferred to a customer are accounted for as a fulfillment cost and are recorded under S&M expenses.

Teva does not adjust the promised amount of consideration for the effects of a significant financing component since the Company expects, at contract inception, that the period between the time of transfer of the promised goods or services to the customer and the time the customer pays for these goods or services to be generally one year or less, based on the practical expedient. The Company s credit terms to customers are in average between thirty and ninety days.

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The Company generally recognizes the incremental costs of obtaining contracts as an expense since the amortization period of the assets that the Company otherwise would have recognized is one year or less. The costs are recorded under S&M expenses. Similarly, Teva does not disclose the value of unsatisfied performance obligations for contracts with original expected duration of one year or less.

Disaggregation of revenue

The following table disaggregates Teva s revenues by major revenue streams. For additional information on disaggregation of revenues see note 17.

	Three months ended September 30, 2018				
	North America	Europe	International Markets	Other activities	Total
	(U.S. $ in millions)				
Sale of goods	1,902	1,210	525	166	3,803
Licensing arrangements	29	1		2	32
Distribution	333	1	149		483
Other	1		52	158	211
	$ 2,265	$ 1,212	$ 726	$ 326	$ 4,529

	Three months ended September 30, 2017				
	North America	Europe	International Markets	Other activities	Total
	(U.S. $ in millions)				
Sale of goods	2,724	1,321	672	168	4,885
Licensing arrangements	25		1	1	27
Distribution	294	59	146		499
Other			63	143	206
	$ 3,043	$ 1,380	$ 882	$ 312	$ 5,617

	Nine months ended September 30, 2018				
	North America	Europe	International Markets	Other activities	Total
	(U.S. $ in millions)				
Sale of goods	5,983	3,956	1,617	526	12,082
Licensing arrangements	91	19	21	6	137
Distribution	984	7	456		1,447
Other	1		171	457	629
	$ 7,059	$ 3,982	$ 2,265	$ 989	$ 14,295

	Nine months ended September 30, 2017

	North America	Europe	International Markets	Other activities	Total
	(U.S. $ in millions)				
Sale of goods	8,338	3,848	1,862	567	14,615
Licensing arrangements	249	2	36	4	291
Distribution	864	166	406		1,436
Other	1		181	463	645
	$ 9,452	$ 4,016	$ 2,485	$ 1,034	$ 16,987

Nature of revenue streams

Revenue from sales of goods, including sales to distributors is recognized when the customer obtains control of the product. This generally occurs when products are shipped once the Company has a present right to payment and legal title, and risk and rewards of ownership are obtained by the customer.

Licensing arrangements performance obligations generally include intellectual property (IP) rights, certain R&D and contract manufacturing services. The Company accounts for IP rights and services separately if they are distinct i.e. if they are separately

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identifiable from other items in the arrangement and if the customer can benefit from them on their own or with other resources that are readily available to the customer. The consideration is allocated between IP rights and services based on their relative stand-alone selling prices.

Revenue for distinct IP rights is accounted for based on the nature of the promise to grant the license. In determining whether the Company s promise is to provide a right to access its IP or a right to use its IP, the Company considers the nature of the IP to which the customer will have rights. IP is either functional IP which has significant standalone functionality or symbolic IP which does not have significant standalone functionality. Revenue from functional IP is recognized at the point in time when control of the distinct license is transferred to the customer, when the Company has a present right to payment and risks and rewards of ownership are transferred to the customer. Revenue from symbolic IP is recognized over the access period to the Company s IP.

Revenue from sales based milestones and royalties promised in exchange for a license of IP is recognized only when, or as, the later of subsequent sale or the performance obligation to which some or all of the sales-based royalty has been allocated, is satisfied. Revenues from licensing arrangements included royalty income of $31 million and $27 million for the three months ended September 30, 2018 and 2017, respectively. Revenues from licensing arrangements included royalty income of $82 million and $239 million for the nine months ended September 30, 2018 and 2017, respectively. The amounts recognized in 2017 include royalty income resulting from the Ninlaro® transaction.

Distribution revenues are derived from sales of third-party products for which the Company acts as distributor, mostly in the United States via Anda and in Israel. The Company is the principal in these arrangements and therefore records revenue on a gross basis as it controls the promised goods before transferring these goods to the customer. Revenue is recognized when the customer obtains control of the products. This generally occurs when products are shipped once the Company has a present right to payment and legal title, and risk and rewards of ownership are obtained by the customer.

Other revenues are primarily comprised of contract manufacturing services, sales of medical devices, and other miscellaneous items. Revenue is recognized when the customer obtains control of the products. This generally occurs when products are shipped once the Company has a present right to payment and legal title and risk and rewards of ownership are obtained by the customer.

Contract assets and liabilities

Contract assets are mainly comprised of trade receivables net of allowance for doubtful debts, which includes amounts billed and currently due from customers.

Contract liabilities are mainly comprised of deferred revenues which were immaterial as of September 30, 2018 and December 31, 2017, respectively.

Variable consideration

Variable consideration mainly includes SR&A, comprised of rebates (including Medicaid and other governmental program discounts), chargebacks, returns and other promotional (including shelf stock adjustments) items. Provisions for prompt payment discounts are netted against trade receivables.

The Company recognizes these provisions at the time of sale and adjusts them if the actual amounts differ from the estimated provisions. The following describes the nature of each deduction and how provisions are estimated:

Rebates

Rebates are primarily related to volume incentives and are offered to key customers to promote loyalty. These rebate programs provide that, upon the attainment of pre-established volumes or the attainment of revenue milestones for a specified period, the customer receives a rebate. Since rebates are contractually agreed upon, they are estimated based on the specific terms in each agreement based on historical trends and expected sales. Externally obtained inventory levels are evaluated in relation to estimates made for rebates payable to indirect customers.

Medicaid and Other Governmental Rebates

Pharmaceutical manufacturers whose products are covered by the Medicaid program are required to provide a rebate to each state as a percentage of their average manufacturer s price for the products dispensed. Many states have also implemented supplemental rebate programs that obligate manufacturers to pay rebates in excess of those required under federal law. The Company estimates these rebates based on historical trends of rebates paid, as well as on changes in wholesaler inventory levels and increases or decreases in sales.

Chargebacks

The Company has arrangements with various third parties, such as managed care organizations and drug store chains, establishing prices for certain of Teva s products. While these arrangements are made between the Company and the customers, the customers independently select a wholesaler from which they purchase the products. Alternatively, certain wholesalers may enter into

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agreements with the customers, with Teva s concurrence, which establish the pricing for certain products which the wholesalers provide. Under either arrangement, Teva will issue a credit (referred to as a chargeback) to the wholesaler for the difference between the invoice price to the wholesaler and the customer s contract price. Provisions for chargebacks involve estimates of contract prices of over 2,000 products and multiple contracts with multiple wholesalers. The provision for chargebacks varies in relation to changes in product mix, pricing and the level of inventory at the wholesalers and therefore will not necessarily fluctuate in proportion to an increase or decrease in sales. Provisions for estimating chargebacks are calculated using historical chargeback experience and/or expected chargeback levels for new products and anticipated pricing changes. Teva considers current and expected price competition when evaluating the provision for chargebacks. Chargeback provisions are compared to externally obtained distribution channel reports for reasonableness. The Company regularly monitors the provision for chargebacks and makes adjustments when the Company believes that actual chargebacks may differ from estimated provisions.

Other Promotional Arrangements

Other promotional or incentive arrangements are periodically offered to customers, specifically related to the launch of products or other targeted promotions. Provisions are made in the period for which the Company can estimate the incentive earned by the customer, in accordance with the contractual terms. The Company regularly monitors the provision for other promotional arrangements and makes adjustments when Teva believes that the actual provision may differ from the estimated provisions.

Shelf Stock Adjustments

The custom in the pharmaceutical industry is generally to grant customers a shelf stock adjustment based on the customers existing inventory contemporaneously with decreases in the market price of the related product. The most significant of these relate to products for which an exclusive or semi-exclusive period exists. Provisions for price reductions depend on future events, including price competition, new competitive launches and the level of customer inventories at the time of the price decline. Teva regularly monitors the competitive factors that influence the pricing of its products and customer inventory levels and adjust these estimates where appropriate.

Returns

Returns primarily relate to customer returns of expired products which, the customer has the right to return up to one year following the expiration date. Such returned products are destroyed and credits and/or refunds are issued to the customer for the value of the returns. Accordingly, no returned assets are recoded in connection with those products. The returns provision is estimated by applying a historical return rate to the amounts of revenue estimated to be subject to returns. Revenue subject to returns is estimated based on the lag time from time of sale to date of return. The estimated lag time is developed by analyzing historical experience. Additionally, The Company considers specific factors, such as levels of inventory in the distribution channel, product dating and expiration, size and maturity of launch, entrance of new competitors, changes in formularies or packaging and any changes to customer terms, for determining the overall expected levels of returns.

Prompt Pay Discounts

Prompt pay discounts are offered to most customers to encourage timely payment. Discounts are estimated at the time of invoice based on historical discounts in relation to sales. Prompt pay discounts are almost always utilized by customers. As a result, the actual discounts do not vary significantly from the estimated amount.

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SR&A to U.S. customers comprised approximately 84% of the Company s total SR&A as of September 30, 2018, with the remaining balance primarily in Canada and Germany. The changes in SR&A for third-party sales for the period ended September 30, 2018 were as follows:

	Sales Reserves and Allowances							
	Reserves included in Accounts Receivable, net	Rebates	Medicaid and other governmental allowances	Chargebacks	Returns	Other	Total reserves included in Sales Reserves and Allowances	Total
				(U.S.$ in millions)				
Balance at December 31, 2017	$ 196	$ 3,077	$ 1,908	$ 1,849	$ 780	$ 267	$ 7,881	$ 8,077
Provisions related to sales made in current year period	380	4,956	931	7,738	232	309	14,166	14,546
Provisions related to sales made in prior periods	7	(39)	17	3	21	(19)	(17)	(10)
Credits and payments	(412)	(5,082)	(1,288)	(8,203)	(364)	(354)	(15,291)	(15,703)
Translation differences		(20)	(4)	(3)	(4)	(7)	(38)	(38)
Balance at September 30, 2018	$ 171	2,892	$ 1,564	$ 1,384	$ 665	$ 196	$ 6,701	$ 6,872

NOTE 10 Accumulated other comprehensive loss:

The components of, and changes within, accumulated other comprehensive losses attributable to Teva are presented in the table below:

	Net Unrealized Gains/(Losses)			Benefit Plans Actuarial gains/(losses) and prior service (costs)/credits	
	Foreign currency translation adjustments	Available-for-sale securities	Derivative financial instruments		Total
			(U.S.$ in millions)		
Balance as of December 31, 2017 *	$ (1,316)	$ 1	$ (442)	$ (91)	$ (1,848)
Other comprehensive income (loss) before reclassifications	(562)		54		(508)
Amounts reclassified to the statements of income			21	2	23
	(562)		75	2	(485)

Net other comprehensive income (loss) before tax					
Corresponding income tax				(2)	(2)
Net other comprehensive income (loss) after tax **	(562)		75		(487)
Balance as of September 30, 2018	$ (1,878)	$ 1	$ (367)	$ (91)	$ (2,335)

* Following the adoption of ASU 2016-01, the Company recorded a $5 million opening balance reclassification from accumulated other comprehensive income to retained earnings.

** Amounts do not include a $15 million gain from foreign currency translation adjustments attributable to non-controlling interests.

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	Net Unrealized Gains/(Losses)			Benefit Plans	
	Foreign currency translation adjustments	Available-for-sale securities	Derivative financial instruments	Actuarial gains/(losses) and prior service (costs)/credits	Total
	(U.S.$ in millions)				
Balance, December 31, 2016	$ (2,769)	$ (7)	$ (302)	$ (81)	$ (3,159)
Other comprehensive income (loss) before reclassifications	1,124	56	(138)	(9)	1,033
Amounts reclassified to the statements of income	(52)	(41)	20	2	(71)
Net other comprehensive income (loss) before tax	1,072	15	(118)	(7)	962
Corresponding income tax		5		(5)	
Net other comprehensive income (loss) after tax *	1,072	20	(118)	(12)	962
Balance, September 30, 2017	$ (1,697)	$ 13	$ (420)	$ (93)	$ (2,197)

* Amounts do not include a $64 million gain from foreign currency translation adjustments attributable to non-controlling interests.

NOTE 11 Debt obligations:

Short-term debt:

	Weighted average interest rate as of September 30, 2018	Maturity	September 30, 2018	December 31, 2017
			(U.S. $ in millions)	
Term loan JPY 28.3 billion [(5)]	JPY LIBOR+0.25%	2018	$	$ 251
Convertible debentures	0.25%	2026*	514	514
Other	9.37%	2018	1	1
Current maturities of long-term liabilities			2,158	2,880
Total short term debt			$ 2,673	$ 3,646

* Net-share settlement feature exercisable at any time.

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Senior notes and loans:

	Weighted average interest rate as of September 30, 2018	Maturity	September 30, 2018	December 31, 2017
	%		(U.S. $ in millions)	
Senior notes EUR 1,660 million [8]	0.38%	2020	$ 1,924	$ 2,095
Senior notes EUR 1,500 million	1.13%	2024	1,731	1,788
Senior notes EUR 1,300 million	1.25%	2023	1,501	1,550
Senior notes EUR 1,000 million [3]	2.88%	2019		1,199
Senior notes EUR 900 million [1]	4.50%	2025	1,045	
Senior notes EUR 750 million	1.63%	2028	863	891
Senior notes EUR 700 million [1]	3.25%	2022	812	
Senior notes EUR 700 million	1.88%	2027	810	837
Senior notes USD 3,500 million	3.15%	2026	3,493	3,492
Senior notes USD 3,000 million	2.20%	2021	2,997	2,996
Senior notes USD 3,000 million	2.80%	2023	2,993	2,992
Senior notes USD 1,700 million [8]	1.70%	2019	1,700	2,000
Senior notes USD 2,000 million	4.10%	2046	1,984	1,984
Senior notes USD 1,500 million [3]	1.40%	2018		1,500
Senior notes USD 1,250 million [2]	6.00%	2024	1,250	
Senior notes USD 1,250 million [2]	6.75%	2028	1,250	
Senior notes USD 844 million	2.95%	2022	862	864
Senior notes USD 789 million	6.15%	2036	782	781
Senior notes USD 700 million	2.25%	2020	700	700
Senior notes USD 613 million	3.65%	2021	622	624
Senior notes USD 588 million	3.65%	2021	587	587
Senior notes CHF 450 million	1.50%	2018	458	461
Senior notes CHF 350 million	0.50%	2022	357	360
Senior notes CHF 350 million	1.00%	2025	357	360
Senior notes CHF 300 million [9]	0.13%	2018		308
Fair value hedge accounting adjustments			(24)	(2)
Total senior notes			29,054	28,367
Term loan USD 2.5 billion [4]	LIBOR +1.1375%	2018		285
Term loan USD 2.5 billion [4]	LIBOR +1.50%	2017-2020		2,000
Term loan JPY 58.5 billion [5]	JPY LIBOR +0.55%	2022		519
Term loan JPY 35 billion [6]	1.42%	2019		311
Term loan JPY 35 billion [6]	JPY LIBOR +0.3%	2018		311
Total loans				3,426
Debentures USD 15 million [7]	7.20%	2018		15
Other	7.78%	2026	6	5
Total debentures and others			6	20
Less current maturities			(2,158)	(2,880)

Derivative instruments	24	2
Less debt issuance costs	(110)	(106)
Total senior notes and loans	$ 26,816	$ 28,829

(1) In March 2018, Teva Pharmaceutical Finance Netherlands II B.V., a Teva finance subsidiary, issued senior notes in an aggregate principal amount of 1.6 billion.

(2) In March 2018, Teva Pharmaceutical Finance Netherlands III B.V., a Teva finance subsidiary, issued senior notes in an aggregate principal amount of $2.5 billion.

(3) In March 2018, Teva redeemed in full its $1.5 billion 1.4% senior notes due in July 2018 and its 1.0 billion 2.88% senior notes due in April 2019.

(4) During the first quarter of 2018, Teva prepaid approximately $2.3 billion principal amount of the remaining term loan facilities.

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(5) During the first quarter of 2018, Teva prepaid in full JPY 86.8 billion principal amount of the outstanding term loan facilities of which JPY 28.3 billion were in short-term debt as of December 31, 2017.

(6) During the first quarter of 2018, Teva prepaid in full JPY 70 billion of its 1.42% and JPY LIBOR+0.3% outstanding term loans.

(7) During the first quarter of 2018, Teva prepaid in full $15 million of its outstanding debentures.

(8) In September 2018, Teva consummated a cash tender offer for certain of its outstanding senior notes. As a result of the offer, Teva redeemed $300 million aggregate principal amount of its 1.7% senior notes and 90 million principal amount of its 0.38% senior notes.

(9) In July 2018, Teva repaid at maturity CHF 300 million of its 0.13% senior notes.

Long term debt was issued by several indirect wholly-owned subsidiaries of the Company and is fully and unconditionally guaranteed by the Company as to payment of all principal, interest, discount and additional amounts (as defined), if any.

Long term debt as of September 30, 2018 is effectively denominated (taking into consideration cross currency swap agreements) in the following currencies: U.S. dollar 63%, euro 34% and Swiss franc 3%.

Teva s principal sources of short-term liquidity are its existing cash investments, liquid securities and available credit facilities, primarily its $3 billion syndicated revolving credit facility (RCF), which was not utilized as of September 30, 2018, as well as internally generated funds. In connection with the requirements of the RCF, the Company entered into negative pledge agreements with certain banks and institutional investors. Under the agreements, the Company and its subsidiaries have undertaken not to register floating charges on assets in favor of any third parties without the prior consent of the banks, to maintain certain financial ratios, including the requirement to maintain compliance with a net debt to EBITDA ratio, which becomes more restrictive over time, and to fulfill other restrictions, as stipulated by the agreements. As of September 30, 2018, the Company did not have any outstanding debt under the RCF, which is its only debt subject to the net debt to EBITDA covenant. Assuming utilization of the RCF, and under specified circumstances, including non-compliance with such covenants and the unavailability of any waiver, amendment or other modification thereto and the expiration of any applicable grace period thereto, substantially all of the Company s debt could be negatively impacted by non-compliance with such covenants. The Company has sufficient resources to meet its financial obligations in the ordinary course of business for at least twelve months from the date of the release of this quarterly report.

NOTE 12 Fair value measurement:

Teva s financial instruments consist mainly of cash and cash equivalents, investment in securities, current and non-current receivables, short-term debt, current and non-current payables, contingent consideration, senior notes and loans, convertible senior debentures and derivatives.

The fair value of the financial instruments included in working capital and non-current receivables and payables approximates their carrying value. The fair value of term loans and bank facilities mostly approximates their carrying value, since they bear interest at rates close to the prevailing market rates.

Financial instruments measured at fair value

The Company measures fair value and discloses fair value measurements for financial assets and liabilities. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The accounting standard establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable inputs that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available.

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In determining fair value, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs, to the extent possible, and considers counterparty credit risk in its assessment of fair value.

There were no transfers between Level 1, Level 2 and Level 3 during the first nine months of 2018.

Financial items carried at fair value as of September 30, 2018 and December 31, 2017 are classified in the tables below in one of the three categories described above:

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
	(U.S. $ in millions)			
Cash and cash equivalents:				
Money markets	$ 302	$	$	$ 302
Cash, deposits and other	1,573			1,573
Investment in securities:				
Equity securities	53			53
Other, mainly debt securities	2		18	20
Derivatives:				
Asset derivatives options and forward contracts		23		23
Asset derivatives cross currency swaps		42		42
Liabilities derivatives options and forward contracts		(14)		(14)
Liabilities derivatives interest rate and cross-currency swaps		(82)		(82)
Contingent consideration*			(717)	(717)
Total	$ 1,930	$ (31)	$ (699)	$ 1,200

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
	(U.S. $ in millions)			
Cash and cash equivalents:				
Money markets	$ 5	$	$	$ 5
Cash, deposits and other	958			958
Investment in securities:				
Equity securities	65			65
Other, mainly debt securities	14		18	32
Derivatives:				
Asset derivatives options and forward contracts		17		17
Asset derivatives cross-currency swaps		25		25
Liability derivatives options and forward contracts		(15)		(15)
Liabilities derivatives interest rate and cross-currency swaps		(98)		(98)
Contingent consideration*			(735)	(735)
Total	$ 1,042	$ (71)	$ (717)	$ 254

* Contingent consideration represents liabilities recorded at fair value in connection with acquisitions.

Teva determined the fair value of the liability for the contingent consideration based on a probability-weighted discounted cash flow analysis. This fair value measurement is based on significant unobservable inputs in the market and thus represents a Level 3 measurement within the fair value hierarchy. The fair value of the contingent consideration is based on several factors, such as: the cash flows projected from the success of unapproved product candidates; the probability of success of product candidates, including risks associated with uncertainty regarding achievement and payment of milestone events; the time and resources needed to complete the development and approval of product candidates; the life of the potential commercialized products and associated risks of obtaining regulatory approvals in the U.S. and Europe, and the risk adjusted discount rate for fair value measurement.

The contingent consideration is evaluated quarterly, or more frequently, if circumstances dictate. Changes in the fair value of contingent consideration are recorded in earnings.

Significant changes in unobservable inputs, mainly the probability of success and cash flows projected, could result in material changes to the contingent consideration liability.

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The following table summarizes the activity for those financial assets and liabilities where fair value measurements are estimated utilizing Level 3 inputs:

	Nine months ended September 30, 2018 (U.S. $ in millions)
Fair value at the beginning of the period	$ (717)
Adjustments to provisions for contingent consideration:	
Actavis Generics transaction	(21)
Labrys transaction	(17)
Eagle transaction	(46)
Settlement of contingent consideration:	
Eagle transaction	102
Fair value at the end of the period	$ (699)

Financial instruments not measured at fair value

Financial instruments measured on a basis other than fair value mostly consist of senior notes and convertible senior debentures and are presented in the table below in terms of fair value:

	Estimated fair value*	
	September 30, 2018	December 31, 2017
	(U.S. $ in millions)	
Senior notes included under senior notes and loans	$ 24,775	$ 23,459
Senior notes and convertible senior debentures included under short-term debt	2,614	2,713
Total	$ 27,389	$ 26,172

* The fair value was estimated based on quoted market prices, where available.

NOTE 13 Derivative instruments and hedging activities:

The following table summarizes the notional amounts for hedged items, when transactions are designated as hedge accounting:

	September 30, 2018	December 31, 2017

		(U.S. $ in millions)	
Cross-currency swap	cash flow hedge	$ 588	$ 588
Cross-currency swap	net investment hedge	1,000	1,000
Interest rate swap	fair value hedge	500	500

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The following table summarizes the classification and fair values of derivative instruments:

	Fair value			
	Designated as hedging instruments		Not designated as hedging instruments	
	September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
Reported under	(U.S. $ in millions)			
Asset derivatives:				
Other current assets:				
Option and forward contracts	$	$	$ 23	$ 17
Other non-current assets:				
Cross-currency swaps cash flow hedge	42	25		
Liability derivatives:				
Other current liabilities:				
Option and forward contracts			(14)	(15)
Other taxes and long-term liabilities:				
Cross-currency swaps net investment hedge	(58)	(96)		
Senior notes and loans:				
Interest rate swaps fair value hedge	(24)	(2)		

Derivatives on foreign exchange contracts mainly hedge Teva s balance sheet items from currency exposure but are not designated as hedging instruments for accounting purposes. With respect to such derivatives, gains of $11 million and losses of $72 million were recognized under financial expenses, net for the nine months ended September 30, 2018 and 2017, respectively, and gains of $6 million and losses of $14 million were recognized under financial expenses, net for the three months ended September 30, 2018 and 2017, respectively. Such losses and gains offset the revaluation of the balance sheet items which is also recorded under financial expenses, net.

During the second quarter of 2018, the Company entered into option contracts and designed these transactions to limit the exposure of foreign exchange fluctuations on the euro denominated revenues with respect to the quarter for which such instruments are purchased. These derivative instruments do not meet the criteria for hedge accounting, however, they are accounted for as economic hedge. These derivative instruments are recognized on the balance sheet at their fair value, with changes in the fair value recognized under the same line item in the statements of income as the underlying exposure being hedged. The cash flows associated with these derivatives are reflected as cash flows from operating activities in the consolidated statements of cash flows. During the third quarter of 2018, the impact of such derivative instruments was immaterial.

With respect to the interest rate and cross-currency swap agreements, gains of $1 million and $4 million were recognized under financial expenses, net for the nine months ended September 30, 2018 and 2017, respectively, and gains of $0.5 million and $1 million were recognized under financial expenses, net for the three months ended September 30, 2018 and 2017, respectively. Such gains mainly reflect the differences between the fixed interest rate and the floating interest rate.

Commencing in the third quarter of 2015, Teva entered into forward starting interest rate swap and treasury lock agreements designated as cash flow hedges of the U.S. dollar debt issuance in July 2016, with respect to $3.75 billion and $1.5 billion notional amounts, respectively. These agreements hedged the variability in anticipated future interest

payments due to possible changes in the benchmark interest rate between the date the agreements were entered into and the actual date of the U.S. dollar debt issuance in July 2016 (in connection with the closing of the Actavis Generics acquisition).

Certain of the forward starting interest rate swaps and treasury lock agreements matured during the first half of 2016. In July 2016, Teva terminated the remaining forward starting interest rate swaps and treasury lock agreements. The termination of these transactions resulted in a loss position of $493 million, of which $242 million were settled on October 7, 2016 and the remaining amount was settled in January 2017. The change in fair value of these instruments recorded as part of other comprehensive income is amortized under financial expenses, net over the life of the debt. Such losses mainly reflect the changes in the benchmark interest rate between the date the agreements were entered into and the actual date of the U.S. debt issuance in July 2016.

With respect to the forward starting interest rate swaps and treasury lock agreements, losses of $21 million and $20 million were recognized under financial expenses, net for the nine months ended September 30, 2018 and 2017, respectively, and losses of $7 million were recognized under financial expenses, net for each of the three months ended September 30, 2018 and 2017.

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In the third quarter of 2016, Teva terminated interest rate swap agreements designated as fair value hedge relating to certain senior notes. Settlement of these transactions resulted in a gain position of $41 million. The fair value hedge accounting adjustments of these instruments recorded under senior notes and loans will be amortized under financial expenses, net over the life of the debt. With respect to these terminated interest rate swap agreements, gains of $5 million were recognized under financial expenses, net for both the nine months ended September 30, 2018 and 2017, and gains of $2 million were recognized under financial expenses, net for both the three months ended September 30, 2018 and 2017.

In the fourth quarter of 2016, Teva entered into an interest rate swap agreement designated as fair value hedge relating to its 2.8% senior notes due 2023 with respect to $500 million notional amount of outstanding debt.

In each of the first and second quarters of 2017, Teva entered into a cross currency swap agreement maturing in 2020 with a notional amount of $500 million. These cross currency swaps were designated as a net investment hedge of Teva s euro denominated net assets, in order to reduce the risk of adverse exchange rate fluctuations. The effective portion of the hedge will be determined by looking into changes in spot exchange rate. The change in fair value of the cross currency swap attributable to changes other than those due to fluctuations in the spot exchange rates are excluded from the assessment of hedge effectiveness and are reported directly in the statement of income.

With respect to these cross currency swap agreements, gains of $22 million and $8 million were recognized under financial expenses, net for the nine months ended September 30, 2018 and 2017, respectively, and gains of $6 million and $4 million were recognized under financial expenses, net for the three months ended September 30, 2018 and 2017, respectively.

NOTE 14 Other asset impairments, restructuring and other items:

Other impairments, restructuring and other items consisted of the following:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	(U.S. $ in millions)			
Restructuring expenses	$ 88	$ 72	$ 442	$ 300
Integration and acquisition expenses	4	31	9	87
Contingent consideration	29	18	84	179
Impairments of long-lived assets	521	408	1,501	564
Other	16	21	44	79
Total	$ 658	$ 550	$ 2,080	$ 1,209

In determining the estimated fair value of long-lived assets, Teva utilized a discounted cash flow model. The key assumptions within the model related to forecasting future revenue and operating income, an appropriate WACC and an appropriate terminal value based on the nature of the long-lived asset. The Company s updated forecasts of net cash flows for the impaired assets reflect, among others, the following: (i) for IPR&D assets, the impact of changes to the development programs, the projected development and regulatory timeframes and the risks associated with these assets; and (ii) for product rights, pricing and volume projections, as well as patent life and any significant changes to the competitive environment.

As a result of Teva s plant rationalization acceleration, following the two year restructuring plan that was announced in December, 2017, to the extent the Company will change its plans on any given asset and/or the assumptions underlying such plan, there could be additional impairments in the future.

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Impairments

Impairments of long-lived intangible assets in the third quarter of 2018 were $519 million, mainly consisting of:

a) IPR&D assets of $306 million, mainly related to revaluation of generic products acquired from Actavis Generics due to development progress and changes in other key valuation indications (e.g., market size, legal landscape, launch date or discount rate).

b) Identifiable product rights of $185 million, mainly due to updated market assumptions regarding price and volume of products acquired from Actavis Generics currently marketed in the United States and supply constraints.

Impairments of property, plant and equipment of $2 million.

Impairments of long-lived intangible assets in the first nine months of 2018 were $1,246 million, mainly consisting of:

a) IPR&D assets of $867 million, mainly related to revaluation of generic products acquired from Actavis Generics due to development progress and changes in other key valuation indications (e.g., market size, legal landscape, launch date or discount rate).

b) Identifiable product rights of $328 million due to updated market assumptions regarding price and volume of products acquired from Actavis Generics currently marketed in the United States and supply constraints.

Impairments of property, plant and equipment in the first nine months of 2018 were $255 million, mainly consisting of:

a) $155 million related to the restructuring plan, including:

$113 million related to site closures in Israel; and

$42 million related to the consolidation of headquarters and distribution sites in the United States.

b) Other impairment costs, mainly $64 million related to a plant located in India in connection with the P&G separation agreement. See note 3.

Restructuring

In the three months ended September 30, 2018, Teva recorded $88 million of restructuring expenses, compared to $72 million in the three months ended September 30, 2017.

In the first nine months of 2018, Teva recorded $442 million of restructuring expenses, compared to $300 million in the first nine months of 2017. The expenses in the first nine months of 2018 were primarily related to headcount reductions across all functions.

Since the announcement of its restructuring plan, Teva reduced its global headcount by approximately 9,100 full-time-equivalent employees.

During the three months ended September 30, 2018, Teva recorded a $2 million impairment of property, plant and equipment related to restructuring costs.

During the first nine months of 2018 Teva recorded a $155 million impairment of property, plant and equipment related to restructuring costs as detailed in Impairments above.

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The following tables provide the components of costs associated with Teva s restructuring plan, including other costs associated with Teva s restructuring plan and recorded under different items:

	Three months ended September 30,	
	2018	2017
	(U.S. $ in millions)	
Restructuring		
Employee termination	$ 62	$ 54
Other	26	18
Total	$ 88	$ 72

	Three months ended September 30,	
	2018	2017
	(U.S. $ in millions)	
Other		
Cost of sales	$ 8	$ 3
Selling and marketing expenses		3
Other items	16	

	Nine months ended September 30,	
	2018	2017
	(U.S. $ in millions)	
Restructuring		
Employee termination	$ 380	$ 228
Other	62	72
Total	$ 442	$ 300

	Nine months ended September 30,	
	2018	2017
	(U.S. $ in millions)	
Other		
Cost of sales	$ 23	$ 5
Selling and marketing expenses		3
Other items	54	

The following table provides the components of and changes in the Company s restructuring accruals:

	Employee termination costs	Other	Total

	(U.S. $ in millions)		
Balance as of January 1, 2018	$ (294)	$ (17)	$ (311)
Provision	(380)	(62)	(442)
Utilization and other*	418	51	469
Balance as of September 30, 2018	$ (256)	$ (28)	$ (284)

* Includes adjustments for foreign currency translation.

In July 2018, the FDA completed an inspection of Teva s manufacturing plant in Davie, Florida in the United States and issued a Form FDA-483 to the site. In October 2018, the FDA notified Teva that the inspection of the site is classified as official action indicated (OAI). Teva is working diligently to investigate the FDA s observations in a manner consistent with Current Good Manufacturing Practices (CGMPs) and to address those observations as quickly and as thoroughly as possible. The impact of such investigation and remediation on the financial statements in the third quarter of 2018 was immaterial. However, if Teva is unable to remediate the findings in a timely manner, Teva may face additional consequences, including potential delays in FDA approval for future products from the site, other financial implications due to loss of revenues, impairments, inventory write offs, customer penalties, idle capacity charges and other costs of remediation.

In July 2018, Teva announced the voluntary recall of valsartan and certain combination valsartan medicines in various countries due to the detection of trace amounts of an unexpected impurity in the API provided by a third party supplier, Zhejiang Huahai

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Pharmaceutical (Zhejiang), used in the production of such medicines. On September 28, 2018, the FDA issued an import ban on all APIs and other drug products made by Zhejiang in its Chuannan site into the United States. On the same date, the EU authorities issued to Zhejiang a statement of non-compliance for the manufacture of valsartan (and its intermediates) for EU medicines produced in the Chuannan site, thus prohibiting marketing authorization holders in the EU from using such valsartan materials in the production of finished products. On October 15, 2018, the EU authorities announced that Zhejiang was under increased supervision with respect to other APIs produced by Zhejiang. Many regulatory agencies around the world continue to review information relating to valsartan medicines and the sartan products as a group. The impact of this recall on the Company s financial statements in the first nine months of 2018 was $46 million, primarily related to recall and inventory reserves. Depending on the scope of regulatory actions, duration of the API outage and severity of the impurity, Teva may face additional loss of revenues and profits, customer penalties, impairments and/or other litigation costs.

NOTE 15 Legal settlements and loss contingencies:

In the third quarter of 2018, the Company recorded expenses of $19 million for legal settlements and loss contingencies, compared to income of $20 million in the third quarter of 2017.

In the first nine months of 2018, Teva recorded income of $1,239 million in connection with legal settlements, compared to an expense of $324 million in the first nine months of 2017. The income in the first nine months of 2018 consisted primarily of the working capital adjustment with Allergan, the Rimsa settlement and reversal of the reserve recorded in the second quarter of 2017 with respect to the carvedilol patent litigation.

As of September 30, 2018 and December 31, 2017 Teva s provision for legal settlements and loss contingencies recorded under accrued expenses was $663 million and $1,232 million, respectively.

NOTE 16 Commitments and Contingencies:

General

From time to time, Teva and/or its subsidiaries are subject to claims for damages and/or equitable relief arising in the ordinary course of business. In addition, as described below, in large part as a result of the nature of its business, Teva is frequently subject to litigation. Teva generally believes that it has meritorious defenses to the actions brought against it and vigorously pursues the defense or settlement of each such action. Except as described below, Teva does not currently have a reasonable basis to estimate the loss, or range of loss, that is reasonably possible with respect to matters disclosed in this note.

Teva records a provision in its financial statements to the extent that it concludes that a contingent liability is probable and the amount thereof is estimable. Based upon the status of the cases described below, management s assessments of the likelihood of damages, and the advice of counsel, no provisions have been made regarding the matters disclosed in this note, except as noted below. Litigation outcomes and contingencies are unpredictable, and excessive verdicts can occur. Accordingly, management s assessments involve complex judgments about future events and often rely heavily on estimates and assumptions. Teva continuously reviews the matters described below and may, from time to time, remove previously disclosed matters that the Company has determined no longer meet the materiality threshold for disclosure.

If one or more of such proceedings described below were to result in final judgments against Teva, such judgments could be material to its results of operations and cash flows in a given period. In addition, Teva incurs significant legal fees and related expenses in the course of defending its positions even if the facts and circumstances of a particular

litigation do not give rise to a provision in the financial statements.

In connection with third-party agreements, Teva may under certain circumstances be required to indemnify, and may be indemnified by, in unspecified amounts, the parties to such agreements against third-party claims. Among other things, Teva s agreements with third parties may require Teva to indemnify them, or require them to indemnify Teva, for the costs and damages incurred in connection with product liability claims, in specified or unspecified amounts.

Except as otherwise noted, all of the litigation matters disclosed below involve claims arising in the United States. Except as otherwise noted, all third party sales figures given below are based on IQVIA (formerly IMS Health Inc.) data.

Intellectual Property Litigation

From time to time, Teva seeks to develop generic versions of patent-protected pharmaceuticals for sale prior to patent expiration in various markets. In the United States, to obtain approval for most generics prior to the expiration of the originator s patents, Teva must challenge the patents under the procedures set forth in the Hatch-Waxman Act of 1984, as amended. To the extent that Teva seeks to utilize such patent challenge procedures, Teva is and expects to be involved in patent litigation regarding the validity,

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enforceability or infringement of the originator s patents. Teva may also be involved in patent litigation involving the extent to which its product or manufacturing process techniques may infringe other originator or third-party patents.

Additionally, depending upon a complex analysis of a variety of legal and commercial factors, Teva may, in certain circumstances, elect to market a generic version even though litigation is still pending. To the extent Teva elects to proceed in this manner, it could face substantial liability for patent infringement if the final court decision is adverse to Teva, which could be material to its results of operations and cash flows in a given period.

The general rule for damages in patent infringement cases in the United States is that the patentee should be compensated by no less than a reasonable royalty, and it may also be able in certain circumstances to be compensated for its lost profits. The amount of a reasonable royalty award would generally be calculated based on the sales of Teva s product. The amount of lost profits would generally be based on the lost sales of the patentee s product. In addition, the patentee may seek consequential damages as well as enhanced damages of up to three times the profits lost by the patent holder for willful infringement, although courts have typically awarded much lower multiples.

Teva is also involved in litigation regarding patents in other countries where it does business, particularly in Europe, where Teva has in recent years increased the number of launches of its generic versions of branded pharmaceuticals prior to the expiration of the innovator s patents. The laws concerning generic pharmaceuticals and patents differ from country to country. Damages for patent infringement in Europe may include lost profits or a reasonable royalty, but enhanced damages for willful infringement are generally not available.

In July 2014, GlaxoSmithKline (GSK) sued Teva in Delaware federal court for infringement of a patent expiring in June 2015 directed to using carvedilol in a specified manner to decrease the risk of mortality in patients with congestive heart failure. Teva and eight other generic producers began selling their carvedilol tablets (the generic version of GSK s Coreg®) in September 2007. Teva vigorously disputed GSK s claims on the merits and also disputed the amount and nature of GSK s alleged damages. A jury trial was held and the jury returned a verdict in GSK s favor finding Teva liable for induced infringement, including willful infringement, and assessing damages of $235.5 million, not including pre- or post-judgment interest. Teva filed post-trial motions for judgment as a matter of law asking the court to overturn the jury verdict on inducement, invalidity, and the award of lost profits damages, and GSK filed post-trial motions asking the court to increase the damages amount in light of the willful infringement finding and to set the interest rate(s) to be applied to the total damages amount. On March 28, 2018, the district court issued an opinion overturning the jury verdict and instead found no induced infringement by Teva, thereby finding that Teva did not owe any damages. The district court denied Teva s motion seeking to overturn the jury verdict with respect to invalidity and denied GSK s motion seeking to increase the damages award. On May 25, 2018, GSK appealed the decision, and Teva filed an appeal of certain adverse rulings. If the appeal of the district court s decision is decided against Teva, the case would be remanded to the district court for it to consider Teva s other legal and equitable defenses that have not yet been considered by the district court. The provision that was included in the financial statements for this matter has been reversed as the exposure is no longer considered probable.

In 2014, Teva Canada succeeded in its challenge of the bortezomib (the generic equivalent of Velcade®) product and mannitol ester patents under the Patented Medicines (Notice Of Compliance) Regulations (PM(NOC)). Teva commenced sales in the first quarter of 2015. At the time of Teva s launch, annual sales of Velcade were approximately 94 million Canadian dollars. Teva commenced an action under Section 8 of PM(NOC) to recover damages for being kept off of the market during the PM(NOC) proceedings. Janssen and Millennium filed a counterclaim for infringement of the same two patents as well as a patent covering a process to prepare bortezomib. The product patent expired in October 2015; the other patents expire in January 2022 and March 2025. On December 20, 2017, Teva entered into an agreement with Janssen and Millennium which limits the damages payable by either party depending on the outcome of the infringement/impeachment action. As a result, the most Janssen and

Millennium could recover is 200 million Canadian dollars (approximately $159 million) plus post-judgment interest. The trial, which is limited to the issue of patent validity and infringement, began on January 29, 2018 and concluded on March 8, 2018. On June 27, 2018, the court issued its opinion in Teva s favor and ruled that Janssen and Millennium are to pay Teva 5 million Canadian dollars in Section 8 damages. On September 28, 2018, Janssen and Millennium filed an appeal of this decision with respect to two of the patents subject to the original proceedings. If the decision is overturned on appeal, Teva could owe the capped damages set forth above. In addition to the potential damages that could be awarded, if Janssen and Millennium are ultimately successful in this claim, Teva could be ordered to cease sales of its bortezomib product.

On July 8, 2011, Helsinn sued Teva over its filing of an ANDA to market a generic version of palonosetron IV solution (the generic equivalent of Aloxi®), and in November 2015, the District Court of New Jersey ruled against Teva. Teva appealed this decision, and in May 2017, the Federal Circuit Court of Appeals reversed the district court s ruling and found the asserted patents invalid. In January 2018, full appellate review of that decision was denied. Helsinn filed an appeal with the US Supreme Court, which was granted on June 25, 2018. Oral argument has been scheduled for December 4, 2018. If the Supreme Court reverses the appellate decision, the case may be remanded to the district court. Separately, in October 2014, Helsinn filed an additional claim on later-acquired patents, but that litigation was stayed pending the outcome of the original case. Following the appellate court s decision in

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Teva s favor in the original case, Helsinn reopened the stayed case on the later-acquired patent and filed a motion for a preliminary injunction based on that later-acquired patent. On January 30, 2018, the District Court of New Jersey denied Helsinn s request for a preliminary injunction. Teva launched its generic palonosetron IV solution after obtaining final regulatory approval on March 23, 2018. If Teva ultimately loses either one of the cases discussed above, Teva may be ordered, by the court, to cease sales of its generic product and/or pay damages to Helsinn. Aloxi® annual sales as of November 2017 were $459 million in the U.S.

Product Liability Litigation

Teva s business inherently exposes it to potential product liability claims. Teva maintains a program of insurance, which may include commercial insurance, self-insurance (including direct risk retention), or a combination of both approaches, in amounts and on terms that it believes are reasonable and prudent in light of its business and related risks. However, Teva sells, and will continue to sell, pharmaceuticals that are not covered by its product liability insurance; in addition, it may be subject to claims for which insurance coverage is denied as well as claims that exceed its policy limits. Product liability coverage for pharmaceutical companies is becoming more expensive and increasingly difficult to obtain. As a result, Teva may not be able to obtain the type and amount of commercial insurance it desires, or any commercial insurance on reasonable terms, in all of its markets.

Competition Matters

As part of its generic pharmaceuticals business, Teva has challenged a number of patents covering branded pharmaceuticals, some of which are among the most widely-prescribed and well-known drugs on the market. Many of Teva s patent challenges have resulted in litigation relating to Teva s attempts to market generic versions of such pharmaceuticals under the federal Hatch-Waxman Act. Some of this litigation has been resolved through settlement agreements in which Teva obtained a license to market a generic version of the drug, often years before the patents expire.

Teva and its subsidiaries have increasingly been named as defendants in cases that allege antitrust violations arising from such settlement agreements. The plaintiffs in these cases, which are usually direct and indirect purchasers of pharmaceutical products, and often assert claims on behalf of classes of all direct and indirect purchasers, typically allege that (1) Teva received something of value from the innovator in exchange for an agreement to delay generic entry, and (2) significant savings could have been realized if there had been no settlement agreement and generic competition had commenced earlier. These class action cases seek various forms of injunctive and monetary relief, including damages based on the difference between the brand price and what the generic price allegedly would have been and disgorgement of profits, which are automatically trebled under the relevant statutes, plus attorneys fees and costs. The alleged damages generally depend on the size of the branded market and the length of the alleged delay, and can be substantial potentially measured in multiples of the annual brand sales particularly where the alleged delays are lengthy or branded drugs with annual sales in the billions of dollars are involved.

Teva believes that its settlement agreements are lawful and serve to increase competition, and has defended them vigorously. In Teva s experience to date, these cases have typically settled for a fraction of the high end of the damages sought, although there can be no assurance that such outcomes will continue.

In June 2013, the United States Supreme Court held, in Federal Trade Commission v. Actavis, Inc. (the AndroGel case), that a rule of reason test should be applied in analyzing whether such settlements potentially violate the federal antitrust laws. The Supreme Court held that a trial court must analyze each agreement in its entirety in order to determine whether it violates the antitrust laws.

This new test has resulted in increased scrutiny of Teva s patent settlements, additional action by the FTC and state and local authorities, and an increased risk of liability in Teva s currently pending antitrust litigations.

In April 2006, certain subsidiaries of Teva were named in a class action lawsuit filed in the U.S. District Court for the Eastern District of Pennsylvania. The case alleges that the settlement agreements entered into between Cephalon, Inc., now a Teva subsidiary (Cephalon), and various generic pharmaceutical companies in late 2005 and early 2006 to resolve patent litigation involving certain finished modafinil products (marketed as PROVIGIL®) were unlawful because they had the effect of excluding generic competition. The case also alleges that Cephalon improperly asserted its PROVIGIL patent against the generic pharmaceutical companies. The first lawsuit was brought by King Drug Company of Florence, Inc. on behalf of itself and as a proposed class action on behalf of any other person or entity that purchased PROVIGIL directly from Cephalon. Similar allegations were made in other complaints, including those filed on behalf of a proposed class of end payers of PROVIGIL, by certain individual end payers, by certain retail chain pharmacies and by Apotex, Inc. (collectively, these cases are referred to as the Philadelphia Modafinil Action). Separately, Apotex challenged Cephalon s PROVIGIL patent, and in October 2011, the court found the patent to be invalid and unenforceable based on inequitable conduct. This decision was affirmed on appeal in April 2013. Teva has either settled or reached agreements in principle to settle with all of the plaintiffs in the Philadelphia Modafinil Action. However, one of the end payers, United Healthcare Services, took the position that it is not bound by the settlement that was agreed to on its behalf and brought a separate action in Minnesota federal court, which was transferred to the U.S. District Court for the Eastern District of Pennsylvania, where Teva had filed suit to enforce the settlement. A bench trial was held in April 2018, and the court issued its opinion on September 19, 2018, ruling in Teva s favor

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and holding that United Healthcare is bound by the settlement. On October 16, 2018, United Healthcare moved the court to amend its final judgment and to clarify that the final judgment does not address how settlement proceeds should be allocated among United Healthcare and the other end payers. That motion was denied on October 30, 2018. Additionally, Cephalon and Teva have reached a settlement with 48 state attorneys general, which was approved by the court on November 7, 2016. Certain other claimants, including the State of California, have given notices of potential claims related to these settlement agreements. Teva has produced documents and information in response to discovery requests issued by the California Attorney General s office as part of its ongoing investigation of generic competition to PROVIGIL.

In May 2015, Cephalon entered into a consent decree with the FTC under which the FTC dismissed its claims against Cephalon in the FTC Modafinil Action in exchange for payment of $1.2 billion (less set-offs for prior settlements) by Cephalon and Teva into a settlement fund. Under the consent decree, Teva also agreed to certain injunctive relief with respect to the types of settlement agreements Teva may enter into to resolve patent litigation in the United States for a period of ten years. The settlement fund does not cover any judgments or settlements outside the United States.

Following an investigation initiated by the European Commission in April 2011 regarding a modafinil patent settlement in Europe, the Commission issued a Statement of Objections in July 2017 against both Cephalon and Teva alleging that the 2005 settlement agreement between the parties had the object and effect of hindering the entry of generic modafinil. Teva submitted its defense in writing and an oral hearing was held. No final decision regarding infringement has yet been taken by the Commission. The sales of modafinil in the European Economic Area during the last full year of the alleged infringement amounted to EUR 46.5 million.

In January 2009, the FTC and the State of California filed a complaint for injunctive relief in California federal court alleging that a September 2006 patent lawsuit settlement between Watson Pharmaceuticals, Inc. (Watson), now a Teva subsidiary, and Solvay Pharmaceuticals, Inc. (Solvay) relating to AndroGel® 1% (testosterone gel) violated the antitrust laws. Additional lawsuits alleging similar claims were later filed by private plaintiffs (including plaintiffs purporting to represent classes of similarly situated claimants as well as direct purchaser plaintiffs filing separately) and the various actions were consolidated in a multidistrict litigation in Georgia federal court. The defendants filed various summary judgment motions on September 29, 2017, which the district court granted in part, and denied in part, on June 13, 2018. The direct-purchaser plaintiffs moved for class certification on February 9, 2018 and that motion was denied on July 16, 2018. The direct-purchaser plaintiffs have not sought to immediately appeal the denial of such class certification. As a result, the three direct purchasers that had sought class certification can proceed as individual plaintiffs, but any other member of the proposed direct purchaser class will need to file a separate, individual lawsuit if it wishes to participate in the litigation. The court has ordered a bench trial on the FTC s claims to start on February 25, 2019, with a jury trial on the private plaintiffs claims to be scheduled thereafter. Annual sales of AndroGel® 1% at the time of the settlement were approximately $350 million, and annual sales of the AndroGel franchise (AndroGel® 1% and AndroGel® 1.62%) were approximately $140 million and $1.05 billion, respectively, at the time Actavis launched its generic version of AndroGel® 1% in November 2015.

In December 2011, three groups of plaintiffs sued Wyeth and Teva for alleged violations of the antitrust laws in connection with their settlement of patent litigation involving extended release venlafaxine (generic Effexor® XR) entered into in November 2005. The cases were filed by a purported class of direct purchasers, by a purported class of indirect purchasers and by certain chain pharmacies in the United States District Court for the District of New Jersey. The plaintiffs claim that the settlement agreement between Wyeth and Teva unlawfully delayed generic entry. In October 2014, the court granted Teva s motion to dismiss in the direct purchaser cases, after which the parties agreed that the court s reasoning applied equally to the indirect purchaser cases. Plaintiffs appealed, and on August 21, 2017, the Third Circuit reversed the district court s decision and remanded for further proceedings. On November 20, 2017, Teva and Wyeth filed a petition for a writ of certiorari in the United States Supreme Court. That petition was denied

on February 20, 2018, and litigation has resumed before the district court. Annual sales of Effexor® XR were approximately $2.6 billion at the time of settlement and at the time generic versions were launched in July 2010.

In February 2012, two purported classes of direct-purchaser plaintiffs sued GSK and Teva in New Jersey federal court for alleged violations of the antitrust laws in connection with their settlement of patent litigation involving lamotrigine (generic Lamictal®) entered into in February 2005. The plaintiffs claim that the settlement agreement unlawfully delayed generic entry and seek unspecified damages. In December 2012, the court dismissed the case, but in June 2015, the Third Circuit reversed and remanded for further proceedings. On February 19, 2016, Teva and GSK filed a petition for a writ of certiorari in the United States Supreme Court, which was denied on November 7, 2016. In the meantime, litigation has resumed before the district court, and direct-purchaser plaintiffs moved for class certification in June 2018. That motion has been fully briefed and remains pending. Annual sales of Lamictal® were approximately $950 million at the time of the settlement, and approximately $2.3 billion at the time generic competition commenced in July 2008.

In April 2013, purported classes of direct purchasers of, and end payers for, Niaspan® (extended release niacin) sued Teva and Abbott for violating the antitrust laws by entering into a settlement agreement in April 2005 to resolve patent litigation over the product. A multidistrict litigation has been established in the U.S. District Court for the Eastern District of Pennsylvania. Throughout

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2015 and in January 2016, several individual direct purchaser opt-out plaintiffs filed complaints with allegations nearly identical to those of the direct purchaser class. In October 2016, the District Attorney for Orange County, California, filed a similar complaint, which has since been amended, in California state court, alleging violations of state law. Defendants moved to strike the District Attorney s claims for restitution and civil penalties to the extent not limited to alleged activity occurring in Orange County. The Superior Court denied that motion, but defendants appealed, and on May 31, 2018, the Court of Appeal, Fourth Appellate District, reversed and instructed the Superior Court to grant defendants motion. The District Attorney petitioned the California Supreme Court to review the Court of Appeal s decision. The petition was granted on August 22, 2018, and the District Attorney filed its opening brief before the California Supreme Court on September 21, 2018. Annual sales of Niaspan® were approximately $416 million at the time of the settlement and approximately $1.1 billion at the time generic competition commenced in September 2013.

In November 2013, a putative class action was filed in Pennsylvania federal court against Actavis, Inc. and certain of its affiliates, alleging that Watson s 2012 patent lawsuit settlement with Endo Pharmaceuticals Inc. relating to Lidoderm® (lidocaine transdermal patches) violated the antitrust laws. Additional lawsuits containing similar allegations followed on behalf of other classes of putative direct purchaser and end-payer plaintiffs, as well as retailers acting in their individual capacities, and those cases were consolidated as a multidistrict litigation in federal court in California. On February 21, 2017, the court granted both the indirect purchaser plaintiffs and the direct purchaser plaintiffs motions for class certification. Teva reached an agreement to settle the multidistrict litigation with the various plaintiff groups in the first quarter of 2018. A provision for these settlements has been included in the financial statements, and in September 2018, the district court gave final approval for the settlements with the direct purchaser and end-payer plaintiffs. The FTC has also filed suit to challenge the Lidoderm® settlement, initially bringing antitrust claims against Watson, Endo, and Allergan in Pennsylvania federal court in March 2016. The FTC later voluntarily dismissed those claims and refiled them (along with a stipulated order for permanent injunction to settle its claims against Endo) in the same California federal court in which the private multidistrict litigation referenced above was pending. On February 3, 2017, the State of California filed its own complaint against Allergan and Watson, and that complaint was also assigned to the California federal court presiding over the multidistrict litigation. After the FTC dismissed its claims in Pennsylvania, but before it re-filed them in California, Watson and Allergan filed suit against the FTC in the same Pennsylvania federal court where the agency had initially brought its lawsuit, seeking a declaratory judgment that the FTC s claims are not authorized by statute, or, in the alternative, that the FTC does not have statutory authority to pursue disgorgement. The federal court in California stayed both the FTC s claims and the State of California s claims against Allergan and Watson, pending the outcome of the declaratory judgment action in Pennsylvania. On October 29, 2018, the Pennsylvania court dismissed that declaratory judgment action for lack of jurisdiction. Annual sales of Lidoderm® at the time of the settlement were approximately $1.2 billion, and were approximately $1.4 billion at the time Actavis launched its generic version in September 2013.

Since November 2013, numerous lawsuits have been filed in various federal courts by purported classes of end payers for, and direct purchasers of, Aggrenox® (dipyridamole/aspirin tablets) against Boehringer Ingelheim (BI), the innovator, and several Teva subsidiaries. The lawsuits allege, among other things, that the settlement agreement between BI and Barr entered into in August 2008 violated the antitrust laws. A multidistrict litigation has been established in the U.S. District Court for the District of Connecticut. Teva and BI s motion to dismiss was denied in March 2015. On April 11, 2017, the Orange County District Attorney filed a complaint for violations of California s Unfair Competition Law based on the Aggrenox® patent litigation settlement. Teva has settled with the putative classes of direct purchasers and end payers, as well as with the opt-out direct purchaser plaintiffs, and with two of the opt-out end payer plaintiffs, Humana and Blue Cross/Blue Shield of Louisiana. A provision has been included in the financial statements for this matter. The district court overruled certain objections to the end payer settlement, including objections made by the Orange County District Attorney, and approved such settlement. The District Attorney subsequently appealed the court s approval to the Second Circuit. Opt-outs from the end payer class have also

appealed certain aspects of the court s approval order to the Second Circuit. Those appeals remain pending. Annual sales of Aggrenox® were approximately $340 million at the time of the settlement and approximately $455 million at the time generic competition began in July 2015.

Since January 2014, numerous lawsuits have been filed in the U.S. District Court for the Southern District of New York by purported classes of end payers for and direct purchasers of Actos® and Acto plus Met® (pioglitazone and pioglitazone plus metformin) against Takeda, the innovator, and several generic manufacturers, including Teva, Actavis and Watson. The lawsuits allege, among other things, that the settlement agreements between Takeda and the generic manufacturers (including Takeda s December 2010 settlement agreement with Teva) violated the antitrust laws. The Court dismissed the end payer lawsuits against all defendants in September 2015. In October 2015, the end payers appealed that ruling, and on March 22, 2016, a stipulation was filed dismissing Teva and the other generic defendants from the appeal. On February 8, 2017, the Court of Appeals for the Second Circuit affirmed the dismissal in part and vacated and remanded the dismissal in part with respect to the claims against Takeda. The direct purchasers case had been stayed pending resolution of the appeal in the end payer matter, and the direct purchasers amended their complaint for a second time after the Court of Appeals for the Second Circuit s decision. Defendants had moved to dismiss the direct purchasers original complaint. Supplemental briefing on that motion based on the new allegations in the amended complaint was completed on June 29, 2017 and oral argument was held on October 23, 2018. At the time of the settlement, annual sales of Actos® were approximately $3.7 billion and annual sales of ACTO plus Met® were approximately $500 million. At the time generic

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competition commenced in August 2012, annual sales of Actos® were approximately $2.8 billion and annual sales of ACTO plus Met® were approximately $430 million.

In June 2014, two groups of end payers sued AstraZeneca and Teva, as well as Ranbaxy and Dr. Reddy s, in the Philadelphia Court of Common Pleas for violating the antitrust laws by entering into settlement agreements to resolve the esomeprazole (generic Nexium®) patent litigation (the Philadelphia Esomeprazole Actions). These end payers had opted out of a class action that was filed in the Massachusetts federal court in September 2012 and resulted in a jury verdict in December 2014 in favor of AstraZeneca and Ranbaxy (the Massachusetts Action). Prior to the jury verdict, Teva settled with all plaintiffs in the Massachusetts Action for $24 million. The allegations in the Philadelphia Esomeprazole Actions are nearly identical to those in the Massachusetts Action. The Philadelphia Esomeprazole Actions were stayed pending resolution of the Massachusetts Action, which was on appeal to the Court of Appeals for the First Circuit with respect to the claims against the non-settling defendants, AstraZeneca and Ranbaxy. On November 21, 2016, the First Circuit affirmed the district court s judgment in favor of AstraZeneca and Ranbaxy, and the plaintiffs petitions for rehearing and rehearing en banc were denied on January 10, 2017.

In September 2014, the FTC sued AbbVie Inc. and certain of its affiliates (AbbVie) as well as Teva in the U.S. District Court for the Eastern District of Pennsylvania alleging that they violated the antitrust laws when they entered into a settlement agreement to resolve the AndroGel® patent litigation and a supply agreement under which AbbVie agreed to supply Teva with an authorized generic version of TriCor®. The FTC alleges that Teva agreed to delay the entry of its generic testosterone gel product in exchange for entering into the TriCor supply agreement. In May 2015, the court dismissed the FTC s claim concerning the settlement and supply agreements, and thus dismissed Teva from the case entirely. The FTC proceeded with a separate claim against AbbVie alone and in June 2018, following a bench trial, the court held that AbbVie had violated the antitrust laws by filing sham patent infringement lawsuits against both Teva and Perrigo in the underlying AndroGel patent litigation. The court ordered AbbVie to pay $448 million in disgorgement but declined to award injunctive relief. The FTC has since filed a notice of appeal as to, among other things, the district court s May 2015 dismissal of the FTC s claim against Teva, referenced above.

Since May 2015, two lawsuits have been filed in the U.S. District Court for the Southern District of New York by a purported class of direct purchasers of, and a purported class of end payers for, Namenda IR® (memantine hydrochloride) against Forest Laboratories, LLC (Forest), the innovator, and several generic manufacturers, including Teva. Teva is only a defendant in the end payer case, in which defendants moved to dismiss the claims made by the end payers. The lawsuits allege, among other things, that the settlement agreements between Forest and the generic manufacturers (including Forest s November 2009 settlement agreement with Teva) violated the antitrust laws. On September 13, 2016, the court denied defendants motions to dismiss, but stayed the cases with respect to the claims brought under state law, which are the only claims asserted against Teva. The court lifted the stay on September 10, 2018 and has referred the parties to mediation. Annual sales of Namenda IR® at the time of the settlement were approximately $1.1 billion, and are currently approximately $1.4 billion.

On March 8, 2016 and April 11, 2016, certain Actavis subsidiaries in the United Kingdom, including Auden Mckenzie Holdings Limited, received notices from the U.K. Competition and Markets Authority (CMA) that it had launched formal investigations under Section 25 of the Competition Act of 1998 (Competition Act) into suspected breaches of competition law in connection with the supply of 10mg and 20mg hydrocortisone tablets. On December 16, 2016, the CMA issued a statement of objections (a provisional finding of infringement of the Competition Act) in respect of certain allegations against Actavis UK and Allergan, which was later reissued to include certain Auden Mckenzie entities. A response was submitted and an oral hearing was held. On December 18, 2017, the CMA issued a Statement of Draft Penalty Calculation. A response was submitted and an oral hearing was held. No final decision regarding infringement of competition law has yet been issued by the CMA. On March 3, 2017, the CMA issued a second statement of objection in respect of certain additional allegations (relating to the same products and covering part of

the same time period as for the first statement of objections) against Actavis UK, Allergan, and a number of other companies, which was later reissued to include certain Auden Mckenzie entities. A response was submitted and an oral hearing was held. On January 9, 2017, Teva completed the sale of Actavis UK to Accord Healthcare Limited, pursuant to which Teva will indemnify Accord Healthcare for potential fines imposed by the CMA and/or damages awarded by a court against Actavis UK as a result of the investigations in respect of conduct prior to the closing date of the sale. In the event of any such fines or damages, Teva expects to assert claims, including claims for breach of warranty, against the sellers of Auden Mckenzie. The terms of the purchase agreement may preclude a full recovery by Teva. A liability for this matter has been recorded in purchase accounting related to the acquisition of Actavis Generics. Further to the Master Purchase Agreement with Allergan whereby Teva agreed to indemnify Allergan for liabilities related to acquired assets, Teva agreed with Allergan to settle and release Teva s indemnity claim and Allergan s potential losses arising from the CMA in connection with this matter, pursuant to the agreement the parties entered into on January 31, 2018. See note 3.

In November 2016, three putative indirect purchaser class actions were filed in federal courts in Wisconsin, Massachusetts and Florida against Shire U.S., Inc. and Shire LLC (collectively, Shire) and Actavis, alleging that Shire s 2013 patent litigation settlement with Actavis related to the ADHD drug Intuniv® (guanfacine) violated various state consumer protection and antitrust laws. On December 30, 2016 and January 11, 2017, two additional similar actions were filed, also in Massachusetts federal court, against Shire and Actavis or Teva (as successor to Actavis) by putative classes of direct purchaser plaintiffs. All five cases are now in Massachusetts federal court and on March 10, 2017, both the indirect purchaser plaintiffs and the direct purchaser plaintiffs filed

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consolidated amended complaints. Annual sales of Intuniv® were approximately $335 million at the time of the settlement, and approximately $327 million at the time generic competition began in 2014.

Government Investigations and Litigation Relating to Pricing and Marketing

Teva is involved in government investigations and litigation arising from the marketing and promotion of its pharmaceutical products in the United States. Many of these investigations originate through what are known as *qui tam* complaints, in which the government reviews a complaint filed under seal by a whistleblower (a relator) that alleges violations of the federal False Claims Act. The government considers whether to investigate the allegations and will, in many cases, issue subpoenas requesting documents and other information, including conducting witness interviews. The government must decide whether to intervene and pursue the claims as the plaintiff. Once a decision is made by the government, the complaint is unsealed. If the government decides not to intervene, then the relator may decide to pursue the lawsuit on his own without the active participation of the government.

A number of state attorneys general have filed various actions against Teva and/or certain of its subsidiaries, including certain Actavis subsidiaries, relating to reimbursements or drug price reporting under Medicaid or other programs. Such price reporting is alleged to have caused states and others to pay inflated reimbursements for covered drugs. Teva and its subsidiaries have reached settlements in most of these cases. On October 4, 2018, Teva settled longstanding litigation filed by the State of Illinois against subsidiaries of Teva and Watson for a total settlement amount of $135 million, to be paid over time through January 2020. Teva accepted the settlement while denying any liability with respect to the claims made by the state. Pending the final settlement payment, the Illinois litigation is stayed. In August 2013, judgment was entered in a separate case brought by the State of Mississippi against Watson, pursuant to which Watson was ordered to pay compensatory damages amounting to $12.4 million. In March of 2014, the Mississippi court amended the judgment to also include punitive damages in the amount of $17.9 million. The judgment was affirmed in all respects by the Mississippi Supreme Court in January of 2018 and has since been satisfied in full. The Actavis subsidiaries remain parties to active litigation in Utah where previously dismissed claims against Watson are now on appeal. A provision for these cases has been included in the financial statements.

Several *qui tam* complaints have been unsealed in recent years as a result of government decisions not to participate in the cases. The following is a summary of certain government investigations, *qui tam* actions and related matters.

In January 2014, Teva received a civil investigative demand from the U.S. Attorney for the Southern District of New York seeking documents and information from January 1, 2006 related to sales, marketing and promotion of COPAXONE and AZILECT, focusing on educational and speaker programs. The demand states that the government is investigating possible civil violations of the federal False Claims Act. In March 2015, the docket in this matter and a False Claims Act civil *qui tam* complaint concerning this matter were unsealed by the court, which revealed that the U.S. Attorney had notified the court in November 2014 that it had declined to intervene in and proceed with the lawsuit. The *qui tam* relators, however, are moving forward with the lawsuit. In June 2015, Teva filed motions to dismiss the complaint. In February 2016, the court stayed its decision on the relators claims based on state and local laws, denied Teva s motions to dismiss the False Claims Act claims, and instructed the relators to amend their complaint with additional information. In March 2016, the relators filed an amended complaint, which Teva answered in April 2016. The parties completed discovery. In August 2018, Teva filed a motion for summary judgment on all claims, which is now pending before the court. No trial date has been set.

In January 2014, a *qui tam* complaint was filed in Rhode Island federal court alleging that Teva and several other defendants, including manufacturers of MS drugs and pharmacy benefit managers, violated the False Claims Act. The *qui tam* action was unsealed on April 4, 2018 after the government declined to intervene. The relator alleges that Teva and the other defendants induced fraudulent overpayments for illegitimate Bona Fide Service Fees in excess of fair

market value to inflate prices for the Medicare Part D program. Teva expects to move to dismiss the complaint in November 2018.

In May 2017, a *qui tam* action was filed against a number of Teva subsidiaries. The *qui tam* action was unsealed on June 13, 2018 after the government declined to intervene. The relator in the case alleges that Teva violated the False Claims Act by devising and engaging in promotional schemes that violate the Anti-Kickback Statute (AKS), resulting in false certifications of compliance with the AKS. Specifically, the relator alleges that Teva paid in-kind remuneration to physicians through reimbursement support and nursing services in order to increase the number of Copaxone prescriptions. An amended complaint was filed on October 15, 2018. Teva will move to dismiss in November 2018.

Beginning in May 2014, various complaints were filed with respect to opioid sales and distribution against various Teva affiliates, along with several other pharmaceutical companies, by a number of cities, counties, states and agencies across the country. There are actions currently pending against Teva and its affiliates that have been brought by various states, subdivisions and state agencies in both state and federal courts. Most of the federal cases have been consolidated into a multidistrict litigation in the Northern District of Ohio (MDL Proceeding). In addition to the complaints filed by states, state agencies and political subdivisions, over 1,500 total lawsuits have been filed in various states, both in state and federal courts. Most of the federal class action cases, as well as

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state cases that have been removed, have been consolidated into the MDL Proceeding. Complaints asserting claims under similar provisions of different state law, generally contend that the defendants allegedly engaged in improper marketing and distribution of opioids, including ACTIQ® and FENTORA. The complaints also assert claims related to Teva s generic opioid products. In addition, several dozen complaints filed by cities, counties and the State of Delaware have named Anda, Inc. (and other distributors and manufacturers) alleging that Anda failed to develop and implement systems sufficient to identify suspicious orders of opioid products and prevent the abuse and diversion of such products to individuals who used them for other than legitimate medical purposes. Plaintiffs seek a variety of remedies, including restitution, civil penalties, disgorgement of profits, treble damages, attorneys fees and injunctive relief. None of the complaints specify the exact amount of damages at issue. Teva and its affiliates that are defendants in the various lawsuits deny all allegations asserted in these complaints and have filed or will file motions to dismiss where possible. On August 13, 2018, the judge in the MDL Proceeding issued a revised case management order setting the first trial for September 2019. The court has also commenced motion to dismiss briefing on certain issues in bellwether cases and the first set of briefing was completed in July 2018. On October 5, 2018, the court issued a Report & Recommendation on the first motion to dismiss filed in the bellwether cases, in which it denied defendants motions to dismiss except for the common law public nuisance claim, which was dismissed. Motions to dismiss in eight additional similar cases remain pending. In addition, discovery has commenced in the MDL Proceeding for three cases based in Ohio and fact discovery is ongoing. Other cases remain pending in various state courts, including Oklahoma, where a trial is scheduled to begin in May 2019. In some jurisdictions, such as Connecticut, Illinois, New York, Pennsylvania and Texas, certain state court cases have been transferred to a single court within their respective state court systems for coordinated pretrial proceedings. Several state courts have allowed discovery to begin. On April 27, 2018, Teva received subpoena requests from the DOJ seeking documents relating to the manufacture, marketing and sale of opioids. Teva is complying with this subpoena. In addition, a number of state attorneys general, including a coordinated multistate effort, have initiated investigations into sales and marketing practices of Teva and its affiliates with respect to opioids. Other states are conducting their own investigations outside of the multistate group. Teva is cooperating with these ongoing investigations and cannot predict the outcome at this time.

On June 21, 2016, Teva USA received a subpoena from the Antitrust Division of the DOJ seeking documents and other information relating to the marketing and pricing of certain Teva USA generic products and communications with competitors about such products. Actavis received a similar subpoena in June 2015. Teva and Actavis are cooperating fully with the DOJ subpoena requests. On July 12, 2016, Teva USA received a subpoena from the Connecticut Attorney General seeking documents and other information relating to potential state antitrust law violations. In 2015, Actavis received a similar subpoena from the Connecticut Attorney General.

On December 15, 2016, a civil action was brought by the attorneys general of twenty states against Teva USA and several other companies asserting claims under federal antitrust law (specifically, section 1 of the Sherman Act) alleging price fixing of generic products in the United States. An amended complaint was filed on March 1, 2017 adding twenty additional states to the named plaintiffs and adding supplemental state law claims. The states seek a finding that the defendants actions violated federal antitrust law, and state antitrust and consumer protection laws, as well as injunctive relief, disgorgement, damages on behalf of various state and governmental entities and consumers, civil penalties and costs. On August 3, 2017, the Judicial Panel on Multidistrict Litigation (JPML) transferred this action to the generic drug multidistrict litigation pending in federal court in Pennsylvania, which is discussed in greater detail below. On July 17, 2017, a new complaint was filed in the District Court of Connecticut on behalf of four additional states Arkansas, Missouri, New Mexico and West Virginia, as well as the District of Columbia. These plaintiffs were not previously party to the State Attorney General action that commenced in December 2016. This complaint, which the JPML has also transferred to the generic drug multidistrict litigation discussed below, makes the same factual allegations and claims that are at issue in the earlier State Attorneys General complaint. On October 31, 2017 the attorneys general of 45 states plus Puerto Rico and the District of Columbia filed a motion for leave to file an amended complaint in this action. The proposed amended complaint names Actavis and Teva as defendants, and adds

new allegations and claims to those appearing in the prior complaints. Defendants have opposed the motion. On June 5, 2018, the District Court for the Eastern District of Pennsylvania granted the attorneys general s motion to amend.

Beginning on March 2, 2016, numerous complaints have been filed in the United States on behalf of putative classes of direct and indirect purchasers of several generic drug products, as well as several individual direct purchaser opt-out plaintiffs. These complaints, which allege that the defendants engaged in conspiracies to fix, increase, maintain and/or stabilize the prices of certain generic products, and/or allocate market share of generic products, have been brought against various manufacturer defendants, including Teva and Actavis. The plaintiffs generally seek injunctive relief and damages under federal antitrust law, and damages under various state laws. On April 6, 2017, the JPML entered an order transferring such cases brought by classes of direct or indirect purchasers for coordination or consolidation with the multidistrict litigation currently pending in the Eastern District of Pennsylvania. The panel subsequently transferred further cases to that court and the plaintiffs filed consolidated amended complaints on August 15, 2017. Defendants moved to dismiss certain of those consolidated amended complaints on October 6, 2017. On October 16, 2018, the pending motions to dismiss were denied. Pursuant to orders dated February and April 2018, the court overseeing the multidistrict litigation lifted the stay of discovery on a limited basis to allow for document discovery and non-merits based depositions. Teva and Actavis deny having engaged in any conduct that would give rise to liability with respect to the above-mentioned subpoenas and civil suits.

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In May 2018, Teva received a civil investigative demand from the DOJ Civil Division, pursuant to the federal False Claims Act, seeking documents and information produced since January 1, 2009 relevant to the Civil Division s investigation concerning allegations that generic pharmaceutical manufacturers, including Teva, engaged in market allocation and price-fixing agreements, paid illegal remuneration, and caused false claims to be submitted in violation of the False Claims Act. Teva is cooperating fully with this subpoena.

On March 21, 2017, Teva received a subpoena from the U.S. Attorney s office in Boston, Massachusetts requesting documents related to Teva s donations to patient assistance programs. Teva is cooperating fully in responding to the subpoena.

In December 2016, Teva resolved certain claims under the U.S. Foreign Corrupt Practices Act (FCPA) with the SEC and the DOJ, as more fully described in Teva s 2017 Annual Report. The settlement included a fine, disgorgement and prejudgment interest; a three-year deferred prosecution agreement (DPA) for Teva; a guilty plea by Teva s Russian subsidiary to criminal charges of violations of the anti-bribery provisions of the FCPA; consent to entry of a final judgment against Teva resolving civil claims of violations of the anti-bribery, internal controls and books and records provisions of the FCPA; and the retention of an independent compliance monitor for a period of three years. If, during the term of the DPA (approximately three years, unless extended), the DOJ determines that Teva has committed a felony under federal law, provided deliberately false or misleading information or otherwise breached the DPA, Teva could be subject to prosecution and additional fines or penalties, including the deferred charges.

Following the above resolution with the SEC and DOJ, Teva has had requests for documents and information from various Russian government entities. In addition, on January 14, 2018, Teva entered into an arrangement for the Contingent Cessation of Proceedings pursuant to the Israeli Securities Law with the Government of Israel that ended the investigation of the Israeli government into the conduct that was subject to the FCPA investigation, and provided a payment of approximately $22 million.

Shareholder Litigation

On November 6, 2016 and December 27, 2016, two putative securities class actions were filed in the U.S. District Court for the Central District of California against Teva and certain of its current and former officers and directors. After those two lawsuits were consolidated and transferred to the U.S. District Court for the District of Connecticut, the court appointed the Ontario Teachers Pension Plan Board as lead plaintiff (the Ontario Teachers Securities Litigation). The lead plaintiff then filed a consolidated amended complaint. On December 1, 2017, Teva and the current and former officer and director defendants subsequently filed motions to dismiss the consolidated amended complaint, with prejudice. On April 3, 2018, the court granted the motions to dismiss without prejudice. Lead plaintiff filed a second amended complaint on June 22, 2018, purportedly on behalf of purchasers of Teva s securities between February 6, 2014 and August 3, 2017. The second complaint asserts that Teva and certain of its current and former officers and directors violated federal securities laws in connection with Teva s alleged failure to disclose pricing strategies for various drugs in its generic drug portfolio and by making allegedly false or misleading statements in certain offering materials issued during the class period. The second complaint seeks unspecified damages, legal fees, interest, and costs. Teva and the current and former officer and director defendants filed motions to dismiss the second complaint on September 14, 2018. Lead plaintiff s opposition to the motions to dismiss is due on November 9, 2018.

On July 17, 2017, a lawsuit was filed in the U.S. District Court for the Southern District of Ohio derivatively on behalf of the Teva Employee Stock Purchase Plan, and alternatively as a putative class action lawsuit on behalf of individuals who purchased Teva stock through that plan. That lawsuit seeks unspecified damages, legal fees, interest and costs. The complaint alleges that Teva failed to maintain adequate financial controls based on the facts underpinning Teva s FCPA DPA and also based on allegations substantially similar to those in the Ontario Teachers Securities Litigation.

On November 29, 2017, the court granted Teva s motion to transfer the litigation to the U.S. District Court for the District of Connecticut where the Ontario Teachers Securities Litigation is pending. On February 12, 2018, the district court stayed the case pending resolution of the motions to dismiss filed in the consolidated putative securities class action described above.

On August 3, 2017, a securities lawsuit was filed in the U.S. District Court for the District of Connecticut by OZ ELS Master Fund, Ltd. and related entities. The complaint asserts that Teva and certain of its current and former officers violated the federal securities laws in connection with Teva s alleged failure to disclose Teva s participation in an alleged anticompetitive scheme to fix prices and allocate markets for generic drugs in the United States. On August 30, 2017, the court entered an order deferring all deadlines pending the resolution of the motions to dismiss filed in the Ontario Teachers Securities Litigation described above.

On August 21 and 30, 2017, each of Elliot Grodko and Barry Baker filed a putative securities class action in the U.S. District Court for the Eastern District of Pennsylvania purportedly on behalf of purchasers of Teva s securities between November 15, 2016 and August 2, 2017 seeking unspecified damages, legal fees, interest, and costs. The complaints allege that Teva and certain of its current and former officers violated the federal securities laws and Israeli securities laws by making false and misleading statements in connection with Teva s acquisition and integration of Actavis Generics. On November 1, 2017, the court consolidated the Baker and Grodko cases. On April 10, 2018, the court granted Teva s motion to transfer the consolidated action to the District of Connecticut where the Ontario Teachers Securities Litigation is currently pending.

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Between August and October 2018, four complaints were filed against Teva and current and former officer and director defendants seeking unspecified compensatory and rescissory damages, legal fees, costs and expenses. The allegations in these complaints are substantially similar to the allegations in the Ontario Teachers Securities Litigation, but have been brought on behalf of plaintiffs that have opted out of the putative class in the Ontario Teachers Securities Litigation. The plaintiffs in these opt-out cases are Fir Tree Value Master Fund, L.P. and FT SOF V Holdings, LLC; The Phoenix Insurance Company Ltd., The Phoenix Pension Ltd., Excellence Gemel & Hishtalmut Ltd., Excellence Kesem ETNS and Excellence Mutual Fund; Nordea Investment Management AB; and the State of Alaska Department of Revenue, Treasury Division and the Alaska Permanent Fund Corporation, and they filed their complaints in the Court of Common Pleas of Montgomery County, Pennsylvania on August 3, 2018, the U.S. District Court for the Eastern District of Pennsylvania on August 3, 2018 and the U.S. District Court for the District of Connecticut on October 10 and October 16, 2018, respectively. In the two cases filed in August 2018, Teva and the current and former officer and director defendants filed motions to transfer the cases to the U.S. District Court for the District of Connecticut, where the Ontario Teachers Securities Litigation is pending. In the two cases filed in October 2018, the parties jointly moved to stay the case pending resolution of the motions to dismiss filed in the consolidated putative securities class action described above.

Motions to approve derivative actions against certain past and present directors and officers have been filed in Israel with respect to alleged negligence and recklessness with respect to the acquisition of the Rimsa business and the acquisition of Actavis Generics. Motions for document disclosure prior to initiating derivative actions were filed with respect to dividend distribution, executive compensation and several patent settlement agreements. Motions to approve securities class actions against Teva and certain of its current and former directors and officers were filed in Israel based on allegations of improper disclosure of the above-mentioned pricing investigation, as well as lack of disclosure of negative developments in the generic sector, including price erosion with respect to Teva s products. Other motions were filed in Israel to approve a derivative action, discovery and a class action related to claims regarding Teva s above-mentioned FCPA resolution with the SEC and DOJ.

Environmental Matters

Teva or its subsidiaries are party to a number of environmental proceedings, or have received claims, including under the federal Superfund law or other federal, provincial or state and local laws, imposing liability for alleged noncompliance, or for the investigation and remediation of releases of hazardous substances and for natural resource damages. Many of these proceedings and claims seek to require the generators of hazardous wastes disposed of at a third party-owned site, or the party responsible for a release of hazardous substances that impacted a site, to investigate and clean the site or to pay or reimburse others for such activities, including for oversight by governmental authorities and any related damages to natural resources. Teva or its subsidiaries have received claims, or been made a party to these proceedings, along with others, as an alleged generator of wastes that were disposed of or treated at third-party waste disposal sites, or as a result of an alleged release from one of Teva s facilities or former facilities.

Although liability among the responsible parties, under certain circumstances, may be joint and several, these proceedings are frequently resolved so that the allocation of clean-up and other costs among the parties reflects the relative contributions of the parties to the site conditions and takes into account other pertinent factors. Teva s potential liability varies greatly at each of the sites; for some sites the costs of the investigation, clean-up and natural resource damages have not yet been determined, and for others Teva s allocable share of liability has not been determined. At other sites, Teva has taken an active role in identifying those costs, to the extent they are identifiable and estimable, which do not include reductions for potential recoveries of clean-up costs from insurers, indemnitors, former site owners or operators or other potentially responsible parties. In addition, enforcement proceedings relating to alleged violations of federal, state, commonwealth or local requirements at some of Teva s facilities may result in the imposition of significant penalties (in amounts not expected to materially adversely affect Teva s results of operations)

and the recovery of certain costs and natural resource damages, and may require that corrective actions and enhanced compliance measures be implemented.

Other Matters

On February 1, 2018, former shareholders of Ception Therapeutics, Inc., a company that was acquired by and merged into Cephalon in 2010, prior to Cephalon s acquisition by Teva, filed breach of contract and other related claims against the Company, Teva USA and Cephalon in the Delaware Court of Chancery. Among other things, the plaintiffs allege that Cephalon breached the terms of the 2010 Ception-Cephalon merger agreement by failing to exercise commercially reasonable efforts to develop and commercialize CINQAIR® (reslizumab) for the treatment of eosinophilic esophagitis (EE). The plaintiffs claim damages of at least $200 million, an amount they allege is equivalent to the milestones payable to the former shareholders of Ception in the event Cephalon were to obtain regulatory approval for EE in the United States ($150 million) and Europe ($50 million). All defendants have moved to dismiss the complaint and those motions remain pending.

NOTE 17 Segments:

In November 2017, Teva announced a new organizational structure and leadership changes to enable strategic alignment across its portfolios, regions and functions. Teva now operates its business through three segments: North America, Europe and International Markets. The purpose of the new structure is to enable stronger alignment and integration between operations, commercial regions,

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R&D and Teva s global marketing and portfolio function, in order to optimize its product lifecycle across the therapeutic areas. The Company began reporting its financial results under this structure in the first quarter of 2018.

In addition to these three segments, Teva has other activities, primarily the sale of API to third parties and certain contract manufacturing services.

All the above changes were reflected through retroactive revision of prior period segment information.

Since 2013 and until December 31, 2017, Teva had two reportable segments: generic and specialty medicines. The generic medicines segment included Teva s OTC and API businesses. Teva s other activities included distribution activities, sales of medical devices and certain contract manufacturing operation (CMO) services.

Teva now operates its business and reports its financial results in three segments:

(a) North America segment, which includes the United States and Canada.

(b) Europe segment, which includes the European Union and certain other European countries.

(c) International Markets segment, which includes all countries other than those in the North America and Europe segments.

Teva s Chief Executive Officer (CEO), who is the chief operating decision maker (CODM), reviews financial information prepared on a consolidated basis, accompanied by disaggregated information about revenues and contributed profit by the three identified reportable segments, namely North America, Europe and International Markets, to make decisions about resources to be allocated to the segments and assess their performance.

Segment profit is comprised of gross profit for the segment less R&D expenses, S&M expenses, G&A expenses and other income related to the segment. Segment profit does not include amortization and certain other items.

Teva manages its assets on a company basis, not by segments, as many of its assets are shared or commingled. Teva s CODM does not regularly review asset information by reportable segment and, therefore, Teva does not report asset information by reportable segment.

Teva s CEO may review its strategy and organizational structure. Any changes in strategy may lead to a reevaluation of the Company s segments and goodwill allocation to reporting units, as well as fair value attributable to its reporting units. See note 7.

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a. Segment information:

	North America		Europe		International Markets	
	Three months ended September 30,					
	2018	2017	2018	2017	2018	2017
	(U.S. $ in millions)					
Revenues	$ 2,265	$ 3,043	$ 1,212	$ 1,380	$ 726	$ 882
Gross profit	1,232	1,833	683	721	301	351
R&D expenses	158	230	62	101	21	35
S&M expenses	301	325	249	289	120	158
G&A expenses	128	149	74	90	37	51
Other income (loss)	(4)	(1)	1			(3)
Segment profit	$ 649	$ 1,130	$ 297	$ 241	$ 123	$ 110

	North America		Europe		International Markets	
	Nine months ended September 30,					
	2018	2017	2018	2017	2018	2017
	(U.S. $ in millions)					
Revenues	$ 7,059	$ 9,452	$ 3,982	$ 4,016	$ 2,265	$ 2,485
Gross profit	3,867	5,971	2,211	2,147	942	1,043
R&D expenses	528	777	208	312	70	129
S&M expenses	902	1,158	741	864	384	503
G&A expenses	357	432	243	258	115	144
Other income	(206)	(82)	(1)	(15)	(11)	(4)
Segment profit	$ 2,286	$ 3,686	$ 1,020	$ 728	$ 384	$ 271

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	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	(U.S. $ in millions)		(U.S. $ in millions)	
North America profit	$ 649	$ 1,130	$ 2,286	$ 3,686
Europe profit	297	241	1,020	728
International Markets profit	123	110	384	271
Total segment profit	1,069	1,481	3,690	4,685
Profit (loss) of other activities	35	(11)	87	3
	1,104	1,470	3,777	4,688
Amounts not allocated to segments:				
Amortization	297	357	909	1,088
Other asset impairments, restructuring and other items	658	550	2,080	1,209
Goodwill impairment			300	6,100
Gain on divestitures, net of divestitures related costs	(31)		(114)	
Inventory step-up				67
Other R&D expenses	60	150	82	176
Costs related to regulatory actions taken in facilities	1	(1)	6	48
Legal settlements and loss contingencies	19	(20)	(1,239)	324
Other unallocated amounts	84	56	226	143
Consolidated operating income (loss)	16	378	1,527	(4,467)
Financial expenses, net	229	259	736	704
Consolidated income (loss) before income taxes	$ (213)	$ 119	$ 791	$ (5,171)

b. Segment revenues by major products and activities:

The following tables present revenues by major products and activities for the nine and three months ended September 30, 2018 and 2017:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	(U.S. $ in millions)		(U.S. $ in millions)	
North America segment				
Generic products	$ 922	$ 1,233	$ 2,957	$ 3,979
COPAXONE	463	819	1,403	2,475
BENDEKA / TREANDA	161	179	502	498
ProAir	107	155	352	399
QVAR	36	83	173	265
AUSTEDO	62	6	136	8

Distribution	333	294	984	864

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	(U.S. $ in millions)		(U.S. $ in millions)	
Europe segment				
Generic products	$ 845	$ 871	$ 2,749	$ 2,543
COPAXONE	124	150	417	440
Respiratory products	93	90	312	258

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	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	(U.S. $ in millions)		(U.S. $ in millions)	
International Markets segment				
Generic products	$ 498	$ 629	$ 1,523	$ 1,720
COPAXONE	14	18	52	65
Distribution	149	146	456	406

A significant portion of Teva s revenues, and a higher proportion of the profits, come from the manufacture and sale of patent-protected pharmaceuticals. Many of Teva s specialty medicines are covered by several patents that expire at different times. Nevertheless, once patent protection has expired, or has been lost prior to the expiration date as a result of a legal challenge, Teva no longer has patent exclusivity on these products, and subject to regulatory approval, generic pharmaceutical manufacturers are able to produce and market similar (or purportedly similar) products and sell them for a lower price. The commencement of generic competition, even in the form of non-equivalent products, can result in a substantial decrease in revenues for a particular specialty medicine in a very short time. Any such expiration or loss of IP rights could therefore significantly adversely affect Teva s results of operations and financial condition.

NOTE 18 Other income:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	(U.S. $ in millions)		(U.S. $ in millions)	
Gain on divestitures, net of divestitures related costs [1]	$ 31		$ 114	
Section 8 and similar payments [2]	1		195	83
Gain on sale of assets	1		9	
Other, net	2	4	16	17
Total other income	$ 35	$ 4	$ 334	$ 100

(1) Mainly related to the divestment of the women s health business and the PGT dissolution in 2018. See note 3.
(2) Section 8 of the Patented Medicines (Notice of Compliance) Regulation relates to recoveries of lost revenue related to patent infringement proceedings in Canada.

NOTE 19 Income Taxes:

In the third quarter of 2018, Teva recognized a tax benefit of $26 million, or 12%, on pre-tax loss of $213 million. In the third quarter of 2017, Teva recognized a tax benefit of $494 million, on pre-tax income of $119 million. Teva s tax rate for the third quarter of 2018 was mainly affected by the mix of products sold in different geographies. Teva s tax rate for the third quarter of 2017 was mainly affected by a one-time tax benefit associated with the utilization of Actavis Generics historical capital losses.

In the first nine months of 2018, Teva recognized a tax benefit of $56 million on pre-tax income of $791 million. In the first nine months of 2017, income taxes were $462 million on pre-tax loss of $5,171 million. Teva s tax rate for the

first nine months of 2018 was mainly affected by one-time legal settlements and divestments with low corresponding tax effect, as well as the mix of products sold in different geographies.

The Company recognized the income tax effects of the Tax Cuts and Jobs Act (TCJA) in its audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2017, in accordance with Staff Accounting Bulletin No. 118, which provides SEC staff guidance for the application of ASC Topic 740, Income Taxes, in the reporting period in which the TCJA was enacted into law. The guidance also provides for a measurement period of up to one year from the enactment date for the Company to complete the accounting for the U.S. tax law changes. The Company s financial results for the year ended December 31, 2017 included a $112 million provisional estimate for its one-time deemed repatriation taxes liability. In the third quarter of 2018, the Company recorded an additional provision of $40 million, due to an increase in repatriation taxes as a result of the on-going analysis of the earnings of relevant non-US subsidiaries, partially offset by a decrease for U.S. foreign tax credits, pursuant to guidance issued by the U.S. Department of Treasury and revisions to the Company s estimates since the assessment date. The amounts recorded remain provisional and may require further adjustments as new guidance becomes available.

The statutory Israeli corporate tax rate is 23% in 2018. Teva s tax rate differs from the Israeli statutory tax rate, mainly due to generation of profits in various jurisdictions in which tax rates are different than the Israeli tax rate, tax benefits in Israel and other countries, as well as infrequent or nonrecurring items.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Business Overview

We are a global pharmaceutical company, committed to increasing access to high-quality healthcare to patients around the world. We operate worldwide, with headquarters in Israel and a significant presence in the United States, Europe and many other markets around the world. Our key strengths include our world-leading generics expertise and portfolio, focused specialty portfolio and global infrastructure and scale.

Teva was incorporated in Israel on February 13, 1944, and is the successor to a number of Israeli corporations, the oldest of which was established in 1901.

In November 2017, we announced a new organizational structure and leadership changes to enable strategic alignment across our portfolios, regions and functions. We now operate our business through three segments: North America, Europe and International Markets. The purpose of the new structure is to enable stronger alignment and integration between operations, commercial regions, R&D and our global marketing and portfolio function, in order to optimize our product lifecycle across therapeutic areas. We began reporting our financial results under this structure in the first quarter of 2018.

In addition to these three segments, we have other activities, primarily the sale of active pharmaceutical ingredients (API) to third parties and certain contract manufacturing services.

The data presented in this report for prior periods have been conformed to reflect the changes to our segment reporting commencing in the first quarter of 2018.

Highlights

Significant highlights of the third quarter of 2018 included:

On September 14, 2018, the FDA approved AJOVY™ (fremanezumab-vfrm) injection for the preventive treatment of migraine in adults. We launched the product immediately upon approval.

Revenues in the third quarter of 2018 were $4,529 million, a decrease of 19%, or 18% in local currency terms, compared to the third quarter of 2017.

Our North America segment generated revenues of $2,265 million and profit of $649 million in the third quarter of 2018. Revenues decreased by 26% compared to the third quarter of 2017, mainly due to a decline in revenues of COPAXONE®, as well as a decline in revenues in our U.S. generics business, a decline in revenues of ProAir® and QVAR® and the loss of revenues from the sale of our women s health business, partially offset by higher revenues from AUSTEDO® and our North America distribution business. Profit decreased by 43% mainly due to lower revenues, partially offset by cost reductions and efficiency measures as part of the restructuring plan.

Our Europe segment generated revenues of $1,212 million and profit of $297 million in the third quarter of 2018. Revenues decreased by 12%, or 11% in local currency terms, compared to the third quarter of 2017, mainly due to the loss of revenues from the closure of our distribution business in Hungary, the sale of our women s health business and a decline in COPAXONE revenues due to the entry of competing glatiramer acetate products, partially offset by new generic product launches. Profit increased by 23% mainly due to cost reductions and efficiency measures as part of the restructuring plan.

Our International Markets segment generated revenues of $726 million and profit of $123 million in the third quarter of 2018. Revenues decreased by 18%, or 12% in local currency terms compared to the third quarter of 2017, mainly due to lower sales in Japan and Russia, the effect of the deconsolidation of our subsidiaries in Venezuela and the loss of revenues from the sale of our women s health business. Profit increased by 12%, mainly due to cost reductions and efficiency measures as part of the restructuring plan.

Other asset impairments, restructuring and other items were $658 million in the third quarter of 2018, mainly comprised of a $521 million impairment of long-lived assets and $88 million of restructuring expenses. Other asset impairments, restructuring and other items were $550 million in the third quarter of 2017.

Operating income was $16 million in the third quarter of 2018, compared to $378 million in the third quarter of 2017. The decrease in operating income was mainly due to lower gross profit and higher impairment charges recorded in the third quarter of 2018.

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Exchange rate movements between the third quarter of 2018 and the third quarter of 2017 negatively impacted revenues by $80 million and operating income by $34 million.

As of September 30, 2018, our debt was $29,489 million compared to $30,237 million as of June 30, 2018, mainly due to a debt tender offer completed in September 2018 and repayment of notes in July 2018.

Cash flow generated from operating activities was $421 million in the third quarter of 2018, compared to $795 million in the third quarter of 2017, mainly due to lower net income and higher payments related to restructuring liabilities during the third quarter of 2018.

Transactions

On July 1, 2018, our PGT Healthcare partnership with P&G was dissolved. As part of the separation, we transferred to P&G the shares we held in New Chapter Inc. and ownership rights in an OTC plant located in India.

We will continue to maintain our OTC business on an independent basis and to provide certain services to P&G after the separation for a transition period.

Results of Operations

Comparison of Three Months Ended September 30, 2018 to Three Months Ended September 30, 2017

The following table sets forth, for the periods indicated, certain financial data derived from our U.S. GAAP financial statements:

	Percentage of Net Revenues Three Months Ended September 30,		Percentage Change
	2018	2017	2018 -2017
	%	%	%
Net revenues	100.0	100.0	(19)
Gross profit	44.6	47.2	(24)
Research and development expenses	6.9	9.5	(41)
Selling and marketing expenses	16.4	15.0	(12)
General and administrative expenses	6.8	6.6	(17)
Other asset impairments, restructuring and other items	14.5	9.8	20
Legal settlements and loss contingencies	0.4	(0.4)	
Other income	(0.8)	(0.1)	775
Operating income	0.4	6.7	(96)
Financial expenses, net	5.1	4.6	(12)
Income (loss) before income taxes	(4.7)	2.1	
Tax benefit	(0.6)	(8.8)	(95)
Share in losses of associated companies, net	0.2	0.1	
Net income attributable to non-controlling interests	0.2	0.3	
Net income (loss) attributable to Teva	(4.6)	10.6	

Dividends on preferred shares	1.4	1.2
Net income (loss) attributable to ordinary shareholders	(6.0)	9.4

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Segment Information

North America Segment

The following table presents revenues, expenses and profit for our North America segment for the three months ended September 30, 2018 and 2017:

	Three months ended September 30,			
	2018		2017	
	(U.S. $ in millions /% of Segment Revenues)			
Revenues	$ 2,265	100%	$ 3,043	100%
Gross profit	1,232	54.4%	1,833	60.2%
R&D expenses	158	7.0%	230	7.6%
S&M expenses	301	13.3%	325	10.7%
G&A expenses	128	5.7%	149	4.9%
Other income	(4)	§	(1)	§
Segment profit*	$ 649	28.7%	$ 1,130	37.1%

* Segment profit does not include amortization and certain other items. The data presented for prior periods have been conformed to reflect the changes to our segment reporting commencing in the first quarter of 2018. See note 17 to our consolidated financial statements and Teva Consolidated Results Operating Income below for additional information.

§ Represents an amount less than 0.5%.

North America Revenues

Our North America segment includes the United States and Canada. Revenues from our North America segment in the third quarter of 2018 were $2,265 million, a decrease of $778 million, or 26%, compared to the third quarter of 2017, mainly due to a decline in revenues of COPAXONE, a decline in revenues in our U.S. generics business, a decline in revenues of ProAir and QVAR and the loss of revenues from the sale of our women s health business, partially offset by higher revenues from AUSTEDO and our distribution business.

Revenues by Major Products and Activities

The following table presents revenues for our North America segment by major products and activities for the three months ended September 30, 2018 and 2017:

	Three months ended September 30,		Percentage Change
	2018	2017	2017 -2018
	(U.S. $ in millions)		

Generic products	$ 922	$ 1,233	(25%)
COPAXONE	463	819	(43%)
BENDEKA / TREANDA	161	179	(10%)
ProAir	107	155	(31%)
QVAR	36	83	(57%)
AUSTEDO	62	6	870%
Distribution	333	294	13%

Generic products revenues in our North America segment in the third quarter of 2018 decreased by 25% to $922 million, compared to the third quarter of 2017, mainly due to price erosion in our U.S. generics business, additional competition to methylphenidate extended-release tablets (Concerta® authorized generic) and portfolio optimization, primarily as part of the restructuring plan.

Among the most significant generic products we sold in North America in the third quarter of 2018 were daptomycin injection (the generic equivalent of Cubicin®), tadalafil tablets (the generic equivalent of Cialis®) and methylphenidate extended-release tablets (Concerta® authorized generic).

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In the third quarter of 2018, we led the U.S. generics market in total prescriptions and new prescriptions, with approximately 547 million total prescriptions, representing 14.1% of total U.S. generic prescriptions according to IQVIA data.

COPAXONE revenues in our North America segment in the third quarter of 2018 decreased by 43% to $463 million, compared to the third quarter of 2017, mainly due to generic competition in the United States.

COPAXONE revenues in the United States were $446 million in the third quarter of 2018.

Revenues of COPAXONE in our North America segment were 77% of global COPAXONE revenues in the third quarter of 2018, compared to 83% in the third quarter of 2017.

COPAXONE global sales accounted for approximately 13% of our global revenues in the third quarter of 2018 and a significantly higher percentage of our profits and cash flow from operations during this period.

The FDA approved generic versions of COPAXONE 40 mg/mL in October 2017 and February 2018 and a second generic version of COPAXONE 20 mg/mL in October 2017. Hybrid versions of COPAXONE 20 mg/mL and 40 mg/mL were also approved in the European Union.

On October 12, 2018, the U.S. Court of Appeals for the Federal Circuit (CAFC) handed down its ruling in the consolidated appeal of decisions from the U.S. District Court and Patent Trial and Appeal Board, relating to patents covering COPAXONE 40 mg/ml. The CAFC found all claims at issue to be invalid, and we are currently evaluating our options for further appeals. COPAXONE 40 mg/mL is protected by one European patent expiring in 2030. This patent is being challenged in Italy and Norway and has been opposed at the European Patent Office. The U.K. High Court found this patent invalid and our application for permission to appeal this decision was rejected.

The market for MS treatments continues to develop, particularly with the recent approvals of generic versions of COPAXONE discussed above, as well as additional generic versions expected to be approved in the future. Oral treatments for MS, such as Tecfidera®, Gilenya® and Aubagio®, continue to present significant and increasing competition. COPAXONE also continues to face competition from existing injectable products, as well as from monoclonal antibodies.

BENDEKA and **TREANDA** combined revenues in our North America segment in the third quarter of 2018 decreased by 10% to $161 million, compared to the third quarter of 2017, mainly due to lower volumes, partially offset by higher pricing. Our partner, Eagle Pharmaceuticals, Inc. prevailed in its suit in the U.S. district court against the FDA to obtain seven years of orphan drug exclusivity in the United States for BENDEKA. The FDA has appealed the district court s decision, but barring a reversal by the appellate court, drug applications referencing BENDEKA will not be approved by the FDA until the orphan drug exclusivity expires in December 2022.

ProAir revenues in our North America segment in the third quarter of 2018 decreased by 31% to $107 million, compared to the third quarter of 2017, mainly due to lower net pricing. ProAir is the second-largest short-acting beta-agonist in the market, with an exit market share of 45.2% in terms of total number of prescriptions during the third quarter of 2018, compared to 46.2% in the third quarter of 2017. In June 2014, we settled a patent challenge to ProAir HFA with Perrigo Pharmaceuticals (Perrigo) permitting Perrigo to launch its generic product in limited quantities once it receives FDA approval and without quantity limitations after June 2018. In November 2017, we settled another patent challenge to ProAir HFA with Lupin Pharmaceuticals, Inc.

QVAR revenues in our North America segment in the third quarter of 2018 decreased by 57% to $36 million, compared to the third quarter of 2017. The decrease in sales in the third quarter of 2018 was mainly due to lower volumes during this quarter following wholesaler stocking in the first quarter of 2018 in connection with the launch of QVAR® RediHaler . QVAR maintained its second-place position in the inhaled corticosteroids category in the United States, with an exit market share of 21.7% in terms of total number of prescriptions during the third quarter of 2018, compared to 37.9% in the third quarter of 2017.

AUSTEDO revenues in our North America segment in the third quarter of 2018 were $62 million. AUSTEDO was approved by the FDA and launched in April 2017 in the United States for the treatment of chorea associated with Huntington disease. In August 2017, the FDA approved AUSTEDO for the treatment of tardive dyskinesia.

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Distribution revenues in our North America segment, which are generated by Anda, increased by 13% to $333 million in the third quarter of 2018, compared to the third quarter of 2017, mainly due to higher volumes. Our Anda business distributes generic, specialty and OTC pharmaceutical products from various third party manufacturers to independent retail pharmacies, pharmacy retail chains, hospitals and physician offices in the United States. Anda is able to compete in the secondary distribution market by maintaining high inventory levels for a broad offering of products, next day delivery throughout the United States and competitive pricing.

Product Launches and Pipeline

In the third quarter of 2018, we launched the generic version of the following branded products in North America:

Product Name	Brand Name	Launch Date	Total Annual U.S. Branded Sales at Time of Launch (U.S. $ in millions (IQVIA))*
Budesonide Extended-Release Tablets, 9 mg	Uceris® ER	July	$ 199
Romidepsin for Injection, 10 mg/vial	Istodax®	August	$ 52
Cisatracurium Besylate Injection, USP 2 mg/mL, 10 mg, 10 mg/mL, 200 mg & 2 mg/mL, 20 mg	Nimbex®	September	$ 49
Tadalafil Tablets, USP 2.5 mg, 5 mg, 10 mg & 20 mg	Cialis®	September	$ 1,926

* The figures presented are for the twelve months ended in the calendar quarter immediately prior to our launch or re-launch.

Our generic products pipeline in the United States includes, as of September 30, 2018, 310 product applications awaiting FDA approval, including 93 tentative approvals. This total reflects all pending ANDAs, supplements for product line extensions and tentatively approved applications and includes some instances where more than one application was submitted for the same reference product. Excluding overlaps, the branded products underlying these pending applications had U.S. sales for the twelve months ended June 30, 2018 exceeding $120 billion, according to IQVIA. Approximately 70% of pending applications include a paragraph IV patent challenge and we believe we are first to file with respect to 107 of these products, or 130 products including final approvals where launch is pending a settlement agreement or court decision. Collectively, these first to file opportunities represent over $68 billion in U.S. brand sales for the twelve months ended June 30, 2018, according to IQVIA.

IQVIA reported brand sales are one of the many indicators of future potential value of a launch, but equally important are the mix and timing of competition, as well as cost effectiveness. The potential advantages of being the first filer with respect to some of these products may be subject to forfeiture, shared exclusivity or competition from so-called authorized generics, which may ultimately affect the value derived.

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In the third quarter of 2018, we received tentative approvals for generic equivalents of the products listed in the table below, excluding overlapping applications. A tentative approval indicates that the FDA has substantially completed its review of an application and final approval is expected once the relevant patent expires, a court decision is reached, a 30-month regulatory stay lapses or a 180-day exclusivity period awarded to another manufacturer either expires or is forfeited.

Generic Name	Brand Name	Total U.S. Annual Branded Market (U.S. $ in millions (IQVIA))*
Nicotine Polacrilex Mini Lozenges, 2 mg & 4 mg (Ice Mint)	Nicorette®	
Azelaic Acid Foam, 15%	Finacea®	$ 58
Saxagliptin Tablets, 2.5mg & 5mg	Onglyza®	$383
Mesalamine Extended-Release Capsules USP, 375 mg	Apriso®	$282
Oxcarbazepine Extended-Release Tablets, 150 mg, 300 mg & 600 mg	Oxtellar®XR	$123
Ingenol Mebutate Gel, 0.015%	Picato®	$ 61
Clindamycin Phosphate and Benzoyl Peroxide Gel, 1.2%/3.75%	Onexton®	$125
Axitinib Tablets, 1 mg & 5 mg	Inlyta®	$120
Mesalamine Delayed-Release Capsules, 400mg	Delzicol®	$140

* For the twelve months ended in the calendar quarter immediately prior to the receipt of tentative approval.

In the third quarter of 2018, our pipeline consisted of the following products:

Product	Potential Indication(s)	Route of Administration	Development Phase (date entered phase 3)	Comments
Neurology and Neuropsychiatry				
AUSTEDO (deutetrabenazine)	Tourette syndrome	Oral	3 (December 2017)	
Laquinimod	Huntington disease	Oral		Based on the negative outcome of the phase 2 clinical trial, we will not continue the clinical development of

				laquinimod. We terminated the development and license agreement and returned the development and commercialization rights to Active Biotech in September 2018.
TV-46000 (risperidone LAI)	Schizophrenia	LAI	3 (April 2018)	

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Product	Potential Indication(s)	Route of Administration	Development Phase (date entered phase 3)	Comments
Migraine and Pain				
AJOVY (fremanezumab) (anti CGRP)	Chronic and episodic migraine	Subcutaneous	Approved by FDA and launched (September 2018); Response package submitted for Marketing Authorization Application (MAA) to the European Medicines Agency (EMA) (September 2018)	On September 14, 2018, the FDA approved AJOVY (fremanezumab-vfrm) injection for the preventive treatment of migraine in adults. We launched the product immediately upon approval.
				We filed a lawsuit in the U.S. District Court for the District of Massachusetts alleging that Eli Lilly s planned marketing and sale of its galcanezumab product for the treatment of migraine infringes nine Teva patents. Eli Lilly has also submitted inter partes review petitions to the Patent Trial and Appeal Board, challenging the validity of the nine patents asserted against them in the litigation.
	Episodic cluster headache	Subcutaneous	3 (November 2016)	
	Post traumatic headache	Subcutaneous	2	
Fasinumab	Osteoarthritis pain	Subcutaneous	3 (March 2016)	Developed in collaboration with Regeneron Pharmaceuticals, Inc. (Regeneron). In August 2018 Regeneron and Teva announced positive

			topline phase 3 results in patients with chronic pain from osteoarthritis of the knee or hip with the remaining low dose 1mg every month (1mg4W) and 1mg every two months (1mg8W).
Chronic lower back pain	Subcutaneous	2	

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Product	Potential Indication(s)	Route of Administration	Development Phase (date entered phase 3)	Comments
Respiratory				
CINQAIR/CINQAERO	Severe asthma with eosinophilia	Subcutaneous	3 (August 2015)	In January 2018, we announced that the phase 3 study did not meet its primary endpoint. We are reviewing the full data to determine next steps.
ProAir e-RespiClick	Bronchospasm and exercise induced bronchitis	Oral inhalation	Submitted to FDA (September 2017) Resubmitted to FDA (August 2018)	Following feedback from the FDA, changes on application were implemented resulting in a re-submission of the supplemental new drug application to the FDA on August 30, 2018.
Oncology				
CT-P10	(biosimilar candidate to Rituxan® US)		Submitted to FDA (2017) Resubmitted to FDA (2018)	Developed under a collaboration agreement with Celltrion, Inc. (Celltrion). The FDA acknowledged the resubmission of the marketing approvals for CT-P10 and CT-P06. The review period is approximately six months. On October 10, 2018, the FDA Oncologic Drugs Advisory Committee unanimously recommended to approve CT-P10. The FDA will take the committee s
CT-P06	(biosimilar candidate to Herceptin® US)		Submitted to FDA (2017) Resubmitted to FDA (2018)	

recommendation into consideration before taking action on the Biologics License Application (BLA) for the proposed Rituxan biosimilar. We have reached an agreement with Genentech to settle the patent litigation on CT-P10, which includes a licensed entry date.

North America Gross Profit

Gross profit from our North America segment in the third quarter of 2018 was $1,232 million, a decrease of 33% compared to $1,833 million in the third quarter of 2017. The decrease was mainly due to lower revenues from COPAXONE and generic products.

Gross profit margin for our North America segment in the third quarter of 2018 decreased to 54.4% from 60.2% in the third quarter of 2017. The decrease was mainly due to lower COPAXONE revenues (6.2 points).

North America R&D Expenses

R&D expenses relating to our North America segment in the third quarter of 2018 were $158 million, a decrease of 31% compared to $230 million in the third quarter of 2017.

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For a description of our R&D expenses in the third quarter of 2018, see Teva Consolidated Results Research and Development (R&D) Expenses below.

North America S&M Expenses

S&M expenses relating to our North America segment in the third quarter of 2018 were $301 million, a decrease of 7% compared to $325 million in the third quarter of 2017. The decrease was mainly due to cost reductions and efficiency measures as part of the restructuring plan.

North America G&A Expenses

G&A expenses relating to our North America segment in the third quarter of 2018 were $128 million, a decrease of 14% compared to $149 million in the third quarter of 2017. The decrease was mainly due to cost reductions and efficiency measures as part of the restructuring plan.

North America Other Income

Other income from our North America segment in the third quarter of 2018 was $4 million, compared to $1 million in the third quarter of 2017.

North America Profit

Profit from our North America segment consists of gross profit less R&D expenses, S&M expenses, G&A expenses and any other income related to this segment. Segment profit does not include amortization and certain other items. The data presented for prior periods have been conformed to reflect the changes to our segment reporting commencing in the first quarter of 2018. See note 17 to our consolidated financial statements and Teva Consolidated Results Operating Income below.

Profit from our North America segment in the third quarter of 2018 was $649 million, a decrease of 43% compared to $1,130 million in the third quarter of 2017. The decrease was mainly due to lower revenues from COPAXONE and generic products, partially offset by cost reductions and efficiency measures as part of the restructuring plan.

Europe Segment

The following table presents revenues, expenses and profit for our Europe segment for the three months ended September 30, 2018 and 2017:

	Three months ended September 30,			
	2018		2017	
	(U.S. $ in millions /% of Segment Revenues)			
Revenues	$ 1,212	100.0%	$ 1,380	100%
Gross profit	683	56.4%	721	52.2%
R&D expenses	62	5.1%	101	7.3%
S&M expenses	249	20.5%	289	20.9%
G&A expenses	74	6.1%	90	6.5%
Other expenses	1	§		§

Segment profit*	$ 297	24.5%	241	17.5%

* Segment profit does not include amortization and certain other items. The data presented for prior periods have been conformed to reflect the changes to our segment reporting commencing in the first quarter of 2018. See note 17 to our consolidated financial statements and Teva Consolidated Results Operating Income below for additional information.

§ Represents an amount less than 0.5%.

Europe Revenues

Our Europe segment includes the European Union and certain other European countries. Revenues from our Europe segment in the third quarter of 2018 were $1,212 million, a decrease of 12% or $168 million, compared to the third quarter of 2017. In local currency terms, revenues decreased by 11%, mainly due to the loss of revenues from the closure of our distribution business in Hungary, the sale of our women s health business and a decline in COPAXONE revenues due to the entry of competing glatiramer acetate products, partially offset by new generic product launches.

Revenues by Major Products and Activities

The following table presents revenues for our Europe segment by major products and activities for the three months ended September 30, 2018 and 2017:

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	Three months ended September 30,		Percentage Change
	2018	2017	2017-2018
	(U.S. $ in millions)		
Generic products	$ 845	$ 871	(3%)
COPAXONE	124	150	(17%)
Respiratory products	93	90	3%

Generic products revenues in our Europe segment in the third quarter of 2018, including OTC products, decreased by 3% to $845 million, compared to the third quarter of 2017. In local currency terms, revenues decreased by 1%, mainly due to the loss of revenues from the termination of the PGT joint venture and generic price reductions, partially offset by new generic product launches.

COPAXONE revenues in our Europe segment in the third quarter of 2018 decreased by 17% to $124 million, compared to the third quarter of 2017. In local currency terms, revenues decreased by 16%, mainly due to price reductions resulting from the entry of competing glatiramer acetate products.

Revenues of COPAXONE in our Europe segment were 21% of global COPAXONE revenues in the third quarter of 2018, compared to 15% in the third quarter of 2017.

For further information about COPAXONE, see North America Revenues Revenues by Major Product above.

Respiratory products revenues in our Europe segment in the third quarter of 2018 increased by 3% to $93 million, compared to the third quarter of 2017. In local currency terms, revenues increased by 4%, mainly due to the launch of BRALTUS® in 2017.

Product Launches and Pipeline

As of September 30, 2018, our generic products pipeline in Europe included 576 generic approvals relating to 81 compounds in 172 formulations, and approximately 1,280 marketing authorization applications pending approval in 37 European countries, relating to 180 compounds in 346 formulations, including two applications pending with the EMA for one strength in 30 countries.

For information regarding our specialty pipeline and launches in the third quarter of 2018, see North America Segment Product Launches and Pipeline.

Europe Gross Profit

Gross profit from our Europe segment in the third quarter of 2018 was $683 million, a decrease of 5% compared to $721 million in the third quarter of 2017. The decrease was mainly due to the loss of revenues from the sale of our women s health business and a decline in COPAXONE revenues.

Gross profit margin for our Europe segment in the third quarter of 2018 increased to 56.4%, from 52.2% in the third quarter of 2017. The increase was mainly due to lower cost of goods (3.4 points) and the closure of our distribution business in Hungary (2.6 points), partially offset by a decline in COPAXONE revenues (0.7 points) and the sale of our women s health business (0.8 points).

Europe R&D Expenses

R&D expenses relating to our Europe segment in the third quarter of 2018 were $62 million, a decrease of 39% compared to $101 million in the third quarter of 2017.

For a description of our R&D expenses in the third quarter of 2018, see Teva Consolidated Results Research and Development (R&D) Expenses below.

Europe S&M Expenses

S&M expenses relating to our Europe segment in the third quarter of 2018 were $249 million, a decrease of 14% compared to $289 million in the third quarter of 2017. The decrease was mainly due to cost reductions as part of the restructuring plan.

Europe G&A Expenses

$
250,553

$
251,993

35
%

(1
)%
Percentage of total net revenue
10
%

11
%

15
%

General and administrative expenses for the year ended December 31, 2018, increased by $88.7 million compared to the year ended December 31, 2017, primarily due to the following:

- an increase of $61.7 million in general and administrative personnel costs, mainly as a result of additions to our support, finance, and legal personnel as we continue to add resources and skills as our business scales to support long-term growth. The increase in personnel related costs includes an increase in share-based compensation expense of $9.5 million;
-

we also incurred $4.7 million in acquisition related costs that are not normal recurring operating expenses, including amounts paid to redeem acquirees' unvested share–-based compensation awards, and legal, accounting, and due diligence costs. There was no similar activity in the prior year; and

- an increase of $4.0 million in various tax and licensing expenses as we continue to expand our business and product offerings.

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General and administrative expenses for the year ended December 31, 2017, decreased by $1.4 million compared to the year ended December 31, 2016. Excluding a $48.0 million non-recurring expense related to the settlement of legal proceedings with Robert E. Morley that was recorded in the year ended December 31, 2016, general and administrative expenses for the year ended December 31, 2017 increased by $46.6 million, due to the following:

- an increase of $24.8 million in general and administrative personnel costs, mainly as a result of additions to our finance, legal, compliance, customer success, Square Capital operations, Caviar operations and internal business systems personnel as we continue to add resources and skills as our business scales and drive long-term growth. The increase in personnel related costs includes an increase in share-based compensation expense of $6.6 million; and

- the remaining increase is primarily due to increased third-party legal, finance, consulting, and corporate level expenses such as facilities expansion as our business and personnel continue to scale and diversify.

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

	Year Ended December 31,			2017 to 2018	2016 to 2017
	2018	2017	2016	% Change	% Change
Transaction, loan and advance losses	$88,077	$67,018	$51,235	31 %	31 %

Transaction, loan and advance losses for the year ended December 31, 2018, increased by $21.1 million, or 31%, compared to the year ended December 31, 2017, primarily due to the following:

- growth in GPV. Transaction losses increased by 27%, which is to a lesser extent than GPV growth due to ongoing investment in data science and improvements in our risk operations to mitigate exposure to transaction losses; and

- a $13.2 million charge recorded to loan losses in the year ended December 31, 2018, compared to $8.0 million for the year ended December 31, 2017, as a result of the growth and aging of our Square Capital loan portfolio.

Transaction, loan and advance losses for the year ended December 31, 2017, increased by $15.8 million, or 31%, compared to the year ended December 31, 2016, primarily due to growth in GPV. Transaction losses increased to a lesser extent than GPV growth due to ongoing investment in data science and improvements in our risk operations to mitigate exposure to transaction losses, offset by the netting effect of the following:

- an $8.0 million charge recorded to loan losses in the year ended December 31, 2017, with no similar charges during the prior year, as a result of the growth and increasing maturity of our Square Capital loan portfolio, and continued refinement of inputs to our loan loss estimation methodology. We record loan losses when the amortized cost of a loan exceeds the estimated fair value of the loan, as determined at the individual loan level;

- an out of period adjustment of $5.5 million recorded in the year ended December 31, 2016, as a result of a correction to the calculation of our reserve for transaction losses, with no similar charges during the year ended December 31, 2017.

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

	Year Ended December 31,			2017 to 2018	2016 to 2017
	2018	2017	2016	% Change	% Change
Amortization of acquired customer assets	$4,362	$883	$850	394 %	4 %

Amortization of acquired customer assets for the year ended December 31, 2018, increased $3.5 million compared to the year ended December 31, 2017, as a result of additional customer assets acquired through the business combinations in the second quarter of 2018 offset in part by certain customer assets reaching end of life.

Amortization of acquired customer assets for the year ended December 31, 2017, remained relatively flat compared to the year ended December 31, 2016, as a result of certain customer assets reaching end of life offset by additional customer assets acquired.

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

	Year Ended December 31,			2017 to 2018	2016 to 2017
	2018	2017	2016	% Change	% Change
Interest expense, net	$17,982	$10,053	$(533)	79 %	NM
Other income, net	$(18,469)	$(1,595)	$(247)	NM	NM

Interest expense, net, for the year ended December 31, 2018, increased by $7.9 million, compared to the year ended December 31, 2017, primarily due to interest expense related to our convertible notes issued in May 2018, offset in part by interest income earned on our investment in marketable debt securities.

Other income, net, for the year ended December 31, 2018, increased by $16.9 million, compared to the year ended December 31, 2017, primarily due to a gain of $20.3 million arising from revaluation of an equity investment in Eventbrite, Inc. (Eventbrite) as result of its initial public offering and the subsequent mark to market of this investment. Gains or losses arising from marking to market this investment may fluctuate significantly in the future periods due to volatility of the investee stock price. This activity was offset in part by a $5.0 million loss recorded on the extinguishment of debt upon conversion of certain 2022 Notes.

Interest expense, net, for the year ended December 31, 2017, increased by $10.6 million, compared to the year ended December 31, 2016, primarily due to interest expense related to our convertible notes issued in March 2017 offset in part by income earned on our investment in marketable securities.

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

	Year Ended December 31,			2017 to 2018	2016 to 2017
	2018	2017	2016	% Change	% Change
Provision for income taxes	$2,326	$149	$1,917	NM	(92)%
Effective tax rate	(6.4)%	(0.2)%	(1.1)%		

Provision for income taxes for the year ended December 31, 2018, increased by $2.2 million compared to the year ended December 31, 2017, primarily due to an increase in foreign tax expense in 2018 compared to 2017 and one-time events in 2017 creating income tax benefits related to the change in the U.S. tax rate and ability to monetize AMT credits.

Provision for income taxes for the year ended December 31, 2017, decreased by $1.8 million compared to the year ended December 31, 2016, primarily related to the federal income tax benefit resulting from the release of the valuation allowance on certain deferred tax assets due to the enactment of the 2017 Tax Act.

Quarterly Results of Operations

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

	Three Months Ended,							
	Dec. 31, 2018	Sep. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sep. 30, 2017	Jun. 30, 2017	Mar. 31, 2017
	(in thousands, except per share data) (unaudited)							
Revenue:								
Transaction-based revenue	$667,802	$655,384	$625,228	$523,037	$524,612	$510,019	$482,065	$403,478
Subscription and services-based revenue	194,117	166,203	134,332	97,054	79,402	65,051	59,151	49,060
Hardware revenue	18,166	17,558	18,362	14,417	12,021	10,089	10,289	9,016
Bitcoin revenue	52,443	42,963	37,016	34,095	—	—	—	—
Total net revenue	932,528	882,108	814,938	668,603	616,035	585,159	551,505	461,554
Cost of revenue:								
Transaction-based costs	420,846	414,456	395,349	327,911	333,377	328,043	311,092	257,778
Subscription and services-based costs	52,654	47,078	39,784	30,368	24,559	18,169	17,116	15,876
Hardware costs	25,647	23,229	25,536	19,702	16,783	18,775	14,173	12,662
Bitcoin costs	51,951	42,408	36,596	33,872	—	—	—	—
Amortization of acquired technology	1,376	2,277	1,857	1,580	1,486	1,556	1,695	1,807
Total cost of revenue	552,474	529,448	499,122	413,433	376,205	366,543	344,076	288,123
Gross profit	380,054	352,660	315,816	255,170	239,830	218,616	207,429	173,431
Operating expenses:								
Product development	141,811	135,773	114,800	105,095	92,633	82,547	78,126	68,582
Sales and marketing	119,305	116,337	98,243	77,266	76,821	66,533	59,916	49,900
General and administrative	95,445	85,527	82,772	75,501	66,318	64,312	62,988	56,935
Transaction, loan and advance losses	24,474	23,596	21,976	18,031	16,833	19,893	18,401	11,891
Amortization of acquired customer assets	2,127	1,294	672	269	234	222	222	205
Total operating expenses	383,162	362,527	318,463	276,162	252,839	233,507	219,653	187,513
Operating loss	(3,108)	(9,867)	(2,647)	(20,992)	(13,009)	(14,891)	(12,224)	(14,082)
Interest expense, net	5,176	7,224	3,470	2,112	2,483	3,080	3,494	996
Other expense (income), net	19,439	(37,800)	(815)	707	356	(1,226)	(228)	(497)
Loss before income tax	(27,723)	20,709	(5,302)	(23,811)	(15,848)	(16,745)	(15,490)	(14,581)
Provision (benefit) for income taxes	481	1,066	604	175	(185)	(647)	472	509

Net income (loss)	(28,204)	19,643	(5,906)	(23,986)	(15,663)	(16,098)	(15,962)	(15,090)
Net income (loss) per share:								
Basic	$(0.07)	$0.05	$(0.01)	$(0.06)	$(0.04)	$(0.04)	$(0.04)	$(0.04)
Diluted	$(0.07)	$0.04	$(0.01)	$(0.06)	$(0.04)	$(0.04)	$(0.04)	$(0.04)
Weighted-average shares used to compute net loss per share:								
Basic	413,984	409,690	403,301	395,948	390,030	383,951	376,357	366,737
Diluted	413,984	474,915	403,301	395,948	390,030	383,951	376,357	366,737

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

	Three Months Ended,							
	Dec. 31, 2018	Sep. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sep. 30, 2017	Jun. 30, 2017	Mar. 31, 2017
	(in thousands)							
Share-Based Compensation	(unaudited)							
Cost of revenue	$18	$18	$30	$31	$30	$29	$18	$—
Product development	40,788	39,525	33,806	30,482	28,564	25,254	25,136	19,356
Sales and marketing	6,094	6,108	5,634	4,961	4,699	4,579	4,355	3,935
General and administrative	12,125	13,262	12,649	11,350	11,232	10,186	10,084	8,379
Total share-based compensation	$59,025	$58,913	$52,119	$46,824	$44,525	$40,048	$39,593	$31,670

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

	Three Months Ended,							
	Dec. 31, 2018	Sep. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sep. 30, 2017	Jun. 30, 2017	Mar. 31, 2017
	(in thousands, except for GPV and per share data)							
Key Operating Metrics and non-GAAP Financial Measures	(unaudited)							
Gross Payment Volume (GPV) (in millions)	$22,958	$22,498	$21,372	$17,827	$17,888	$17,386	$16,421	$13,647
Adjusted Revenue	$464,252	$431,136	$385,433	$306,820	$282,658	$257,116	$240,413	$203,776
Adjusted EBITDA	$81,310	$70,997	$68,322	$35,894	$41,184	$34,304	$36,496	$27,025
Adjusted Net Income Per Share:								
Basic	$0.16	$0.16	$0.15	$0.07	$0.09	$0.08	$0.08	$0.05
Diluted	$0.14	$0.13	$0.13	$0.06	$0.08	$0.07	$0.07	$0.05

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

	Three Months Ended,							
	Dec. 31, 2018	Sep. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sep. 30, 2017	Jun. 30, 2017	Mar. 31, 2017
	(in thousands)							
Adjusted Revenue Reconciliation	(unaudited)							
Total net revenue	$932,528	$882,108	$814,938	$668,603	$616,035	$585,159	$551,505	$461,554
Less: transaction-based costs	420,846	414,456	395,349	327,911	333,377	328,043	311,092	257,778
Less: bitcoin costs	51,951	42,408	36,596	33,872	—	—	—	—
Add: deferred revenue adjustment related to purchase accounting	4,521	5,892	2,440	—	—	—	—	—
Adjusted Revenue	$464,252	$431,136	$385,433	$306,820	$282,658	$257,116	$240,413	$203,776

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

	Three Months Ended,							
	Dec. 31, 2018	Sep. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sep. 30, 2017	Jun. 30, 2017	Mar. 31, 2017
	(in thousands)							
Adjusted EBITDA Reconciliation	(unaudited)							
Net loss	$(28,204)	$19,643	$(5,906)	$(23,986)	$(15,663)	$(16,098)	$(15,962)	$(15,090)
Share-based compensation expense	59,025	58,913	52,119	46,824	44,525	40,048	39,593	31,670
Depreciation and amortization	22,638	15,835	12,328	10,160	9,632	9,085	9,125	9,437
Interest expense, net	5,176	7,224	3,470	2,112	2,483	3,080	3,494	996
Other expense (income), net	19,439	(37,800)	(815)	707	356	(1,226)	(228)	(497)
Provision (benefit) for income taxes	481	1,066	604	175	(185)	(647)	472	509
Loss (gain) on disposal of property and equipment	(1,005)	806	73	(98)	36	62	2	—
Acquisition related costs	—	345	4,363	—	—	—	—	—
Acquired deferred revenue adjustment	4,521	5,892	2,440	—	—	—	—	—
Acquired deferred costs adjustment	(761)	(927)	(354)	—	—	—	—	—
Adjusted EBITDA	$81,310	$70,997	$68,322	$35,894	$41,184	$34,304	$36,496	$27,025

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

	Three Months Ended,							
	Dec. 31, 2018	Sep. 30, 2018	Jun. 30, 2018	Mar. 31, 2018	Dec. 31, 2017	Sep. 30, 2017	Jun. 30, 2017	Mar. 31, 2017
	(in thousands, except per share data)							
Adjusted Net Income (Loss) Per Share:	(unaudited)							
Net loss	$(28,204)	$19,643	$(5,906)	$(23,986)	$(15,663)	$(16,098)	$(15,962)	$(15,090)
Share-based compensation expense	59,025	58,913	52,119	46,824	44,525	40,048	39,593	31,670
Amortization of intangible assets	4,029	4,384	2,816	1,875	1,747	1,804	1,943	2,121
Amortization of debt discount and issuance costs	10,005	11,627	6,830	4,393	4,335	4,277	4,221	1,390
Loss (gain) on revaluation of equity investment	16,566	(36,908)	—	—	—	—	—	—
Loss on extinguishment of long-term debt	3,403	1,625	—	—	—	—	—	—
Loss (gain) on disposal of property and equipment	(1,005)	806	73	(98)	36	62	2	—
Acquisition related costs	—	345	4,363	—	—	—	—	—
Acquired deferred revenue adjustment	4,521	5,892	2,440	—	—	—	—	—

Acquired deferred cost adjustment	(761)	(927)	(354)	—	—	—	—	—
Adjusted Net Income - basic	$67,579	$65,400	$62,381	$29,008	$34,980	$30,093	$29,797	$20,091
Cash interest expense on convertible senior notes	1,292	—	—	—	—	—	—	—
Adjusted Net Income - diluted	$68,871	$65,400	$62,381	$29,008	$34,980	$30,093	$29,797	$20,091
Weighted-average shares used to compute Adjusted Net Income (Loss) Per Share:								
Basic	413,984	409,690	403,301	395,948	390,030	383,951	376,357	366,737
Diluted	488,177	495,621	470,022	461,761	450,703	432,284	418,468	404,319
Adjusted Net Income Per Share:								
Basic	$0.16	$0.16	$0.15	$0.07	$0.09	$0.08	$0.08	$0.05
Diluted	$0.14	$0.13	$0.13	$0.06	$0.08	$0.07	$0.07	$0.05

Quarterly Trends

Transaction-based revenue is highly correlated with the level of GPV generated by sellers using our managed payments services. Historically our transaction-based revenue has been strongest in our fourth quarter and weakest in our first quarter, as our sellers typically generate additional GPV during the holiday season. We believe that this seasonality has affected and will continue to affect our quarterly results; however, to date its effect has been masked by our rapid growth.

Subscription and services-based revenue generally demonstrates less seasonality than transaction-based revenue. The sequential increase was primarily driven by continued growth of Instant Deposit, Caviar, Cash Card and Square Capital.

Hardware revenue generally demonstrates less seasonality than transaction-based revenue, with most fluctuations tied to periodic product launches, promotions, or other arrangements with our retail partners. Recent product launches include Square Register in the fourth quarter of 2017 and Square Terminal during the third quarter of 2018.

During the fourth quarter of 2017, we started offering our Cash App customers the ability to purchase bitcoin from us. Bitcoin revenue comprises the total sale amount we receive from bitcoin sales to customers and is recorded upon transfer of bitcoin to the customer's account. The sale amount generally includes a small margin added to the price we pay to purchase bitcoin and accordingly, the amount of bitcoin revenue will fluctuate depending on the volatility of market bitcoin prices and customer demand.

Changes in product development expenses primarily reflect the timing of additions of engineering, product, and design personnel. To a lesser extent, they also reflect the timing of fees and supply costs related to maintenance and capacity expansion at third-party data center facilities, development and tooling costs related to the design, testing, and shipping of our hardware products, and fees for software licenses, consulting, legal, and other services that are directly related to growing and maintaining our products and services.

Changes in sales and marketing expenses reflect the variable nature of the timing and magnitude of paid marketing and customer acquisition initiatives across our advertising channels. Changes in sales and marketing expenses are also affected by the timing of additions of direct sales, account management, local, product and paid marketing, retail and ecommerce, partnerships, and communications personnel. Additionally, sales and marketing expenses are affected by the timing and magnitude of costs related to our Cash App peer-to-peer transfer service and Cash Card issuance costs. We offer the peer-to-peer service to our Cash App customers for free and we consider this to be a marketing tool intended to encourage the usage of Cash App which includes Cash Card among other features.

Changes in general and administrative expenses primarily reflect the timing of additions of finance, legal, risk operations, human resources, and administrative personnel, as well as the timing of non income tax payments and reserves. They also reflect the timing of costs related to support personnel and systems, as well as fees paid for professional services, including legal and financial services.

Changes in interest expense (income), net are driven by interest expense related to our convertible notes and interest income earned on our investment in marketable debt securities. Changes in other expense (income), net is primarily due to gains or losses arising from revaluation of an equity investment in Eventbrite as result of their initial public offering and subsequent mark to market of this investment. Gains or losses arising from marking to market this investment may fluctuate significantly in future periods due to volatility of the investee stock price. To a lesser extent this balance is also impacted by gains or losses recorded on the extinguishment of long-term debt as well as foreign exchange gains or losses.

Liquidity and Capital Resources

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

	Year Ended December 31,		
	2018	2017	2016
Cash and cash equivalents	$583,173	$696,474	$452,030
Short-term restricted cash	33,838	28,805	22,131
Long-term restricted cash	15,836	9,802	14,584
Cash, cash equivalents, and restricted cash	632,847	735,081	488,745
Short-term investments	540,991	169,576	59,901
Long-term investments	464,680	203,667	27,366
Cash, cash equivalents, restricted cash and investments in marketable debt securities	1,638,518	1,108,324	576,012

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

	Year Ended December 31,		
	2018	2017	2016
Net cash provided by operating activities	$295,080	$127,711	$23,131
Net cash used in investing activities:	(905,848)	(340,611)	(114,241)
Net cash provided by financing activities	515,755	454,933	90,741
Effect of foreign exchange rate on cash and cash equivalents	(7,221)	4,303	(438)
Net increase (decrease) in cash, cash equivalents and restricted cash	$(102,234)	$246,336	$(807)

Our principal sources of liquidity are our cash and cash equivalents, and investments in marketable debt securities. As of December 31, 2018, we had $1.6 billion of cash and cash equivalents, and investments in marketable debt securities, which were held primarily in cash deposits, money market funds, U.S. government and agency securities, commercial paper, and corporate bonds. We consider all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Our investments in marketable debt securities are classified as available-for-sale.

On March 6, 2017, we issued $440.0 million in aggregate principal amount of convertible senior notes (2022 Notes) that mature on March 1, 2022, unless earlier converted or repurchased, and bear interest at a rate of 0.375% payable semi-annually on March 1 and September 1 of each year. The 2022 Notes are convertible at an initial conversion rate of 43.5749 shares of Class A common stock per $1,000 principal amount of 2022 Notes, which is equivalent to an initial conversion price of approximately $22.95 per share of Class A common stock. In connection with the offering of the 2022 Notes, we entered into convertible note hedge transactions (2022 convertible note hedges) with certain financial institutions (2017 Counterparties) whereby we have the option to purchase a total of approximately 19.2 million shares of our Class A common stock at a price of approximately $22.95 per share. The total cost of the 2022 convertible note hedge transactions was approximately $92.1 million. In addition, we sold warrants (2022 warrants) to the 2017 Counterparties whereby the 2017 Counterparties have the option to purchase a total of approximately 19.2 million shares of our Class A common stock at a price of approximately $31.18 per share. We received approximately $57.2 million in cash proceeds from the sale of these 2022 warrants. Taken together, the purchase of the 2022 convertible note hedges and sale of the 2022 warrants are intended to offset any actual dilution from the conversion of the 2022 Notes. The net proceeds from this transaction, after issuance costs was approximately $393.4 million. The Company settled certain of the 2022 Notes through a combination of cash of $219.4 million for the principal amount and issuing 6.9 million shares of the Company's Class A common stock in respect of the conversion value in excess of the principal amount in settlement thereof.

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On May 25, 2018, we issued $862.5 million in aggregate principal amount of convertible senior notes (2023 Notes) that mature on May 15, 2023, unless earlier converted or repurchased, and bear interest at a rate of 0.50% payable semi-annually on May 15 and November 15 of each year. The 2023 Notes are convertible at an initial conversion rate of 12.8456 shares of our Class A common stock per $1,000 principal amount of 2023 Notes, which is equivalent to an initial conversion price of approximately $77.85 per share of Class A common stock. In connection with the offering of the 2023 Notes, we entered into convertible note hedge transactions (2023 convertible note hedges) with certain financial institution counterparties (2018 Counterparties) whereby we have the option to purchase a total of approximately 11.1 million shares of our Class A common stock at a price of approximately $77.85 per share. The total cost of the 2023 convertible note hedge transactions was approximately $172.6 million. In addition, we sold warrants (2023 warrants) to the 2018 Counterparties whereby the 2018 Counterparties have the option to purchase a total of approximately 11.1 million shares of our Class A common stock at a price of approximately $109.26 per share. We received approximately $112.1 million in cash proceeds from the sale of the 2023 warrants. Taken together, the purchase of the 2023 convertible note hedges and sale of the 2023 warrants are intended to reduce and/or offset dilution from the conversion of the 2023 Notes. The net proceeds from this transaction, after issuance costs was approximately $795.2 million.

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

See Note 12, Indebtedness, of the Notes to the Consolidated Financial Statements for more details on these transactions.

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

Short-term restricted cash of $33.8 million as of December 31, 2018 reflects pledged cash deposited into savings accounts at the financial institutions that process our sellers' payments transactions and as collateral pursuant to an agreement with the originating bank for the Company's loan product. We use the restricted cash to secure letters of credit with these financial institutions to provide collateral for liabilities arising from cash flow timing differences in the processing of these payments. We have recorded this amount as a current asset on our consolidated balance sheets given the short-term nature of these cash flow timing differences and that there is no minimum time frame during which the cash must remain restricted.
Long-term restricted cash of $15.8 million as of December 31, 2018 reflects cash held as collateral pursuant to multi-year lease agreements. The Company has recorded this amount as a non-current asset on the consolidated balance sheets as the lease terms extend beyond one year.

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

- Timing of period end. For periods that end on a weekend or a bank holiday, our cash and cash equivalents, settlements receivable, and customers payable amounts typically will be more than for periods ending on a weekday, as we settle

to our sellers for payment processing activity on business days; and

- Fluctuations in daily GPV. When daily GPV increases, our cash and cash equivalents, settlements receivable, and customers payable amounts increase. Typically our settlements receivable, and customers payable balances at period end represent one to four days of receivables and disbursements to be made in the subsequent period. Customers payable and settlements receivable balances typically move in tandem, as pay-out and pay-in largely occur on the same business day. However, customers payable balances will be greater in amount than settlements receivable balances due to the fact that a subset of funds are held due to unlinked bank accounts, risk holds, and chargebacks. Also customer funds obligations, which are included in customers payable, may cause customers payable to trend differently than settlements receivable. Holidays and day-of-week may also cause significant volatility in daily GPV amounts.

Cash Flows from Operating Activities

Cash provided by (used in) operating activities consisted of net loss adjusted for certain non-cash items including gain or loss on revaluation of equity investment, depreciation and amortization, non-cash interest and other expense, share-based compensation expense, transaction, loan and advance losses, deferred income taxes, and gain (loss) on disposal of property and equipment, as well as the effect of changes in operating assets and liabilities, including working capital.

For the year ended December 31, 2018, cash provided by operating activities was $295.1 million, primarily as a result of:

- Net loss of $38.5 million, less non-cash gain on revaluation of equity investment of $20.3 million, offset by add back of non-cash expenses consisting primarily of share-based compensation of $216.9 million, transaction, loan and advance losses of $88.1 million, depreciation and amortization of $61.0 million, and non-cash interest and other expenses of $31.3 million. The gain on revaluation of the equity investment is as result of the initial public offering of Eventbrite and subsequent mark to market valuation of this investment, while the other items are largely driven by growth and expansion of our business activities.

- Additional cash provided from changes in operating assets and liabilities, including decreases in settlements receivable of $245.8 million, increases in other current liabilities of $35.3 million, increases in customers payable of $15.6 million, and increases in other non-current liabilities of $13.9 million. Settlements receivable decreased significantly compared to December 31, 2017, due to the period ending on a weekday this year compared to a weekend in the prior year, as we settle processing payment activity on business days. Settlements receivable balances are generally offset by customers payable which moves in tandem, however, increases in customer funds obligations, which are included in customers payable, mitigated the impact. Other current liabilities increased primarily due to general increases in accounts payable balances. Other non-current liabilities increased primarily due to increased statutory liabilities and deferred tax liabilities.

- These were offset in part by cash used from changes in operating assets and liabilities, including increases in customer funds of $131.0 million as a result of increasing customer base and stored funds on the Cash App, increases in other current assets of $77.4 million, decreases in settlements payable of $60.7 million, increase in charge-offs to accrued transaction losses of $58.2 million arising as a result in growth in GPV, and due to the net loan activity related to loans held for sale of $29.8 million arising from increased loan purchases.

For the year ended December 31, 2017, cash provided by operating activities was $127.7 million, primarily as a result of:

- Net loss of $62.8 million, offset by non-cash items consisting primarily of share-based compensation of $155.8 million, transaction, loan and advance losses of $67.0 million, and depreciation and amortization of $37.3 million. These items are largely driven by growth and expansion of our business activities.

- Additional cash provided from changes in operating assets and liabilities, including increases in customers payable of $301.8 million, and increases in settlements payable of $63.6 million. Customers payable and settlements payable balances increased significantly as the year ended on a Sunday and transactions over a weekend will not settle until the following week. These balances are largely offset by settlements receivable, described below, which moves in tandem.

These were offset in part by cash used from changes in operating assets and liabilities, including increases in settlements receivable of $305.8 million for reasons aforementioned, increases in customer funds of $59.5 million as result of an increasing customer base with stored funds on the Cash App, charge-offs to accrued transaction losses of $46.1 million arising as a result of growth in GPV, and due to the net activity related to loans held for sale of $39.3 million arising from increased loan purchases.

For the year ended December 31, 2016, cash provided by operating activities was $23.1 million, primarily as a result of:

- Net loss of $171.6 million, offset by non-cash items consisting primarily of share-based compensation of $138.8 million, transaction, loan and advance losses of $51.2 million, and depreciation and amortization of $37.7 million.
- Additional cash provided from changes in operating assets and liabilities, including increases in customers payable of $206.6 million, increases in settlements payable of $38.0 million and decreases in other current assets of $16.1 million.
- These were offset in part by cash used from changes in operating assets and liabilities, including increases in settlements receivable of $177.7 million, charge-offs to accrued transaction losses of $47.9 million, the net activity related to loans held for sale of $41.3 million and increases in customer funds of $34.1 million

Cash Flows from Investing Activities

Cash flows used in investing activities primarily relate to capital expenditures to support our growth, investments in marketable debt securities, investment in privately held entity and business acquisitions.

For the year ended December 31, 2018, cash used in investing activities was $905.8 million, primarily as a result of the purchase of marketable debt securities of $1,000.3 million, offset in part by proceeds from maturities and sales of marketable debt securities of $369.4 million. We increased our investment portfolio using proceeds from the financing activities described below. During the year ended December 31, 2018, the Company started investing a portion of customer funds in short-term marketable debt securities. Such uses of cash include the purchase of marketable debt securities from customer funds of $148.1 million, offset in part by proceeds from sales of marketable securities from customer funds of $48.3 million. Additional uses of cash were a result of business acquisitions, net of cash acquired of $112.4 million and the purchase of property and equipment of $61.2 million to help us scale.

For the year ended December 31, 2017, cash used in investing activities was $340.6 million, primarily as a result of the purchase of marketable securities of $544.9 million, offset in part by proceeds from maturities and sales of marketable securities of $257.3 million. We increased our investment portfolio using proceeds from the financing activities described below. Additional uses of cash were a result of a strategic investment in a privately held entity of $25.0 million and the purchase of property and equipment of $26.1 million to help us scale.

For the year ended December 31, 2016, cash used in investing activities was $114.2 million, primarily as a result of the purchase of marketable securities of $164.8 million, offset in part by proceeds from maturities and sales of marketable securities of $77.4 million. Additional uses of cash were as a result of the purchase of property and equipment of $25.4 million.

Cash Flows from Financing Activities

For the year ended December 31, 2018, cash provided by financing activities was $515.8 million, primarily as a result of $795.2 million in net proceeds from the 2023 Notes offering and as a result of proceeds from issuances of common stock from the exercise of options and purchases under the employee stock purchase plan, net of $133.9 million, offset in part by the cash payment of $219.4 million for the principal amount of certain 2022 Notes upon conversion and payments for employee tax withholding related to vesting of restricted stock units of $189.1 million. We intend to use the proceeds from financing activities to support general corporate purposes and help us grow to scale.

For the year ended December 31, 2017 cash provided by financing activities was $454.9 million, primarily as a result of $393.4 million in net proceeds from the 2022 Notes offering and as a result of proceeds from issuances of common stock from the exercise of options and purchases under the employee stock purchase plan, net of $162.5 million, offset in part by the settlement of a warrant with Starbucks of $54.8 million and payments for employee tax withholding related to vesting of restricted stock units of $44.7 million. We intend to use the proceeds from financing activities to support general corporate purposes and help us grow to scale.

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

Contractual Obligations and Commitments

Our principal commitments consist of convertible senior notes, operating leases, capital leases, and purchase commitments. The following table summarizes our commitments to settle contractual obligations in cash as of December 31, 2018.

	Payments due by period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
	(in thousands)				
Convertible senior notes, including interest	$1,095,799	$5,110	$10,219	$1,080,470	$—
Operating leases	429,466	28,405	90,450	100,652	209,959
Capital leases	7,475	5,029	2,446	—	—
Purchase commitments	21,077	21,077	—	—	—
Total	$1,553,817	$59,621	$103,115	$1,181,122	$209,959

Convertible Senior Notes

On May 25, 2018, we issued $862.5 million in aggregate principal amount of 2023 Notes that mature on May 15, 2023, unless earlier converted or repurchased, and bear interest at a rate of 0.50% payable semi-annually on May 15 and November 15 of each year. See Note 12, Indebtedness, of the Notes to the Condensed Consolidated Financial Statements for more details on this transaction.

On March 6, 2017, we issued $440.0 million in aggregate principal amount of Notes that mature on March 1, 2022, unless earlier converted or repurchased, and bear interest at a rate of 0.375% payable semi-annually on March 1 and September 1 of each year. See Note 12, Indebtedness, of the Notes to the Consolidated Financial Statements for more details on this transaction.

Lease Commitments

We have entered into various non-cancelable operating leases for certain offices with contractual lease periods expiring between 2019 and 2031. We recognized total rental expenses under operating leases of $23.3 million, $12.9 million, and $11.3 million during the years ended December 31, 2018, 2017, and 2016, respectively.

Purchase commitments

We had non-cancelable purchase obligations to hardware suppliers for $21.1 million for the year ended December 31, 2018.

Other Estimates

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As disclosed in Note 17 of the Notes to the Consolidated Financial Statements, depending on the outcome of the classification of our primary business activity, we could be obligated to pay additional San Francisco Gross Receipts Tax together with associated penalties and interest, that in the aggregate could be material to our financial statements. Additionally, on November 6, 2018, voters of the City and County of San Francisco approved a ballot measure that may require increased taxes on gross receipts. If applicable to our business, the impact of this measure could further increase our tax exposure.

Off-balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

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

We believe accounting policies and the assumptions and estimates associated with accrued transaction losses and revenue recognition have the greatest potential effect on our consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates.

Accrued Transaction Losses

We are exposed to transaction losses due to chargebacks as a result of fraud or uncollectibility of transaction payments. We estimate accrued transaction losses based on available data as of the reporting date, including expectations of future chargebacks, and historical trends related to loss rates. During the year ended December 31, 2018, we recorded transaction losses of $65.0 million, which as a percentage of GPV were less than 0.1%, and continues to show improvement relative to historical averages. We expect transaction losses to increase to a lesser extent than GPV growth due to ongoing investment in data science and improvements in our risk operations to mitigate exposure to transaction losses.

Revenue Recognition

Application of the various accounting principles in U.S. GAAP requires that we make judgments and estimates related to the classification, measurement and recognition of revenue. Complex arrangements may require significant judgment in contract interpretation to determine the appropriate accounting. Specifically, under ASC 606, the determination of whether we are a principal in the delivery of managed payments solutions and sale of bitcoin, and therefore recognize the revenue on a gross basis, or if we are an agent and therefore recognize revenue on a net basis can require considerable judgment. We have concluded that we are the principal in these arrangements because we control the services or product before delivery to the customers, and have the unilateral ability to accept or reject a transaction based on criteria we have established.

Recent Accounting Pronouncements

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest Rate Sensitivity

Our cash and cash equivalents, and marketable debt securities as of December 31, 2018, were held primarily in cash deposits, money market funds, U.S. government and agency securities, commercial paper, and corporate bonds. The fair value of our cash, cash equivalents, and marketable debt securities would not be significantly affected by either an increase or decrease in interest rates due mainly to the short-term nature of a majority of these instruments. Additionally, we have the ability to hold these instruments until maturity if necessary to reduce our risk. Any future borrowings incurred under our credit facility would accrue interest at a floating rate based on a formula tied to certain market rates at the time of incurrence (as described above). A hypothetical 100 basis point increase or decrease in interest rates would not have a material effect on our financial results.

Foreign Currency Risk

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

Equity Investment Risk

We hold an equity investment at fair value based on readily determinable market values, which is subject to market price volatility, and represents $45.3 million on our consolidated balance sheets as of December 31, 2018. A hypothetical decrease in price of 10%, which could be experienced in the near term, would result in a loss of $4.5 million in other expense on the consolidated statements of operations.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

SQUARE, INC.
INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Square, Inc.:

Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting
We have audited the accompanying consolidated balance sheets of Square, Inc. and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018 based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.
The Company acquired Weebly, Inc. on May 31, 2018, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2018, Weebly, Inc.'s internal control over financial reporting associated with 2% of total assets and 1% of total net revenue included in the consolidated financial statements of the Company as of and for the year ended December 31, 2018. Our audit of internal control over financial reporting of Square, Inc. as of December 31, 2018, also excluded an evaluation of the internal control over financial reporting of Weebly, Inc.

Change in Accounting Principle
As discussed in Note 2 to the consolidated financial statements, the Company adopted Accounting Standard Codification Topic 606, Revenue from Contracts with Customers, effective January 1, 2018.
Basis for Opinions
The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Form 10-K. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.
We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.
Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating

the design and operating effectiveness of internal control based on the assessed risk.

Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ KPMG LLP

We have served as the Company's auditor since 2011.
San Francisco, California
February 27, 2019

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

	December 31,	
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	$583,173	$696,474
Short-term investments	540,991	169,576
Restricted cash	33,838	28,805
Settlements receivable	364,946	620,523
Customer funds	334,017	103,042
Loans held for sale	89,974	73,420
Other current assets	164,966	86,454
Total current assets	2,111,905	1,778,294
Property and equipment, net	142,402	91,496
Goodwill	261,705	58,327
Acquired intangible assets, net	77,102	14,334
Long-term investments	464,680	203,667
Restricted cash	15,836	9,802
Build-to-suit lease asset	149,000	—
Other non-current assets	58,393	31,350
Total assets	$3,281,023	$2,187,270
Liabilities and Stockholders' Equity		
Current liabilities:		
Customers payable	749,215	733,736
Settlements payable	54,137	114,788
Accrued transaction losses	33,682	26,893
Accrued expenses	82,354	52,280
Other current liabilities	99,153	45,130
Total current liabilities	1,018,541	972,827
Long-term debt (Note 12)	899,695	358,572
Build-to-suit lease liability	149,000	—
Other non-current liabilities	93,286	69,538
Total liabilities	2,160,522	1,400,937
Commitments and contingencies (Note 17)		
Stockholders' equity:		
Preferred stock, $0.0000001 par value: 100,000,000 shares authorized at December 31, 2018 and December 31, 2017. None issued and outstanding at December 31, 2018 and December 31, 2017.	—	—
Class A common stock, $0.0000001 par value: 1,000,000,000 shares authorized at December 31, 2018 and December 31, 2017; 323,546,864 and 280,400,813 issued and outstanding at December 31, 2018 and December 31, 2017, respectively.	—	—
Class B common stock, $0.0000001 par value: 500,000,000 shares authorized at December 31, 2018 and December 31, 2017; 93,501,142 and 114,793,262 issued and outstanding at December 31, 2018 and December 31, 2017, respectively.	—	—
Additional paid-in capital	2,012,328	1,630,386
Accumulated other comprehensive loss	(6,053)	(1,318)
Accumulated deficit	(885,774)	(842,735)

Total stockholders' equity	1,120,501	786,333
Total liabilities and stockholders' equity	$3,281,023	$2,187,270

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2018	2017	2016
Revenue:			
Transaction-based revenue	$2,471,451	$1,920,174	$1,456,160
Starbucks transaction-based revenue	—	—	78,903
Subscription and services-based revenue	591,706	252,664	129,351
Hardware revenue	68,503	41,415	44,307
Bitcoin revenue	166,517	—	—
Total net revenue	3,298,177	2,214,253	1,708,721
Cost of revenue:			
Transaction-based costs	1,558,562	1,230,290	943,200
Starbucks transaction-based costs	—	—	69,761
Subscription and services-based costs	169,884	75,720	43,132
Hardware costs	94,114	62,393	68,562
Bitcoin costs	164,827	—	—
Amortization of acquired technology	7,090	6,544	8,028
Total cost of revenue	1,994,477	1,374,947	1,132,683
Gross profit	1,303,700	839,306	576,038
Operating expenses:			
Product development	497,479	321,888	268,537
Sales and marketing	411,151	253,170	173,876
General and administrative	339,245	250,553	251,993
Transaction, loan and advance losses	88,077	67,018	51,235
Amortization of acquired customer assets	4,362	883	850
Total operating expenses	1,340,314	893,512	746,491
Operating loss	(36,614)	(54,206)	(170,453)
Interest expense, net	17,982	10,053	(533)
Other income, net	(18,469)	(1,595)	(247)
Loss before income tax	(36,127)	(62,664)	(169,673)
Provision for income taxes	2,326	149	1,917
Net loss	$(38,453)	$(62,813)	$(171,590)
Net loss per share:			
Basic	$(0.09)	$(0.17)	$(0.50)
Diluted	$(0.09)	$(0.17)	$(0.50)
Weighted-average shares used to compute net loss per share:			
Basic	405,731	379,344	341,555
Diluted	405,731	379,344	341,555

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2018	2017	2016
Net loss	$(38,453)	$(62,813)	$(171,590)
Net foreign currency translation adjustments	(4,496)	1,900	(716)
Net unrealized gain (loss) on revaluation of intercompany loans	303	385	(11)
Net unrealized loss on marketable debt securities	(542)	(1,614)	(77)
Total comprehensive loss	$(43,188)	$(62,142)	$(172,394)

See accompanying notes to consolidated financial statements.

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

	Convertible preferred stock		Class A and B common stock		Additional paid-in	Accumulated other comprehensive	Accumulated	Total stockholders'
	Shares	Amount	Shares	Amount	capital	loss	deficit	equity
Balance at December 31, 2015	—	$ —	334,949,445	$ —	$ 1,116,882	$ (1,185)	$ (607,649)	$ 508,048
Net loss	—	—	—	—	—	—	(171,590)	(171,590)
Shares issued in connection with:								
Exercise of stock options and warrants	—	—	24,413,821	—	82,438	—	—	82,438
Purchases under employee stock purchase plan	—	—	1,852,900	—	14,201	—	—	14,201
Vesting of restricted stock units	—	—	3,392,726	—	—	—	—	—
Vesting of early exercised stock options and other	—	—	—	—	2,313	—	—	2,313
Cancellation of shares related to business combinations	—	—	(228)	—	—	—	—	—
Repurchase of common stock	—	—	(61,288)	—	—	—	—	—
Change in other comprehensive loss	—	—	—	—	—	(804)	—	(804)
Share-based compensation	—	—	—	—	141,547	—	—	141,547
Balance at December 31, 2016	—	$ —	364,547,376	$ —	$ 1,357,381	$ (1,989)	$ (779,239)	$ 576,153
Net loss	—	—	—	—	—	—	(62,813)	(62,813)
Shares issued in connection with:								
Exercise of stock options	—	—	24,510,745	—	144,774	—	—	144,774
Purchases under employee stock purchase plan	—	—	1,670,045	—	17,859	—	—	17,859
Vesting of restricted stock units	—	—	5,964,153	—	—	—	—	—
Vesting of early exercised stock options and other	—	—		—	661	—	—	661
Repurchase of common stock	—	—	(24,209)	—	—	—	—	—
Change in other comprehensive loss	—	—	—	—	—	671	—	671
Share-based compensation	—	—	—	—	159,509	—	—	159,509
Tax withholding related to vesting of restricted stock units	—	—	(1,474,035)	—	(44,682)	—	—	(44,682)
Conversion feature of convertible senior notes, due 2022, net of allocated debt issuance costs	—	—	—	—	83,901	—	—	83,901
Purchase of bond hedges in conjunction with issuance of convertible senior notes, due 2022	—	—	—	—	(92,136)	—	—	(92,136)
Sale of warrants in conjunction with issuance of convertible senior notes, due 2022	—	—	—	—	57,244	—	—	57,244
	—	—	—	—	(54,808)	—	—	(54,808)

Payment for termination of Starbucks warrant	—	—	—	—	—	—	—
Cumulative adjustment due to adoption of new standard (Note 12)	—	—	—	683	—	(683)	—
Balance at December 31, 2017	—	$ —	395,194,075	$ —	$ 1,630,386	$ (1,318)	$ (842,735)	$ 786,333
Net loss	—	—	—	—	—	—	(38,453)	(38,453)
Shares issued in connection with:								
Exercise of stock options	—	—	13,402,680	—	106,962	—	—	106,962

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	Convertible preferred stock		Class A and B common stock		Additional paid-in	Accumulated other comprehensive	Accumulated	Total stockholders'
	Shares	Amount	Shares	Amount	capital	loss	deficit	equity
Vesting of early exercised stock options and other	—	—	—	—	177	—	—	177
Purchases under employee stock purchase plan	—	—	826,356	—	26,888	—	—	26,888
Vesting of restricted stock units	—	—	8,046,640	—	—	—	—	—
Issuance of common stock in connection with business combination	—	—	2,649,590	—	140,107	—	—	140,107
Replacement stock awards issued in connection with acquisition	—	—	24,613	—	899	—	—	899
Repurchase of common stock	—	—	—	—	—	—	—	—
Change in other comprehensive loss	—	—	—	—	—	(4,735)	—	(4,735)
Share-based compensation	—	—	—	—	226,182	—	—	226,182
Tax withholding related to vesting of restricted stock units	—	—	(3,013,394)	—	(189,124)	—	—	(189,124)
Conversion feature of convertible senior notes, due 2023, net of allocated costs	—	—	—	—	154,019	—	—	154,019
Purchase of bond hedges in conjunction with issuance of convertible senior notes, due 2023	—	—	—	—	(172,586)	—	—	(172,586)
Sale of warrants in conjunction with issuance of convertible senior notes, due 2023	—	—	—	—	112,125	—	—	112,125
Issuance of common stock in conjunction with the conversion of senior notes, due 2022	—	—	7,288,907	—	(20,962)	—	—	(20,962)
Exercise of bond hedges in conjunction with the conversion of senior notes, due 2022	—	—	(6,901,567)	—	—	—	—	—
Cumulative adjustment due to adoption of ASC 606	—	—	—	—	—	—	(4,586)	(4,586)
Recovery of common stock in connection with indemnification settlement agreement	—	—	(469,894)	—	(2,745)	—	—	(2,745)
Balance at December 31, 2018	—	—	417,048,006	—	2,012,328	(6,053)	(885,774)	1,120,501

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2018	2017	2016
Cash flows from operating activities:			
Net loss	$(38,453)	$(62,813)	$(171,590)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	60,961	37,279	37,745
Non-cash interest and other expense	31,257	14,421	(49)
Loss on extinguishment of long-term debt	5,047	—	—
Share-based compensation	216,881	155,836	138,786
Replacement stock awards issued in connection with acquisition	899	—	—
Gain on revaluation of equity investment	(20,342)	—	—
Recovery of common stock in connection with indemnification settlement agreement	(2,745)	—	—
Transaction, loan and advance losses	88,077	67,018	51,235
Change in deferred income taxes	(646)	(1,385)	58
Changes in operating assets and liabilities:			
Settlements receivable	245,795	(305,831)	(177,662)
Customer funds	(131,004)	(59,468)	(34,128)
Purchase of loans held for sale	(1,609,611)	(1,184,630)	(668,976)
Sales and principal payments of loans held for sale	1,579,834	1,145,314	627,627
Other current assets	(77,405)	(26,119)	16,116
Other non-current assets	(6,641)	(3,274)	631
Customers payable	15,597	301,778	206,574
Settlements payable	(60,651)	63,637	38,046
Charge-offs to accrued transaction losses	(58,192)	(46,148)	(47,931)
Accrued expenses	7,190	12,207	(409)
Other current liabilities	35,294	8,198	3,909
Other non-current liabilities	13,938	11,691	3,149
Net cash provided by operating activities	295,080	127,711	23,131
Cash flows from investing activities:			
Purchase of marketable debt securities	(1,000,346)	(544,910)	(164,766)
Proceeds from maturities of marketable debt securities	197,454	168,224	43,200
Proceeds from sale of marketable debt securities	171,992	89,087	34,222
Purchase of marketable debt securities from customer funds	(148,096)	—	—
Proceeds from sale of marketable debt securities from customer funds	48,334	—	—
Purchase of property and equipment	(61,203)	(26,097)	(25,433)
Proceeds from sale of property and equipment	—	—	296
Purchase of equity investment	—	(25,000)	—
Purchase of intangible assets	(1,584)	—	(400)
Business combinations, net of cash acquired	(112,399)	(1,915)	(1,360)
Net cash used in investing activities:	(905,848)	(340,611)	(114,241)
Cash flows from financing activities:			
Proceeds from issuance of convertible senior notes, net	855,663	428,250	—
Purchase of convertible senior note hedges	(172,586)	(92,136)	—
Proceeds from issuance of warrants	112,125	57,244	—
Principal payment on conversion of senior notes	(219,384)	—	—

Payment of deferred purchase consideration	(848)	—	—
Payment for termination of Starbucks warrant	—	(54,808)	—
Payments of offering costs related to initial public offering	—	—	(5,530)
Principal payments on capital lease obligation	(3,941)	(1,439)	(168)
Proceeds from the exercise of stock options and purchases under the employee stock purchase plan, net	133,850	162,504	96,439
Payments for tax withholding related to vesting of restricted stock units	(189,124)	(44,682)	—

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Net cash provided by financing activities	515,755	454,933	90,741
Effect of foreign exchange rate on cash and cash equivalents	(7,221)	4,303	(438)
Net increase (decrease) in cash, cash equivalents and restricted cash	(102,234)	246,336	(807)
Cash, cash equivalents and restricted cash, beginning of the year	735,081	488,745	489,552
Cash, cash equivalents and restricted cash, end of the year	$632,847	$735,081	$488,745

See accompanying notes to consolidated financial statements.

SQUARE, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

Business

Square, Inc. (together with its subsidiaries, Square or the Company) creates tools that help sellers start, run, and grow their businesses. Square enables sellers to accept card payments and also provides reporting and analytics, next-day settlement, and chargeback protection. Square's point-of-sale software and other business services help sellers manage inventory, locations, and employees; access financing; engage buyers; build a website or online store; and grow sales. The Cash App is an easy way to send, spend, and store money, and Caviar is a food-ordering service. Square was founded in 2009 and is headquartered in San Francisco, with offices in the United States, Canada, Japan, Australia, Ireland, and the UK.

Reclassifications and Other Adjustments

During the year ended December 31, 2018, the Company has reclassified prior period balances within interest and other (income) expense, net, to disaggregate the amounts and separately present interest (income) expense, net and other (income) expense, net on its consolidated statements of operations to conform to the current period presentation. This classification change was made to provide clarity of the balances as the activity continues to grow, particularly as a result of the impact of revaluation of an equity investment in the current period. During the year ended December 31, 2018, the Company recorded a gain of $20.3 million to other income on the consolidated statements of operations arising from revaluation of this investment (Note 11). There was no impact to the net income (loss) on its consolidated statements of operations to any of the periods presented as result of this change.

Litigation Settlement

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

Basis of Presentation

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

Use of Estimates

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

past experience and other assumptions that the Company believes are reasonable under the circumstances, and the Company evaluates these estimates on an ongoing basis.

Estimates, judgments, and assumptions in these consolidated financial statements include, but are not limited to, those related to revenue recognition, accrued transaction losses, valuation of the debt component of convertible senior notes, valuation of loans held for sale, goodwill, acquired intangible assets and deferred revenue, income and other taxes, build-to-suit lease asset and liability, and share-based compensation.

Revenue Recognition

On January 1, 2018, the Company adopted Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers, using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic revenue recognition methodology under ASC 605, Revenue Recognition. Refer to Note 2 for the impact of this adoption.

Revenue is recognized when control of the promised goods or services is transferred to customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services.

Transaction-based revenue

The Company charges its sellers a transaction fee for managed payments solutions that is generally calculated as a percentage of the total transaction amount processed. The Company selectively offers custom pricing for certain sellers. The Company collects the transaction amount from the seller's customer's bank, net of acquiring interchange and assessment fees, processing fees, and bank settlement fees paid to third-party payment processors and financial institutions. The Company retains its fees and remits the net amount to the sellers.

The Company acts as the merchant of record for its sellers and works directly with payment card networks and banks so that its sellers do not need to manage the complex systems, rules, and requirements of the payments industry. The Company satisfies its performance obligations and therefore recognizes the transaction fees as revenue upon authorization of a transaction by the seller's customer's bank.

Revenue is recognized net of refunds, which arise from reversals of transactions initiated by sellers.

The transaction fees collected from sellers are recognized as revenue on a gross basis as the Company is the principal in the delivery of the managed payments solutions to the sellers. The Company has concluded it is the principal because as the merchant of record, it controls the services before delivery to the seller, it is primarily responsible for the delivery of the services to its sellers, and it has discretion in setting prices charged to sellers. The Company also has the unilateral ability to accept or reject a transaction based on criteria established by the Company. As the merchant of record, Square is liable for the costs of processing the transactions for its sellers, and records such costs within cost of revenue.

Subscription and services-based revenue

Subscription and services-based revenue is primarily comprised of revenue the Company generates from Instant Deposit and Cash Card, Caviar, Square Capital, website hosting and domain name registration services, and various other software as a service (SaaS) products.

Instant Deposit is a functionality within the Cash App and the Company's managed payments solution that enables customers, including individuals and sellers, to instantly deposit funds into their bank accounts. The Company charges a per transaction fee which is recognized as revenue when customers instantly deposit funds to their bank account. The Company also offers Cash App customers the ability to use funds stored in the Cash App via a Visa debit card (Cash Card), for which the Company charges a per transaction fee that is recorded as revenue.

Caviar is a food ordering platform that facilitates food delivery services. The Company's performance obligations are the delivery of food orders from restaurants to customers and the provision of catered meals to corporate customers. For delivery of food orders, the Company charges fees to restaurants, as sellers, and also charges delivery and service

fees to individuals. For provision of catered meals the Company charges corporate customers a fee. All fees are billed upon delivery of food orders or catered meals, when the Company considers that it has satisfied its performance obligations. Revenue is recognized upon delivery of the food orders or catered meals, net of refunds. Refunds are estimated based on historical experience.

Square Capital facilitates a loan that is offered through a partnership with an industrial bank that is either repaid through withholding a percentage of the collections of the seller's receivables processed by the Company or a specified monthly amount. The Company generally facilitates loans to its sellers pre-qualified through an analysis of the aggregated data of the seller’s business which includes, but is not limited to, the seller’s historical processing volumes, transaction count, chargebacks, growth, and length of time as a Square customer. The Company also facilitates loans to the customers of certain sellers as well as to the

sellers of its partners who do not process payments through the Company. The loans are generally originated by a bank partner, from whom the Company purchases the loans obtaining all rights, title, and interest. The loans have no stated coupon rate but the seller is charged a one-time origination fee by the bank partner based upon their risk rating, which is derived primarily from processing activity. It is the Company's intent to sell all of its rights, title, and interest of these loans to third-party investors for an upfront fee when the loans are sold. The Company records the net amounts paid to the bank as the cost of the loans purchased and subsequently records a gain on sale of the loans to the third-party investors as revenue upon transfer of title. The Company is retained by the third-party investors to service the loans and earns a servicing fee for facilitating the repayment of these receivables through its managed payments solutions. The Company records servicing revenue as servicing is delivered. For the loans which are not immediately sold to third-party investors, the Company recognizes a portion of the expected seller repayments over the cost of the loans as revenue in proportion to the loan principal reduction.

Following the acquisition of Weebly, the Company offers customers website hosting services for a fee that is generally billed at inception. The Company also acts as a reseller of domain names registration services for a registrar for a fee, which is also generally billed at inception. The Company considers that it satisfies its performance obligations over time and as such recognizes revenue ratably over the term of the relevant arrangements, which vary from one month to twenty four months for website hosting, and one year to ten years for domain name registration.

SaaS represents software products and solutions that provide customers with access to various technologies for a fee which is recognized as revenue ratably as the service is provided. The Company's contracts with customers are generally for a term of one month and renew automatically each month. The Company invoices its customers monthly. The Company considers that it satisfies its performance obligations over time each month as it provides the SaaS services to customers and hence recognizes revenue ratably over the month.

Hardware revenue

The Company generates revenue through the sale of hardware through e-commerce and through its retail distribution channels. The Company satisfies its performance obligation upon delivery of hardware to its customers who include end user customers, distributors, and retailers. The Company may at times offer concessions to customers and also allow for customer returns, which are accounted for as variable consideration. The Company estimates these amounts based on historical experience and reduces revenue recognized. The Company invoices end user customers upon delivery of the products to customers, and payments from such customers are due upon invoicing. Distributors and retailers have payment terms that range from 30 to 90 days after delivery.

The Company offers hardware installment sales to customers with terms ranging from three to twenty four months. The Company allocates a portion of the consideration received from these arrangements to a financing component when it determines that a significant financing component exists. The financing component is subsequently recognized as financing revenue separate from hardware revenue, within subscription and services-based revenue, over the terms of the arrangement with the customer. Pursuant to practical expedients afforded under ASC 606, the Company does not recognize a financing component for hardware installment sales that have a term of one year or less.

Bitcoin revenue

During the fourth quarter of 2017, the Company started offering its Cash App customers the ability to purchase bitcoin, a cryptocurrency denominated asset, from the Company. The Company satisfies its performance obligation and records revenue when bitcoin is transferred to the customer's account.

Arrangements with Multiple Performance Obligations

The Company's contracts with customers generally do not include multiple performance obligations with differing patterns of revenue recognition, except for domain name registration offered with website hosting services sold after May 31, 2018 following the acquisition of Weebly (Note 7). The Company offers its customers the option to buy website hosting bundled with domain name registration, and infrequently the Company has offered its hardware customers free managed payments solutions with the purchase of its hardware as part of a marketing promotion. For such arrangements, the Company allocates revenue to each performance obligation based on its relative standalone selling price. The Company determines standalone selling prices based on the prices charged to customers since the Company's products and services are normally sold on a stand alone basis.

Cost of Revenue

Transaction-based costs

Transaction-based costs consist primarily of interchange and assessment fees, processing fees and bank settlement fees paid to third-party payment processors and financial institutions.

Subscription and services-based costs

Subscription and services-based costs consist primarily of Caviar-related costs, which include processing fees, payments to third-party couriers for deliveries and the cost of equipment provided to sellers. Caviar-related costs for catered meals also includes food costs and personnel costs. These costs also include costs associated with Cash Card and Instant Deposit.

Hardware costs

Hardware costs consist of all product costs associated with contactless and chip readers, chip card readers, Square Stand, Square Register, Square Terminal and third-party peripherals. Product costs consist of third-party manufacturing costs.

Bitcoin costs

Bitcoin cost of revenue comprises of the amounts the Company pays to purchase bitcoin, which will fluctuate in line with the price of bitcoin in the market.

Advertising Costs

Advertising costs are expensed as incurred and included in sales and marketing expense on the consolidated statements of operations. Total advertising costs for the years ended December 31, 2018, 2017, and 2016 were $101.9 million, $81.9 million, and $58.3 million, respectively.

Share-based Compensation

Share-based compensation expense relates to stock options, restricted stock awards (RSAs), restricted stock units (RSUs), and purchases under the Company’s 2015 Employee Stock Purchase Plan (ESPP) which is measured based on the grant-date fair value. The fair value of RSAs and RSUs is determined by the closing price of the Company’s common stock on each grant date.The fair value of stock options and ESPP shares granted to employees is estimated on the date of grant using the Black-Scholes-Merton option valuation model. This share-based compensation expense valuation model requires the Company to make assumptions and judgments regarding the variables used in the calculation. These variables include the expected term (weighted average period of time that the options granted are expected to be outstanding), the expected volatility of the Company’s stock, expected risk-free interest rate and expected dividends. The Company uses the simplified calculation of expected term, as the Company does not have sufficient historical data to use any other method to estimate expected term. Expected volatility is based on a weighted average of the historical volatilities of the Company's common stock along with several entities with characteristics similar to those of the Company. The Company will continue to weight its own volatility more heavily as more of its own historical stock price information becomes available. Once its own historical data is equal to that of the expected

term of option grants a peer group is no longer considered necessary. The expected risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option. Share-based compensation expense is recorded on a straight-line basis over the requisite service period. For the year ended December 31, 2016 and prior, the Company recorded share-based compensation expense net of estimated forfeitures. On January 1, 2017, as a result of the Company's adoption of ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, the Company elected to account for forfeitures as they occur.

Income and Other Taxes

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

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

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

Cash and Cash Equivalents and Restricted Cash

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

As of December 31, 2018 and 2017, restricted cash of $33.8 million and $28.8 million, respectively, is related to pledged cash deposited into savings accounts at the financial institutions that process the Company's sellers' payment transactions and as collateral pursuant to an agreement with the originating bank for the Company's loan product. The Company uses the restricted cash to secure letters of credit with the financial institution to provide collateral for cash flow timing differences in the processing of these payments. The Company has recorded this amount as a current asset on the consolidated balance sheets due to the short-term nature of these cash flow timing differences and that there is no minimum time frame during which the cash must remain restricted. Additionally, this balance includes certain amounts held as collateral pursuant to multi-year lease agreements, discussed in the paragraph below that we expect to become unrestricted within the next year.

As of December 31, 2018 and 2017, the remaining restricted cash of $15.8 million and $9.8 million, respectively, is primarily related to cash held as collateral pursuant to multi-year lease agreements (Note 17). The Company has recorded this amount as a non-current asset on the consolidated balance sheets as the terms of the related leases extend beyond one year.

Concentration of Credit Risk

For the years ended December 31, 2018, 2017 and 2016, the Company had no customer who accounted for greater than 10% of total net revenue.

The Company had three third-party payment processors that represented approximately 45%, 33%, and 9% of settlements receivable as of December 31, 2018. The same three parties represented approximately 46%, 42%, and 8% of settlements receivable as of December 31, 2017. All other third-party processors were insignificant.

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

partially mitigated by credit evaluations that are performed prior to facilitating the offering of loans and ongoing performance monitoring of the Company’s loan customers.

Investments

The Company's short-term and long-term investments include marketable debt securities such as government and agency securities, corporate bonds, commercial paper and municipal securities. The Company determines the appropriate classification of its investments in marketable debt securities at the time of purchase and reevaluates such designation at each balance sheet date. The Company has classified and accounted for its marketable debt securities as available-for-sale. Investments are reviewed periodically to identify possible other-than-temporary impairments. If any impairment is considered other-than-temporary, the Company writes down the investment to its fair value and record the corresponding charge through other income (expense), net on its consolidated statements of operations.

Customer funds

Customer funds held in deposit represent Cash App customers' stored balances that customers would later use to send money or make payments, or customers cash in transit. As of December 31, 2017, the Company held these stored balances as short term bank deposits. During the year ended December 31, 2018, the Company started investing a portion of these stored balances in short-term marketable debt securities (Note 4). The Company determines the appropriate classification of the investments in marketable debt securities within customer funds at the time of purchase and reevaluates such designation at each balance sheet date. The Company has classified and accounted for its marketable debt securities within customer funds as available-for-sale.

Fair Value of Financial Instruments

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

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

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

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

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

Loans Held for Sale

The Company classifies customer loans as held for sale upon purchase from an industrial bank partner, as there is an available market for such loans and it is the Company's intent to sell all of its rights, title, and interest in these loans to third-party investors. Loans held for sale are recorded at the lower of amortized cost or fair value determined on an individual loan basis. To determine the fair value the Company utilizes industry-standard valuation modeling, such as discounted cash flow models, taking into account the estimated timing and amounts of periodic repayments. The Company recognizes a charge within transaction, loan and advance losses on the consolidated statement of operations whenever the amortized cost of a loan exceeds its fair value, with such charges being reversed for subsequent increases in fair value, but only to the extent that such reversals

do not result in the amortized cost of a loan exceeding its fair value. A loan that is initially designated as held for sale may be reclassified to held for investment if and when the Company's intent for that loan changes. There have been no reclassifications made to date.

Settlements Receivable

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

Inventory

Inventory is comprised of contactless and chip readers, chip card readers, Square Stand, Square Register, Square Terminal and third-party peripherals, as well as component parts that are used to manufacture these products. Inventory is stated at the lower of cost (generally on a first-in, first-out basis) or net realizable value. Inventory that is obsolete or in excess of forecasted usage is written down to its net realizable value based on the estimated selling prices in the ordinary course of business. The Company's inventory is held at the Company's warehouses as well as at third party contract manufacturer premises.

Deferred Revenue

Deferred revenue is primarily comprised of payments for website hosting and domain name registration received from customers at inception of the arrangements prior to the services being rendered. Deferred revenue also includes unearned revenue related to managed payments services offered in conjunction with hardware sales for which the cash payments from customers are received and due upon the sale of the hardware.

Cryptocurrency transactions

During the fourth quarter of 2017, the Company started offering its Cash App customers the ability to purchase bitcoin, a cryptocurrency denominated asset, from the Company. The Company purchases bitcoin from private broker dealers or from Cash App customers. Upon purchase, the Company records the cost of bitcoin within other current assets in its consolidated balance sheets. Upon sale, the Company records the total sale amount received from customers as bitcoin revenue and the associated cost as cost of revenue. The carrying value of bitcoin held by the Company was $0.2 million and $0.3 million as of December 31, 2018 and 2017, respectively. The Company assesses the carrying value of bitcoin held by the Company at each reporting date and records an impairment charge if the carrying value exceeds the fair value. Losses on bitcoin for the years ended December 31, 2018 and 2017, were insignificant.

Property and Equipment

Property and equipment are recorded at historical cost less accumulated depreciation, which is computed on a straight-line basis over the asset’s estimated useful life.
The estimated useful lives of property and equipment are described below:

Property and Equipment	Useful Life
Capitalized software	18 months
Computer and data center equipment	Two to three years
Furniture and fixtures	Seven years

Leasehold improvements	Lesser of ten years or remaining lease term

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

Capitalized Software

The Company capitalizes certain cost incurred in developing internal-use software when capitalization requirements

have been met. Costs prior to meeting the capitalization requirements are expensed as incurred. Capitalized costs are included in property and equipment, net, and amortized on a straight-lined basis over the estimated useful life of the software and included in product development costs on the consolidated statements of operations. The Company capitalized $24.0 million, $9.8 million and $7.9 million of internally developed software during the years ended December 31, 2018, 2017 and 2016, respectively, and recognized $10.6 million, $6.6 million and $7.1 million of amortization expense during the years ended December 31, 2018, 2017 and 2016, respectively.

Leases

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

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

The Company records a liability for the estimated fair value for any asset retirement obligation (ARO) associated with its leases, with an offsetting asset. In the determination of the fair value of AROs, the Company uses various assumptions and judgments, including such factors as the existence of a legal obligation, estimated amounts and timing of settlements, and discount and inflation rates. The liability is subsequently accreted while the asset is depreciated. As of December 31, 2018, the Company had a liability for ARO, gross of accretion, of $3.6 million and an associated asset, net of depreciation, of $2.1 million.

Under ASC 840, Leases, the Company is deemed to be the owner, for accounting purposes, during the construction phase of a certain long-lived asset under a build-to-suit lease arrangement because of its involvement with the construction and its exposure to any potential cost overruns under the arrangement. In these cases, the Company recognizes a build-to-suit lease asset and a corresponding build-to-suit lease liability on the consolidated balance sheets. Refer to Note 17 for further details.

Business Combinations

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

Long-Lived Assets, including Goodwill and Acquired Intangibles

The Company evaluates the recoverability of property and equipment and finite lived intangible assets for impairment whenever events or circumstances indicate that the carrying amounts of such assets may not be recoverable. Recoverability is measured by comparing the carrying amount of an asset or an asset group to estimated undiscounted future net cash flows expected to be generated. If the carrying amount of the long–lived asset or asset group is not

recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying amount exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values, and third–part independent appraisals, as considered necessary. For the periods presented, the Company had recorded no impairment charges.

Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired in a business combination. The Company performs a goodwill impairment test annually on December 31 and more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the reporting unit's fair value. The Company has concluded that its business operations as a whole comprise one reporting unit. The Company has the option to first assess qualitative factors to determine whether events or circumstances indicate that it is more likely than not that the fair value of a reporting unit is less than its carrying amount and determine whether further action is needed. If, after assessing the totality of events or circumstances, the Company determines

it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. For the periods presented, the Company had recorded no impairment charges.

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

Customers Payable

Customers payable represents the transaction amounts, less revenue earned by the Company, owed to sellers or Cash App customers. The payable amount comprises amounts owed to customers due to timing differences as the Company typically settles within one business day, amounts held by the Company in accordance with its risk management policies, and amounts held for customers who have not yet linked a bank account. This balance also includes the Company's liability for customer funds held on deposit in the Cash App.

Accrued Transaction Losses

The Company establishes a reserve for estimated transaction losses due to chargebacks, which represent a potential loss due to disputes between a seller and their customer or due to a fraudulent transaction. This also includes estimated transactions losses on Cash App activity related to peer-to-peer payments sent from a credit card, Cash for Business and Cash Card. The reserve is estimated based on available data as of the reporting date, including expectations of future chargebacks, and historical trends related to loss rates. Additions to the reserve are reflected in current operating results, while realized losses are offset against the reserve. These amounts are classified within transaction and advance losses on the consolidated statements of operations.

Recent Accounting Pronouncements

Recently issued accounting pronouncements not yet adopted

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected credit losses for financial assets held. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company intends to adopt this guidance effective January 1, 2020. The Company is currently evaluating the impact this guidance may have on the consolidated financial statements and related disclosures.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. The new guidance eliminates the requirement to calculate the implied fair value of goodwill assuming a hypothetical purchase price allocation (i.e., Step 2 of the goodwill impairment test) to measure a goodwill impairment charge. Instead, entities will record an impairment charge based on the excess of a reporting unit’s carrying amount over its fair value, not to exceed the carrying amount of goodwill. This standard should be adopted when the Company performs its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted. The amendments should be applied on a prospective basis. The Company intends to adopt this guidance effective with its 2019 annual goodwill impairment test. The Company does not expect the adoption of this guidance to have a material impact on the consolidated financial statements and related disclosures.

In July 2018, the FASB issued ASU 2018-13, Changes to the Disclosure Requirements for Fair Value Measurement, which will remove, modify and add disclosure requirements for fair value measurements to improve the overall usefulness of such disclosures. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted for any removed or modified disclosure requirements. Transition is on a prospective basis for the new and modified disclosures, and on a retrospective basis for disclosures that have been eliminated. The Company currently does not intend to early adopt any portion of this disclosure guidance. The Company is currently evaluating the impact this guidance may have on the consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU 2018-15, Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which is intended to align the requirements for capitalization of implementation costs incurred in a cloud computing arrangement that is a service contract with the existing guidance for internal-use software. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted. The guidance provides flexibility in adoption, allowing for either retrospective adjustment or prospective adjustment for all implementation costs incurred after the date of adoption. The Company is currently evaluating whether to early adopt this guidance as well as the impact it may have on the consolidated financial statements and related disclosures.

Recently adopted accounting pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, Leases, which will require, among other items, lessees to recognize a right of use asset and a related lease liability for most leases on the balance sheet. Qualitative and quantitative disclosures will be enhanced to better understand the amount, timing and uncertainty of cash flows arising from leases. The Company adopted this new guidance on January 1, 2019, using the modified retrospective approach. Based on the Company's current portfolio of leases, approximately $96.6 million of lease assets and approximately $123.4 million of lease liabilities is expected to be recognized on its consolidated balance sheet. The Company’s operating leases primarily comprise of office facilities, with the most significant leases relating to corporate headquarters in San Francisco and an office in New York. Additionally, the Company will derecognize $149 million related to the build-to-suit asset and liability upon adoption of this standard. The Company is in the process of finalizing changes to its systems and processes in conjunction with its review of lease agreements and will disclose the actual impact of adopting ASU 2016–02 in its interim report on Form 10–Q for the quarter ended March 31, 2019.

In March 2017, the FASB issued ASU No. 2017-08, Premium Amortization on Purchased Callable Debt Securities, which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. The amendments in this guidance should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company adopted this new guidance on January 1, 2019, and it did not have a material impact on the consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This guidance allows companies to reclassify such tax effects from accumulated other comprehensive income to retained earnings. When the Tax Cuts and Jobs Act of 2017 was enacted in December 2017, there was a valuation allowance on the deferred tax assets included within the Company's accumulated other comprehensive income. No tax expense resulted from the change in the federal income tax rate.

NOTE 2 - REVENUE

Adoption of ASC 606, Revenue from Contracts with Customers

The Company recorded a net reduction to retained earnings of $4.6 million as of January 1, 2018, due to the cumulative impact of adopting ASC 606, primarily related to the effect on revenue and associated cost of revenue from hardware sold through the retail distribution channels and hardware installment sales. The impact to revenue for the year ended December 31, 2018 was an increase of $6.4 million as a result of applying ASC 606.

For the year ended December 31, 2018, the revenue recognized from contracts with customers was $3,205.5 million and revenue from other sources was $92.7 million. Impairment losses arising from contracts with customers were $3.7 million for the year ended December 31, 2018.

Practical Expedients

The Company does not recognize a financing component for hardware installment sales that have a term of one year or less.

The impact of adoption of ASC 606 on the Company's consolidated statement of operations was as follows (in thousands):

	Year Ended December 31, 2018		
	As reported	Balances without adoption of Topic 606	Effect of change
Impact on the Consolidated Statement of Operations:			
Subscription and services-based revenue	$591,706	$591,220	$486
Hardware revenue	68,503	62,572	5,931
Subscription and services-based costs	169,884	169,884	—
Hardware costs	$94,114	$88,625	$5,489

The impact of adoption of ASC 606 on the Company's consolidated balance sheets was as follows (in thousands):

	December 31, 2018		
	As reported	Balances without adoption of Topic 606	Effect of change
Impact on the Consolidated Balance Sheets:			
Other current assets	$164,966	$178,101	$(13,135)
Other current liabilities	99,153	108,334	(9,181)
Other non-current assets	58,393	59,768	(1,375)
Other non-current liabilities	$93,286	$94,717	$(1,431)

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The following table presents the Company's revenue from contracts with customers (i.e. excluding revenue from other sources) disaggregated by revenue source (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Revenue from Contracts with Customers:			
Transaction-based revenue	$2,471,451	$1,920,174	$1,456,160
Starbucks transaction-based revenue	—	—	78,903
Subscription and services-based revenue	499,010	185,485	79,507
Hardware revenue	68,503	41,415	44,307
Bitcoin revenue	$166,517	$—	$—

The deferred revenue balances were as follows (in thousands):

	Year Ended December 31,	
	2018	2017
Deferred revenue, beginning of the period	$5,893	$5,407
Less: accumulative adjustment for adoption of ASC 606	(4,303)	—
Deferred revenue, beginning of the period, as adjusted	1,590	5,407
Deferred revenue, end of the period	36,451	5,893
Deferred revenue arising from business combination	22,800	—
Revenue recognized in the period from amounts included in deferred revenue at the beginning of the period	$1,590	$5,257

NOTE 3 - INVESTMENTS

The Company's short-term and long-term investments as of December 31, 2018 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term securities:				
U.S. agency securities	$80,160	$ 32	$ (70)	$80,122
Corporate bonds	109,807	80	(368)	109,519
Municipal securities	27,839	52	(59)	27,832
U.S. government securities	292,615	161	(509)	292,267
Non-U.S. government securities	31,263	4	(16)	31,251
Total	$541,684	$ 329	$ (1,022)	$540,991
Long-term securities:				
U.S. agency securities	$114,444	$ 194	$ (78)	$114,560
Corporate bonds	159,783	419	(950)	159,252
Municipal securities	28,453	167	(26)	28,594
U.S. government securities	153,743	553	(172)	154,124
Non-U.S. government securities	8,122	28	—	8,150
Total	$464,545	$ 1,361	$ (1,226)	$464,680

The Company's short-term and long-term investments as of December 31, 2017 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term securities:				
U.S. agency securities	$15,122	$ —	$ (39)	$15,083
Corporate bonds	57,855	22	(79)	57,798
Commercial paper	17,428	—	—	17,428
Municipal securities	23,743	8	(51)	23,700
U.S. government securities	55,729	1	(163)	55,567
Total	$169,877	$ 31	$ (332)	$169,576
Long-term securities:				
U.S. agency securities	$20,288	$ 2	$ (121)	$20,169
Corporate bonds	91,959	25	(571)	91,413
Municipal securities	26,371	13	(160)	26,224
U.S. government securities	66,362	19	(520)	65,861
Total	$204,980	$ 59	$ (1,372)	$203,667

Investments classified as cash equivalents are excluded from the table since the amortized cost approximated the fair value due to the short term nature of these investments.

For the years ended December 31, 2018, 2017 and 2016, gains or losses realized on the sale of investments were not material. Investments are reviewed periodically to identify possible other-than-temporary impairments. As the Company has the ability and intent to hold these investments with unrealized losses for a reasonable period of time sufficient for the recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired for any of the periods presented.

The contractual maturities of the Company's short-term and long-term investments as of December 31, 2018 are as follows (in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$541,684	$540,991
Due in one to five years	464,545	464,680
Total	$1,006,229	$1,005,671

NOTE 4 - CUSTOMER FUNDS

The following table presents the assets underlying customer funds (in thousands):

	December 31, 2018	December 31, 2017
Cash	$ 158,697	$ 103,042
Cash Equivalents:		
Money market funds	18	—
U.S. agency securities	39,991	—
U.S. government securities	35,349	—
Short-term debt securities:		
U.S. agency securities	27,291	—
U.S. government securities	72,671	—
Total	$ 334,017	$ 103,042

The Company's investments within customer funds as of December 31, 2018 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term debt securities:				
U.S. agency securities	$ 27,293	$ 2	$ (4)	$27,291
U.S. government securities	72,662	12	(3)	72,671
Total	$ 99,955	$ 14	$ (7)	$99,962

Investments within customer funds classified as cash equivalents are excluded from the table since the amortized cost approximated the fair value due to the short term nature of these investments.

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

The contractual maturities of the Company's investments within customer funds as of December 31, 2018 are as follows (in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$ 99,955	$99,962
Due in one to five years	—	—
Total	$ 99,955	$99,962

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NOTE 5 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company measures its cash equivalents, customer funds, short-term and long-term marketable debt securities, and equity investments at fair value. The Company classifies these investments within Level 1 or Level 2 of the fair value hierarchy because the Company values these investments using quoted market prices or alternative pricing sources and models utilizing market observable inputs.

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

	December 31, 2018			December 31, 2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Cash and cash equivalents:						
Money market funds	$218,109	$—	$ —	$387,698	$—	$ —
U.S. agency securities	—	46,423	—	—	—	—
Commercial paper	—	—	—	—	24,695	—
U.S. government securities	86,239	—	—	—	—	—
Non-U.S. government securities	—	23,981	—	—	—	—
Customer Funds:						
Money market funds	18	—	—	—	—	—
U.S. agency securities	—	67,282	—	—	—	—
U.S. government securities	108,020	—	—	—	—	—
Short-term securities:						
U.S. agency securities	—	80,122	—	—	15,083	—
Corporate bonds	—	109,519	—	—	57,798	—
Commercial paper	—	—	—	—	17,428	—
Municipal securities	—	27,832	—	—	23,700	—
U.S. government securities	292,267	—	—	55,567	—	—
Non-U.S. government securities	—	31,251	—	—	—	—
Long-term securities:						
U.S. agency securities	—	114,560	—	—	20,169	—
Corporate bonds	—	159,252	—	—	91,413	—
Municipal securities	—	28,594	—	—	26,224	—
U.S. government securities	154,124	—	—	65,861	—	—
Non-U.S. government securities	—	8,150	—	—	—	—
Other:						
Equity investment	45,342	—	—	—	—	—
Total	$904,119	$696,966	$ —	$509,126	$276,510	$ —

The carrying amounts of certain financial instruments, including settlements receivable, accounts payable, customers payable, and settlements payable, approximate their fair values due to their short-term nature.

The Company estimates the fair value of its convertible senior notes based on their last actively traded prices (Level 1) or market observable inputs (Level 2). The estimated fair value and carrying value of the convertible senior notes were as follows (in thousands):

	December 31, 2018		December 31, 2017	
	Carrying Value	Fair Value (Level 2)	Carrying Value	Fair Value (Level 2)
2023 Notes	$718,522	$901,468	$—	$—
2022 Notes	181,173	515,693	358,572	719,356
Total	$899,695	$1,417,161	$358,572	$719,356

The estimated fair value and carrying value of loans held for sale is as follows (in thousands):

	December 31, 2018		December 31, 2017	
	Carrying Value	Fair Value (Level 3)	Carrying Value	Fair Value (Level 3)
Loans held for sale	$89,974	$93,064	$73,420	$76,070
Total	$89,974	$93,064	$73,420	$76,070

For the years ended December 31, 2018 and 2017, the Company recorded a charge for the excess of amortized cost over fair value of the loans of $13.2 million and $8.0 million, respectively. No charges were recorded for the year ended December 31, 2016.

If applicable, the Company will recognize transfers into and out of levels within the fair value hierarchy at the end of the reporting period in which the actual event or change in circumstance occurs. During the years ended December 31, 2018, 2017 and 2016, the Company did not have any transfers in or out of Level 1, Level 2, or Level 3 assets or liabilities.

NOTE 6 - PROPERTY AND EQUIPMENT, NET

The following is a summary of property and equipment, less accumulated depreciation and amortization (in thousands):

	December 31, 2018	December 31, 2017
Leasehold improvements	$ 107,611	$ 77,073
Computer equipment	80,093	66,186
Capitalized software	58,908	35,063
Office furniture and equipment	20,699	14,490
Total	267,311	192,812
Less: Accumulated depreciation and amortization	(124,909)	(101,316)
Property and equipment, net	$ 142,402	$ 91,496

Depreciation and amortization expense on property and equipment was $46.8 million, $29.7 million, and $28.7 million, for the years ended December 31, 2018, 2017, and 2016, respectively.

NOTE 7 - ACQUISITIONS

Weebly, Inc.

On May 31, 2018, the Company acquired 100% of the outstanding shares of Weebly, a technology company that offers customers website hosting and domain name registration solutions. The acquisition of Weebly enables the Company to combine Weebly’s web presence tools with the Company's in-person and online offerings to create a cohesive solution for sellers to start or grow an omnichannel business. The acquisition expanded the Company’s customer base globally and added a new recurring revenue stream.

The purchase consideration was comprised of $132.4 million in cash and 2,418,271 shares of the Company’s Class A common stock with an aggregate fair value of $140.1 million based on the closing price of the Company’s Class A common stock on the acquisition date. As part of the acquisition, the Company paid an aggregate of $17.7 million in cash and shares to settle outstanding vested and unvested employee options, of which $2.6 million was accounted for as post-combination compensation expense and is excluded from the purchase consideration. Third-party acquisition-related costs were insignificant. The results of Weebly's operations have been included in the consolidated financial statements since the closing date.

The acquisition was accounted for as a business combination. This method requires, among other things, that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date and that the difference between the fair value of the consideration paid for the acquired entity and the fair value of the net assets acquired be recorded as goodwill, which is not amortized but is tested at least annually for impairment.

The table below summarizes the consideration paid for Weebly and the preliminary assessment of the fair value of the assets acquired and liabilities assumed at the closing date (in thousands, except share data).

Consideration:	
Cash	$132,432
Stock (2,418,271 shares of Class A common stock)	140,107
	$272,539
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Current assets (inclusive of cash acquired of $25,758)	$44,685
Intangible customer assets	42,700
Intangible technology assets	14,900
Intangible trade name	11,300
Intangible other assets	961
Total liabilities assumed (including deferred revenue of $22,800)	(37,592)
Total identifiable net assets acquired	76,954
Goodwill	195,585
Total	$272,539

The Company prepared an initial determination of the fair value of the assets acquired and liabilities assumed as of the acquisition date using preliminary information. Subsequently, the Company has recognized measurement period adjustments to the purchase consideration and the fair value of certain liabilities assumed as a result of further refinements in the Company’s estimates. These adjustments were prospectively applied. The effect of these adjustments on the preliminary purchase price allocation was an increase in goodwill and tax liabilities assumed of $6.1 million and $4.8 million, respectively. There was no impact to the consolidated statements of operations as result of these adjustments. The Company continues the process of completing the evaluation of contingencies and tax effects related to the acquisition. Accordingly, the preliminary values reflected in the table above are subject to change.

As of December 31, 2018, $19.9 million of cash and 372,578 shares of the total consideration were withheld as security for indemnification obligations related to general representations and warranties, in addition to certain potential tax exposures.

Goodwill from the Weebly acquisition is primarily attributable to the value of expected synergies created by incorporating Weebly solutions into the Company's technology platform and the value of the assembled workforce. None of the goodwill generated from the Weebly acquisition or the acquired intangible assets are expected to be deductible for tax purposes. Additionally the acquisition would have resulted in recognition of deferred tax assets arising mainly from the net of deferred tax assets from acquired net operating losses (NOLs) and research and development credits, and deferred tax liabilities associated with intangible assets and deferred revenue. However, the realization of such deferred tax assets depends primarily on the Company's post-acquisition ability to generate taxable income in future periods. Accordingly, a valuation allowance was recorded against the net acquired deferred tax asset in accounting for the acquisition.

The acquisition of Weebly did not have a material impact on the Company's reported revenue or net loss amounts for any period presented. Accordingly, pro forma financial information has not been presented.

Other acquisitions

The Company also spent an aggregate of $9.9 million, net of cash acquired, in connection with other immaterial acquisitions during the year ended December 31, 2018, which resulted in the recognition of additional intangible assets and goodwill. Pro forma financial information has not been presented for any of these acquisitions as the impact to our consolidated financial statements was not material.

NOTE 8 - GOODWILL

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

The change in carrying value of goodwill in the period was as follows (in thousands):

Balance at December 31, 2016	$57,173
Acquisitions completed during the year ended December 31, 2017	1,154
Balance at December 31, 2017	58,327
Acquisitions completed during the year ended December 31, 2018	203,378
Balance at December 31, 2018	$261,705

The Company performed its annual goodwill impairment test as of December 31, 2018. The Company determined that the business operations as a whole is represented by a single reporting unit and through qualitative analysis concluded that it was more likely than not that the fair value of the reporting unit was greater than its carrying amount. As a result, the two-step goodwill impairment test was not required, and no impairments of goodwill were recognized during the year ended December 31, 2018.

NOTE 9 - ACQUIRED INTANGIBLE ASSETS

The Company entered into various transactions accounted for as business combinations during the year ended December 31, 2018, that involved the acquisition of intangible assets. Refer to Note 7 for further details. During the year ended December 31, 2017, the Company did not make any material acquisitions.

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

	Balance at December 31, 2018		
	Cost	Accumulated Amortization	Net
Patents	$1,285	$ (664)	$621
Technology Assets	45,978	(28,420)	17,558
Customer Assets	57,109	(8,068)	49,041
Trade Name	11,300	(1,648)	9,652
Other	961	(731)	230
Total	$116,633	$ (39,531)	$77,102

	Balance at December 31, 2017		
	Cost	Accumulated Amortization	Net
Patents	$1,285	$ (559)	$726
Technology Assets	29,158	(21,329)	7,829
Customer Assets	10,319	(4,540)	5,779
Total	$40,762	$ (26,428)	$14,334

The weighted average amortization periods for acquired patents, acquired technology, customer intangible assets, and acquired trade name are approximately 13 years, 5 years, 11 years, and 4 years, respectively.

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All intangible assets are amortized over their estimated useful lives. The changes to the carrying value of intangible assets were as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Acquired intangible assets, net, beginning of the period	$14,334	$19,292	$26,776
Acquisitions	75,871	2,657	1,529
Amortization expense	13,104	7,615	9,013
Acquired intangible assets, net, end of the period	$77,102	$14,334	$19,292

The total estimated annual future amortization expense of these intangible assets as of December 31, 2018, is as follows (in thousands):

2019	$13,744
2020	11,496
2021	10,299
2022	8,369
2023	6,839
Thereafter	26,355
Total	$77,102

NOTE 10 - OTHER CONSOLIDATED BALANCE SHEET COMPONENTS (CURRENT)

Other Current Assets

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

	December 31, 2018	December 31, 2017
Inventory, net	$ 28,627	$ 16,777
Processing costs receivable	46,102	21,083
Prepaid expenses	21,782	14,473
Accounts receivable, net	22,393	8,606
Deferred hardware costs (i)	—	7,931
Deferred magstripe reader costs (ii)	9,361	2,469
Prepaid compensation, current (iii)	4,995	—
Other	31,706	15,115
Total	$ 164,966	$ 86,454

(i) The deferred hardware costs represented costs associated with hardware sold through the retail distribution channels. The adoption of ASC 606 on January 1, 2018, has resulted in the recognition of such costs upon delivery of the hardware to the distribution channel.

(ii) The Company capitalizes the cost of its magstripe readers, including packaging and shipping costs, held on-hand by the Company as of each consolidated balance sheet date. Once the readers are shipped to a third-party distributor or an end-customer, they are recorded as marketing expense on the consolidated statements of operations.

(iii) Prepaid compensation relates to cash transferred by the Company to an escrow agent in connection with a business combination that will be paid to officers of the acquiree and recognized as compensation expense over time as they provide services to the Company.

Accrued Expenses

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

	December 31, 2018	December 31, 2017
Accrued facilities expenses	$ 13,040	$ 568
Accrued payroll	9,612	9,103
Accrued professional fees	5,232	5,638
Accrued advertising and other marketing	12,201	6,723
Processing costs payable	12,683	10,145
Accrued non income tax liabilities	9,503	6,155
Accrued hardware costs	5,125	2,496
Other accrued liabilities	14,958	11,452
Total	$ 82,354	$ 52,280

Other Current Liabilities

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

	December 31, 2018	December 31, 2017
Accounts payable	$ 36,416	$ 16,763
Square Capital payable (iv)	6,092	7,671
Square Payroll payable (v)	7,534	2,850
Deferred revenue, current	31,474	5,893
Deferred rent, current	3,842	3,311
Accrued redemptions	1,305	1,036
Other	12,490	7,606
Total	$ 99,153	$ 45,130

(iv) Square Capital payable represents unpaid amounts arising from the purchase of loans or loan repayments collected on behalf of third parties.

(v) Square Payroll payable represents amounts received from Square Payroll product customers that will be utilized to settle the customers employee payroll and related obligations.

NOTE 11 - OTHER CONSOLIDATED BALANCE SHEET COMPONENTS (NON-CURRENT)

Other Non-Current Assets

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

	December 31, 2018	December 31, 2017
Equity investment (i)	$ 45,342	$ 25,000
Prepaid compensation, non-current (ii)	5,915	—
Deposits	2,747	2,738
Other	4,389	3,612
Total	$ 58,393	$ 31,350

(i) In August, 2017, the Company invested $25.0 million for preferred shares of Eventbrite, Inc. (Eventbrite) which was carried at cost. In September, 2018, upon Eventbrite's initial public offering, the preferred shares held by the Company converted into Class B common shares of Eventbrite. The Company revalued this investment and will subsequently carry it at fair value, with changes in fair value being recorded within other income or expense on the consolidated statement of operations. During the year ended December 31, 2018, the Company recorded a gain of $20.3 million to other income on the consolidated statements of operations arising from revaluation of this investment.

(ii) Prepaid compensation relates to cash transferred by the Company to an escrow agent in connection with a business combination that will be paid to officers of the acquiree and recognized as compensation expense over time as they provide services to the Company.

Other Non-Current Liabilities

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

	December 31, 2018	December 31, 2017
Statutory liabilities (iii)	$ 54,748	$ 40,768
Deferred rent, non-current	23,003	20,349
Deferred purchase consideration	3,900	—
Deferred revenue, non-current	4,977	432
Other	6,658	7,989
Total	$ 93,286	$ 69,538

(iii) Statutory liabilities represent loss contingencies that may arise from the Company's interpretation and application of certain guidelines and rules issued by various federal, state, local, and foreign regulatory authorities.

NOTE 12 - INDEBTEDNESS

Revolving Credit Facility

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

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Loans under the credit facility bear interest, at the Company’s option of (i) a base rate based on the highest of the prime rate, the federal funds rate plus 0.50% and an adjusted LIBOR rate for a one-month interest period in each case plus a margin ranging from 0.00% to 1.00%, or (ii) an adjusted LIBOR rate plus a margin ranging from 1.00% to 2.00%. This margin is determined based on the Company’s total leverage ratio for the preceding four fiscal quarters. The Company is obligated to pay other customary fees for a credit facility of this size and type including an annual administrative agent fee of $0.1 million and an unused commitment fee of 0.15%. To date no funds have been drawn under the credit facility, with $375.0 million remaining available. The Company paid $0.6 million in unused commitment fees for both the years ended December 31, 2018 and 2017. As of December 31, 2018, the Company was in compliance with all financial covenants associated with this credit facility.

Convertible Senior Notes due in 2023

On May 25, 2018, the Company issued an aggregate principal amount of $862.5 million of convertible senior notes (2023 Notes). The 2023 Notes mature on May 15, 2023, unless earlier converted or repurchased, and bear interest at a rate of 0.50% payable semi-annually on May 15 and November 15 of each year. The 2023 Notes are convertible at an initial conversion rate of 12.8456 shares of the Company's Class A common stock per $1,000 principal amount of 2023 Notes, which is equivalent to an initial conversion price of approximately $77.85 per share of Class A common stock. Holders may convert their 2023 Notes at any time prior to the close of business on the business day immediately preceding February 15, 2023 only under the following circumstances: (1) during any calendar quarter commencing after September 30, 2018 (and only during such calendar quarter), if the last reported sale price of the Company’s Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period (the measurement period) in which the trading price (as defined in the indenture governing the 2023 Notes) per $1,000 principal amount of 2023 Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company’s Class A common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events, including certain distributions, the occurrence of a fundamental change (as defined in the indenture governing the 2023 Notes) or a transaction resulting in the Company’s Class A common stock converting into other securities or property or assets. On or after February 15, 2023, up until the close of business on the second scheduled trading day immediately preceding the maturity date, a holder may convert all or any portion of its 2023 Notes regardless of the foregoing circumstances. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of its Class A common stock, or a combination of cash and shares of its Class A common stock, at the Company’s election. Effective October 2018, the Company revised its prior stated policy of settling conversions through combination settlement with a specified dollar amount of $1,000 per $1,000 principal amount of 2023 Notes, and currently expects to settle future conversions entirely in shares of the Company's Class A common stock. The Company will reevaluate this policy from time to time as conversion notices are received from holders of the 2023 Notes.

In accounting for the issuance of the 2023 Notes, the Company separated the 2023 Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was $155.3 million and was determined by deducting the fair value of the liability component from the par value of the 2023 Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the liability component over its carrying amount ("debt discount") is amortized to interest expense over the term of the 2023 Notes at an effective interest rate of 4.69% over the contractual terms of the 2023 Notes.

Debt issuance costs related to the 2023 Notes comprised of discounts and commissions payable to the initial purchasers of $6.0 million and third party offering costs of $0.8 million. The Company allocated the total amount incurred to the liability and equity components of the 2023 Notes based on their relative values. Issuance costs attributable to the liability component were $5.6 million and will be amortized to interest expense using the effective interest method over the contractual term. Issuance costs attributable to the equity component were netted with the equity component in stockholders' equity.

Convertible Senior Notes due in 2022

On March 6, 2017, the Company issued an aggregate principal amount of $440.0 million of convertible senior notes (2022 Notes). The 2022 Notes mature on March 1, 2022, unless earlier converted or repurchased, and bear interest at a rate of 0.375% payable semi-annually on March 1 and September 1 of each year. The 2022 Notes are convertible at an initial

conversion rate of 43.5749 shares of the Company's Class A common stock per $1,000 principal amount of 2022 Notes, which is equivalent to an initial conversion price of approximately $22.95 per share of Class A common stock. Holders may convert their 2022 Notes at any time prior to the close of business on the business day immediately preceding December 1, 2021 only under the following circumstances: (1) during any calendar quarter (and only during such calendar quarter), if the last reported sale price of the Company's Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period (the measurement period) in which the trading price (as defined in the indenture governing the 2022 Notes) per $1,000 principal amount of 2022 Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's Class A common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events, including certain distributions, the occurrence of a fundamental change (as defined in the indenture governing the 2022 Notes) or a transaction resulting in the Company's Class A common stock converting into other securities or property or assets. On or after December 1, 2021, up until the close of business on the second scheduled trading day immediately preceding the maturity date, a holder may convert all or any portion of its 2022 Notes regardless of the foregoing circumstances. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of its Class A common stock, or a combination of cash and shares of its Class A common stock, at the Company's election. The circumstances required to allow the holders to convert their 2022 Notes were met starting January 1, 2018 and continued to be met through December 31, 2018. During the year ended December 31, 2018, certain holders of the 2022 Notes converted an aggregate principal amount of $228.3 million of their 2022 Notes. The Company settled certain of the 2022 Notes through a combination of cash of $219.4 million for the principal amount and the issuance of 6.9 million shares of the Company's Class A common stock. Effective October 2018, the Company revised its prior stated policy of settling conversions through combination settlement, and expects to settle future conversions in shares of the Company's Class A common stock. Subsequently, the Company settled $8.9 million principal of the 2022 Notes entirely in shares of the Company's Class A common stock. The Company will reevaluate its settlement policy from time to time as conversion notices are received from holders of the 2022 Notes.

In accounting for the issuance of the 2022 Notes, the Company separated the 2022 Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was $86.2 million and was determined by deducting the fair value of the liability component from the par value of the 2022 Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. The debt discount is amortized to interest expense over the term of the 2022 Notes at an effective interest rate of 5.34% over the contractual terms of the 2022 Notes.

Debt issuance costs related to the 2022 Notes comprised of discounts and commissions payable to the initial purchasers of $11.0 million and third party offering costs of $0.8 million. The Company allocated the total amount incurred to the liability and equity components of the 2022 Notes based on their relative values. Issuance costs attributable to the liability component were $9.4 million and will be amortized to interest expense using the effective interest method over the contractual term. Issuance costs attributable to the equity component were netted with the equity component in stockholders' equity.

The debt component associated with the 2022 Notes that were converted was accounted for as an extinguishment of debt, with the Company recording loss on extinguishment of $5.0 million, as the difference between the estimated fair value and the carrying value of such 2022 Notes. The equity component associated with the 2022 Notes that were converted was accounted for as a reacquisition of equity upon the conversion of such 2022 Notes. Accordingly, the excess of the fair value of the consideration issued to settle the conversion over the fair value of the debt component of $21.0 million was accounted for as a reduction to the additional paid in capital.

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The net carrying amount of the Notes were as follows (in thousands):

	Principal outstanding	Unamortized debt discount	Unamortized debt issuance costs	Net carrying value
December 31, 2018				
2023 Notes	$ 862,500	$ (138,924)	$ (5,054)	$ 718,522
2022 Notes	211,728	(27,569)	(2,986)	181,173
Total	1,074,228	(166,493)	(8,040)	899,695
December 31, 2017				
2022 Notes	$ 440,000	$ (73,384)	$ (8,044)	$ 358,572

The net carrying amount of the equity component of the Notes were as follows (in thousands):

	Amount allocated to conversion option	Less: allocated issuance costs	Equity component, net
December 31, 2018			
2023 Notes	$ 155,250	$ (1,231)	$ 154,019
2022 Notes	41,481	(1,108)	40,373
Total	196,731	(2,339)	194,392
December 31, 2017			
2022 Notes	$ 86,203	$ (2,302)	$ 83,901

The Company recognized interest expense on the Notes as follows (in thousands, except for percentages):

	Year Ended December 31,	
	2018	2017
Contractual interest expense	$ 4,023	$ 1,351
Amortization of debt discount and issuance costs	32,855	14,223
Total	$ 36,878	$ 15,574

The effective interest rate of the liability component is 4.69% and 5.34% for the 2023 Notes and 2022 Notes, respectively.

Convertible Note Hedge and Warrant Transactions

In connection with the offering of the 2023 Notes, the Company entered into convertible note hedge transactions (2023 convertible note hedges) with certain financial institution counterparties (2018 Counterparties) whereby the Company has the option to purchase a total of approximately 11.1 million shares of its Class A common stock at a price of approximately $77.85 per share. The total cost of the 2023 convertible note hedge transactions was $172.6

million. In addition, the Company sold warrants (2023 warrants) to the 2018 Counterparties whereby the 2018 Counterparties have the option to purchase a total of 11.1 million shares of the Company's Class A common stock at a price of approximately $109.26 per share. The Company received $112.1 million in cash proceeds from the sale of the 2023 warrants. Taken together, the purchase of the 2023 convertible note hedges and sale of the 2023 warrants are intended to reduce dilution from the conversion of the 2023 Notes and/or offset

any cash payments the Company is required to make in excess of the principal amount of the converted 2023 Notes, as the case may be, and to effectively increase the overall conversion price from approximately $77.85 per share to approximately $109.26 per share. As these instruments are considered indexed to the Company's own stock and are considered equity classified, the 2023 convertible note hedges and 2023 warrants are recorded in stockholders' equity, are not accounted for as derivatives and are not remeasured each reporting period. The net costs incurred in connection with the 2023 convertible note hedge and 2023 warrant transactions were recorded as a reduction to additional paid-in capital on the condensed consolidated balance sheets.

In connection with the offering of the 2022 Notes, the Company entered into convertible note hedge transactions (2022 convertible note hedges) with certain financial institution counterparties (2017 Counterparties) whereby the Company has the option to purchase a total of approximately 19.2 million shares of its Class A common stock at a price of approximately $22.95 per share. The total cost of the 2022 convertible note hedge transactions was $92.1 million. In addition, the Company sold warrants (2022 warrants) to the 2017 Counterparties whereby the 2017 Counterparties have the option to purchase a total of 19.2 million shares of the Company's Class A common stock at a price of approximately $31.18 per share. The Company received $57.2 million in cash proceeds from the sale of the 2022 warrants. Taken together, the purchase of the 2022 convertible note hedges and sale of the 2022 warrants are intended to reduce dilution from the conversion of the 2022 Notes and/or offset any cash payments the Company is required to make in excess of the principal amount of the converted 2022 Notes, as the case may be, and to effectively increase the overall conversion price from approximately $22.95 per share to approximately $31.18 per share. As these instruments are considered indexed to the Company's own stock and are considered equity classified, the 2022 convertible note hedges and 2022 warrants are recorded in stockholders' equity, are not accounted for as derivatives and are not remeasured each reporting period. The net costs incurred in connection with the 2022 convertible note hedge and 2022 warrant transactions were recorded as a reduction to additional paid-in capital on the consolidated balance sheets. During the year ended December 31, 2018, the Company exercised a pro-rata portion of the 2022 convertible note hedges to offset the shares of the Company's Class A common stock issued to settle the conversion of the 2022 Notes discussed above. The 2022 convertible note hedges were net share settled, and the Company received 6.9 million shares of the Company's Class A common stock from the 2017 Counterparties.

NOTE 13 - ACCRUED TRANSACTION LOSSES

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

	Year Ended December 31,	
	2018	2017
Accrued transaction losses, beginning of the year	$26,893	$20,064
Provision for transaction losses	64,981	52,977
Charge-offs to accrued transaction losses	(58,192)	(46,148)
Accrued transaction losses, end of the year	$33,682	$26,893

NOTE 14 - INCOME TAXES

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

	Year Ended December 31,		
	2018	2017	2016
Domestic	$44,538	$(10,900)	$(145,499)
Foreign	(80,665)	(51,764)	(24,174)
Loss before income taxes	$(36,127)	$(62,664)	$(169,673)

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

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	Year Ended December 31,		
	2018	2017	2016
Current:			
Federal	$(4)	$(1,192)	$63
State	752	739	527
Foreign	2,224	1,987	1,269
Total current provision for income taxes	2,972	1,534	1,859
Deferred:			
Federal	(404)	(1,169)	173
State	35	57	18
Foreign	(277)	(273)	(133)
Total deferred provision for income taxes	(646)	(1,385)	58
Total provision for income taxes	$2,326	$149	$1,917

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

	Balance at December 31,		
	2018	2017	2016
Tax at federal statutory rate	21.0 %	34.0 %	34.0 %
State taxes, net of federal benefit	(1.1)	(0.4)	(0.1)
Foreign rate differential	(14.7)	(14.9)	(2.4)
Non-deductible meals (i)	(3.4)	(0.3)	(0.1)
Other non-deductible expenses	(1.7)	(0.7)	(0.8)
Credits	164.8	41.5	8.5
Other items	2.3	(1.2)	0.2
Change in valuation allowance	(718.5)	(119.5)	(37.4)
Impact of U.S. tax reform	—	(209.1)	—
Share-based compensation (ii)	549.0	243.5	(2.4)
Change in uncertain tax positions	(4.1)	(2.4)	(0.6)
Termination of warrant	—	29.3	—
Total	(6.4)%	(0.2)%	(1.1)%

(i) This item was previously included in other non-deductible expenses in 2016 and 2017.

(ii) Starting in 2017, excess tax benefits from share-based award activity are reflected in the provision for income taxes.

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

	Balance at December 31,		
	2018	2017	2016
Deferred tax assets:			
Capitalized costs	$30,131	$35,608	$61,897
Accrued expenses	31,494	23,553	29,421
Net operating loss carryforwards	485,562	244,197	65,507
Tax credit carryforwards	133,275	60,567	38,927
Property, equipment and intangible assets	—	7,390	5,721
Share-based compensation	38,265	35,728	52,091
Deferred Interest	8,290	—	—
Other	105	2,519	1,640
Total deferred tax assets	727,122	409,562	255,204
Valuation allowance	(719,040)	(409,043)	(254,898)
Total deferred tax assets, net of valuation allowance	8,082	519	306
Deferred tax liabilities:			
Property, equipment and intangible assets	(7,361)	—	—
Indefinite-lived intangibles	(275)	(644)	(476)
Total deferred tax liabilities	(7,636)	(644)	(476)
Net deferred tax assets (liabilities)	$446	$(125)	$(170)

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On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act ("2017 Tax Act"). The 2017 Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35% to 21%; (2) requiring companies to pay a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries; (3) in part eliminating U.S. federal income taxes on dividends from foreign subsidiaries; (4) requiring a current inclusion in U.S. federal taxable income of certain unrepatriated earnings of controlled foreign corporations; (5) eliminating the corporate alternative minimum tax ("AMT") and changing how existing AMT credits can be realized; (6) creating the base erosion anti-abuse tax ("BEAT"), a new minimum tax; (7) creating a new limitation on deductible interest expense; and (8) changing rules related to uses and limitations of net operating loss carryforwards created in tax years beginning after December 31, 2017.

In connection with the Company's analysis of the impact of the 2017 Tax Act, it recorded no tax benefit or expense for the year ended December 31, 2018 and recorded a benefit of $1.3 million for the year ended December 31, 2017. The net benefit for 2017 consisted of the release of the valuation allowance on the Company's AMT credit carryforward, which will be refunded in tax years 2018-2021. In addition, the 2017 Tax Act reduces the corporate tax rate to 21%, effective January 1, 2018. Consequently, the Company recorded no change to its U.S. federal and state deferred tax assets for the year ended December 31, 2018 and recorded a $63.6 million decrease, with an offset to the valuation allowance, for the year ended December 31, 2017. The Company has also completed its analysis of the deemed repatriation transition tax and has concluded that it will not owe any transition tax. Additionally, on December 22, 2017, the SEC staff issued Staff Accounting Bulletin No. 118 ("SAB 118") to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the 2017 Tax Act. The Company has recognized the tax impacts related to refundable AMT credits and revaluation of deferred tax assets, offset by the valuation allowance, and included these amounts in its consolidated financial statements for the year ended December 31, 2017. During the third quarter of 2018, the Company finalized its federal and state income tax returns, making no material adjustments to provisional amounts previously recorded.

Realization of deferred tax assets is dependent upon the generation of future taxable income, the timing and amount of which are uncertain. Due to the history of losses generated in the U.S. and certain foreign jurisdictions, the Company believes that it is more likely than not that its deferred tax assets in these jurisdictions will not be realized as of December 31, 2018. Accordingly, the Company retained a full valuation allowance on its deferred tax assets in these jurisdictions. The amount of deferred tax assets considered realizable in future periods may change as management continues to reassess the underlying factors it uses in estimating future taxable income.

The valuation allowance increased by approximately $310.0 million, $154.1 million, and $59.8 million during the years ended December 31, 2018, 2017, and 2016, respectively.

As of December 31, 2018, the Company had $1,709.8 million of federal, $1,903.8 million of state, and $215.1 million of foreign net operating loss carryforwards, which will begin to expire in 2031 for federal and 2021 for state tax purposes. The foreign net operating loss carryforwards do not expire.

As of December 31, 2018, the Company had $107.3 million of federal, $65.6 million of state, and $2.7 million of Canadian research credit carryforwards. The federal credit carryforward will begin to expire in 2029, the state credit carryforward has no expiration date, and the Canadian credit carryforward will begin to expire in 2036.

The Company has federal AMT credit carryforwards of $1.3 million that will be refunded over the 2018-2021 tax years under the 2017 Tax Act. The Company has California Enterprise Zone credit carryforwards of $2.8 million, which will begin to expire in 2023.

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

of the Internal Revenue Code, to result in a limitation that will reduce the total amount of net operating loss carryforwards and credits that can be utilized.

As of December 31, 2018, the unrecognized tax benefit was $198.5 million, of which $5.7 million would impact the annual effective tax rate if recognized and the remainder of which would result in a corresponding adjustment to the valuation allowance.

A reconciliation of the beginning and ending amount of unrecognized tax benefit is presented below (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Balance at the beginning of the year	$70,799	$92,134	$90,372
Gross increases and decreases related to prior period tax positions	513	—	5,190
Gross increases and decreases related to current period tax positions	119,261	4,193	(3,428)
Reductions related to lapse of statute of limitations	(142)	(91)	—
Gross increases and decreases related to U.S. tax reform	—	(25,437)	—
Gross increases and decreases related to acquisition	8,109	—	—
Balance at the end of the year	$198,540	$70,799	$92,134

The Company recognizes interest and penalties related to income tax matters as a component of income tax expense. As of December 31, 2018, there were no significant accrued interest and penalties related to uncertain tax positions. It is reasonably possible that over the next 12-month period the Company may experience a decrease in its unrecognized tax benefits as a result of tax examinations or lapses of statute of limitations. The estimated decrease in unrecognized tax benefits may range up to $13 million.

The Company is subject to taxation in the United States and various state and foreign jurisdictions. The Company is currently under examination in California for tax years 2013 and 2014. The Company’s various tax years starting with 2009 to 2017 remain open in various taxing jurisdictions.

As of December 31, 2018, the Company has not provided deferred U.S. income taxes or foreign withholding taxes on temporary differences resulting from earnings for certain non-U.S. subsidiaries, which are permanently reinvested outside the U.S. Cumulative undistributed earnings for these non-U.S. subsidiaries as of December 31, 2018 are $4.2 million.

NOTE 15 - STOCKHOLDERS' EQUITY

Convertible Preferred Stock

As of December 31, 2018, the Company is authorized to issue 100,000,000 shares of preferred stock, with a $0.0000001 par value. No shares of preferred stock are outstanding as of December 31, 2018.

Common Stock

The Company has authorized the issuance of Class A common stock and Class B common stock. Holders of the Company's Class A common stock and Class B common stock are entitled to dividends when, as and if, declared by the Company's board of directors, subject to the rights of the holders of all classes of stock outstanding having priority rights to dividends. As of December 31, 2018, the Company did not declare any dividends. Holders of shares of Class A common stock are entitled to one vote per share, while holders of shares of Class B common stock are entitled to ten votes per share. Shares of the Company's Class B common stock are convertible into an equivalent number of shares of its Class A common stock and generally convert into shares of its Class A common stock upon transfer. Class A common stock and Class B common stock are referred to as common stock throughout these Notes to the Consolidated Financial Statements, unless otherwise noted. The holders of Class A common stock and Class B common stock have no preemptive or other subscription rights and there are no redemption or sinking fund provisions with respect to such shares.

As of December 31, 2018, the Company was authorized to issue 1,000,000,000 shares of Class A common stock and 500,000,000 shares of Class B common stock, each with a par value of $0.0000001 per share. As of December 31,

2018, there were 323,546,864 shares of Class A common stock and 93,501,142 shares of Class B common stock outstanding. Options and awards granted following the Company's November 2015 initial public offering are related to underlying Class A common stock. Additionally, holders of Class B common stock are able to convert such shares into Class A common stock.

Warrants

On February 24, 2017, the Company and Starbucks entered into a Warrant Cancellation and Payment Agreement pursuant to which the Company paid Starbucks cash consideration of approximately $54.8 million in return for the termination of the Warrant to Purchase Stock dated August 7, 2012, as amended, that provided Starbucks with the right to purchase an aggregate of approximately 9.5 million shares of the Company’s common stock.

In conjunction with the 2022 Notes offering, the Company sold warrants whereby the Counterparties have the option to purchase a total of approximately 19.2 million shares of the Company’s Class A common stock at a price of $31.18 per share. None of the warrants were exercised as of December 31, 2018.

In conjunction with the 2023 Notes offering, the Company sold the 2023 warrants whereby the counterparties have the option to purchase a total of approximately 11.1 million shares of the Company’s Class A common stock at a price of $109.26 per share. None of the warrants were exercised as of December 31, 2018.

Release of Caviar Shares Held Back

In 2014, in conjunction with the Company's acquisition of Caviar, Inc. (Caviar), 1,291,979 shares of the purchase consideration issuable were withheld for indemnification purposes. In April 2018, the Company reached an agreement with the former owners of Caviar whereby 822,085 of the shares held back were released to the former owners and 469,894 shares were forfeited back to the Company as indemnification against liabilities related to Caviar preacquisition matters. Upon reaching the agreement, the Company recorded an indemnification asset of $2.7 million and a corresponding credit to expense to compensate for the costs previously incurred in connection with Caviar preacquisition claims. The remaining value of the forfeited shares was treated as an equity repurchase.

Conversion of 2022 Notes and Exercise of the 2022 Convertible Note Hedges

In connection with the conversion of certain of the 2022 Notes, the Company issued 7.3 million shares of Class A common stock. The Company also exercised a pro-rata portion of the 2022 convertible note hedges and received 6.9 million shares of Class A common stock from the counterparties to offset the shares issued.

Stock Plans

The Company maintains two share-based employee compensation plans: the 2009 Stock Plan (2009 Plan) and the 2015 Equity Incentive Plan (2015 Plan). The 2015 Plan serves as the successor to the 2009 Plan. The 2015 Plan became effective as of November 17, 2015. Outstanding awards under the 2009 Plan continue to be subject to the terms and conditions of the 2009 Plan. Effective November 17, 2015, no additional awards will be granted under the 2009 Plan.

Under the 2015 Plan, shares of shares of the Company's Class A common stock are reserved for the issuance of incentive and nonstatutory stock options (ISOs and NSOs, respectively), restricted stock awards (RSAs), restricted stock units (RSUs), performance shares, and stock bonuses to qualified employees, directors, and consultants. The awards must be granted at a price per share not less than the fair market value at the date of grant. Initially, 30,000,000 shares were reserved under the 2015 Plan and any shares subject to options or other similar awards granted under the 2009 Plan that expire, are forfeited, are repurchased by the Company or otherwise terminate unexercised will become available under the 2015 Plan. The number of shares available for issuance under the 2015 Plan will be increased on the first day of each fiscal year, in an amount equal to the least of (i) 40,000,000 shares, (ii) 5% of the outstanding shares on the last day of the immediately preceding fiscal year, or (iii) such number of shares determined

by the administrator. As of December 31, 2018, the total number of shares subject to stock options, RSAs and RSUs outstanding under the 2015 Plan was 22,666,464 shares, and 64,851,998 shares were available for future issuance. Under the 2009 Plan, shares of common stock are reserved for the issuance of ISOs or NSOs to eligible participants. The options may be granted at a price per share not less than the fair market value at the date of grant. Options granted generally vest over a four-year term from the date of grant, at a rate of 25% after one year, then monthly on a straight-line basis thereafter. Generally, options granted are exercisable for up to 10 years from the date of grant. The Plan allows for early exercise of employee stock options whereby the option holder is allowed to exercise prior to vesting. Any unvested shares are subject to repurchase by the Company at their original exercise prices. As of December 31, 2018, the total number of options and RSUs outstanding under the 2009 Plan was 28,421,145 shares.

A summary of stock option activity for the year ended December 31, 2018 is as follows (in thousands, except share and per share data):

	Number of options outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balance at December 31, 2017	47,270,091	$ 8.67	6.52	$1,229,103
Granted	783,625	44.75		
Exercised	(13,402,680)	7.98		
Forfeited and canceled	(1,498,155)	14.75		
Balance at December 31, 2018	33,152,881	$ 9.52	5.45	$1,543,793
Options vested and expected to vest at December 31, 2018	33,152,881	$ 9.52	5.45	$1,543,793
Options exercisable at December 31, 2018	31,066,578	$ 8.63	5.27	$1,474,339

Aggregate intrinsic value represents the difference between the Company's estimated fair value of its common stock and the exercise price of outstanding, "in-the-money" options. Aggregate intrinsic value for stock options exercised through December 31, 2018, 2017, and 2016 was $720.1 million, $464.1 million, and $202.6 million, respectively. The total weighted average grant-date fair value of options granted was $16.25, $5.97 and $5.80 per share for the years ended December 31, 2018, 2017 and 2016, respectively.

Restricted Stock Activity

The Company issues RSAs and RSUs under the 2015 Plan, which typically vest over a term of four years.

Activity related to RSAs and RSUs during the year ended December 31, 2018 is set forth below:

	Number of shares	Weighted Average Grant Date Fair Value
Unvested at December 31, 2017	21,317,525	$ 17.84
Granted	7,147,541	54.43
Vested	(7,786,561)	19.62
Forfeited	(2,743,777)	19.88
Unvested at December 31, 2018	17,934,728	$ 31.34

Employee Stock Purchase Plan

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

As of December 31, 2018, 4,349,301 shares had been purchased under the ESPP and 10,797,606 shares were available for future issuance under the ESPP. The Company recorded $9.0 million and $6.0 million of share-based compensation expense related to the ESPP during the year ended December 31, 2018 and 2017, respectively.

Share-Based Compensation

The fair value of stock options was estimated using the following weighted-average assumptions:

	Year Ended December 31,		
	2018	2017	2016
Dividend yield	— %	— %	— %
Risk-free interest rate	2.92 %	1.88 %	1.54 %
Expected volatility	30.87%	32.22%	42.74%
Expected term (years)	6.19	6.02	6.08

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

	Year Ended December 31,		
	2018	2017	2016
Cost of revenue	$97	$77	$—
Product development	144,601	98,310	91,404
Sales and marketing	22,797	17,568	14,122
General and administrative	49,386	39,881	33,260
Total	$216,881	$155,836	$138,786

The Company capitalized $9.3 million, $3.7 million, and $2.8 million of share-based compensation expense related to capitalized software during the year ended December 31, 2018, 2017 and 2016, respectively.

As of December 31, 2018, there was $564.5 million of total unrecognized compensation cost related to outstanding stock options and restricted stock awards that are expected to be recognized over a weighted average period of 2.76 years.

NOTE 16 - NET LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted loss per share is the same as basic loss per share for all years presented because the effects of potentially dilutive items were anti-dilutive given the Company's net loss.
The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share data):

	Year Ended December 31,		
	2018	2017	2016
Net loss	$(38,453)	$(62,813)	$(171,590)
Basic shares:			
Weighted-average common shares outstanding	406,313	380,921	344,393
Weighted-average unvested shares	(582)	(1,577)	(2,838)
Weighted-average shares used to compute basic net loss per share	405,731	379,344	341,555
Diluted shares:			
Weighted-average shares used to compute diluted net loss per share	405,731	379,344	341,555
Loss per share:			
Basic	$(0.09)	$(0.17)	$(0.50)
Diluted	$(0.09)	$(0.17)	$(0.50)

Since the Company intends to settle future conversions of its outstanding 2022 Notes and 2023 Notes entirely in shares of its Class A common stock, the Company will consider the number of shares expected to be issued in calculating any potential dilutive effect of the conversions, if applicable. In the periods that the Company has reported a net loss, the diluted loss per share is the same as basic loss per share for those periods.

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

	Year Ended December 31,		
	2018	2017	2016
Stock options and restricted stock units	60,589	68,588	88,705
Common stock warrants	25,798	19,173	9,457
Convertible senior notes	23,820	—	—
Unvested shares	582	1,300	1,892
Employee stock purchase plan	140	157	216
Total anti-dilutive securities	110,929	89,218	100,270

NOTE 17 - COMMITMENTS AND CONTINGENCIES

Operating and Capital Leases

The Company has entered into various non-cancelable operating leases for certain offices with contractual lease periods expiring between 2019 and 2031. The Company recognized total rental expenses under operating leases of $23.3 million, $12.9 million, and $11.3 million during the years ended December 31, 2018, 2017, and 2016, respectively.

Future minimum lease payments under non-cancelable operating leases (with initial lease terms in excess of one year) and future minimum capital lease payments as of December 31, 2018 are as follows (in thousands):

	Capital	Operating
Year:		
2019	$5,029	$28,405
2020	2,446	38,131
2021	—	52,319
2022	—	53,430
2023	—	47,222
Thereafter	—	209,959
Total	$7,475	$429,466
Less amount representing interest	—	
Present value of capital lease obligations	7,475	
Less current portion of capital lease obligation	(5,029)	
Non-current portion of capital lease obligation	$2,446	

Build-to-Suit Lease Arrangement

In December 2018, the Company entered into a lease arrangement for 355,762 square feet of office space in Oakland, California for a term of 12 years with options to renew for two five year terms. The lease commencement date is expected to be in November 2019 with total lease payments over the term of approximately $272 million.

Due to the Company’s involvement with the construction of the property and its exposure to any potential cost overruns, the Company is deemed to be the owner of the property for accounting purposes during the construction phase. Accordingly, as of December 31, 2018, the Company recorded a non-cash build-to-suit lease asset under construction of $149 million, and a corresponding build-to-suit lease liability on the consolidated balance sheets.

Litigation

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

The Treasurer & Tax Collector of the City and County of San Francisco (Tax Collector) has issued a decision for fiscal years 2014 and 2015, that the Tax Collector believes the Company’s primary business activity is financial services rather than information services, and accordingly, the Company would be liable for the Gross Receipts Tax and Payroll Expense Tax under the rules for financial services business activities. The Company paid the liability for fiscal years 2014 and 2015 in the first quarter of 2018, as assessed by the Tax Collector. The Company intends to vigorously defend its position, which it believes has merit. Should the Company not prevail, the Company could be obligated to pay additional taxes together with any associated penalties and interest for subsequent years that together, in aggregate, could be material. The Company is currently unable to estimate the range of possible loss given the uncertainties associated with this matter, including uncertainties about the Tax Collector’s rationale for its position and about the amounts that may ultimately be subject to such taxes.

On May 14, 2018, Joshua Woodle, on behalf of a class of couriers who have delivered with Caviar in California, filed a lawsuit in San Francisco County Superior Court against the Company doing business as Caviar, which alleges that Caviar misclassified Mr. Woodle 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. Plaintiffs seek damages and injunctive relief. The Court compelled arbitration of Mr. Woodle's arbitrable claims on November 5, 2018. On August 24, 2018, Mervyn Cole, on behalf of the State of California and similarly situated couriers who have delivered with Caviar in California filed a lawsuit in Los Angeles County Superior Court against the Company doing business as Caviar. The complaint alleges that Caviar misclassified Mr. Cole and other similarly situated couriers as independent contractors and, in doing so, violated certain provisions of the California Labor Code. The action is being brought as a representative action under the Private Attorneys General Act ("PAGA"). Plaintiffs seek civil penalties and injunctive relief. Caviar filed a Motion to Compel Arbitration on December 12, 2018. Given the early stage of these proceedings, it is not yet possible to reliably determine any potential liability that could result from these matters.

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

NOTE 18 - SEGMENT AND GEOGRAPHICAL INFORMATION

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

Revenue

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

	Year Ended December 31,		
	2018	2017	2016
Revenue			
United States	$3,138,859	$2,120,088	$1,643,852
International	159,318	94,165	64,869
Total net revenue	$3,298,177	$2,214,253	$1,708,721

No individual country from the international markets contributed in excess of 10% of total revenue for the years ended December 31, 2018, 2017, and 2016.

Long-Lived Assets

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

	December 31,	
	2018	2017
Long-lived assets		
United States	$471,970	$158,820
International	9,239	5,337
Total long-lived assets	$481,209	$164,157

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NOTE 19 - SUPPLEMENTAL CASH FLOW INFORMATION

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

	Year Ended December 31,		
	2018	2017	2016
Supplemental Cash Flow Data:			
Cash paid for interest	$4,125	$1,374	$570
Cash paid for income taxes	1,622	1,254	395
Supplemental disclosures of non-cash investing and financing activities:			
Change in purchases of property and equipment in accounts payable and accrued expenses	15,067	143	2,554
Unpaid business acquisition purchase price	3,995	2,115	240
Fair value of shares issued related to business combination	140,107	—	—
Recovery of common stock in connection with indemnification settlement agreement	2,745	—	—
Fair value of common stock issued to settle the conversion of senior notes, due 2022	(571,408)	—	—
Fair value of shares received to settle senior note hedges, due 2022	$544,276	$—	$—

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

None.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2018, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

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Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Our management conducted an assessment of the effectiveness of our internal control over financial reporting based on the criteria established in “Internal Control - Integrated Framework” (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that assessment, our management has concluded that our internal control over financial reporting was effective as of December 31, 2018. The effectiveness of our internal control over financial reporting as of December 31, 2018 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which appears herein.

We acquired Weebly, Inc. on May 31, 2018, and our management excluded from our assessment of the effectiveness of our internal control over financial reporting as of December 31, 2018, Weebly, Inc.’s internal control over financial reporting associated with 2% of total assets and 1% of total net revenue included in the consolidated financial statements as of and for the year ended December 31, 2018.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item will be included under the captions "Board of Directors and Corporate Governance" and "Executive Officers" in our Proxy Statement for the 2019 Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2018 (Proxy Statement) and is incorporated herein by reference. The information required by this item regarding delinquent filers pursuant to Item 405 of Regulation S-K will be included under the caption "Other Matters--Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement and is incorporated herein by reference.

Item 11. EXECUTIVE COMPENSATION

The information required by this item will be included under the captions "Board of Directors and Corporate Governance--Director Compensation," "Executive Compensation," and "Board of Directors and Corporate Governance--Compensation Committee Interlocks and Insider Participation" in the Proxy Statement and is incorporated herein by reference.

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

The information required by this item will be included under the captions "Security Ownership of Certain Beneficial Owners and Management" and "Equity Compensation Plan Information" in the Proxy Statement and is incorporated herein by reference.

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

The information required by this item will be included under the captions "Certain Relationships, Related Party and Other Transactions" and "Board of Directors and Corporate Governance--Director Independence" in the Proxy Statement and is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item will be included under the caption "Ratification Of Appointment Of Independent Registered Public Accounting Firm" in the Proxy Statement and is incorporated herein by reference.

PART IV
Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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

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

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

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

EXHIBIT INDEX

		Incorporated by Reference			
Exhibit Number	Description	Form	File No.	Exhibit	Filing Date
2.1	Agreement and Plan of Reorganization, dated as of April 26, 2018, by and among the Registrant, Weebly, Inc., Forest Merger Sub, Inc., Forest Merger LLC and Shareholder Representative Services.	8-K	001-37622	2.1	April 26, 2018
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	8-K	001-37622	3.1	November 24, 2015
3.2	Amended and Restated Bylaws of the Registrant.	8-K	001-37622	3.1	November 3, 2017
4.1	Form of Class A common stock certificate of the Registrant.	S-1/A	333-207411	4.1	November 6, 2015
4.2	Fifth Amended and Restated Investors’ Rights Agreement among the Registrant and certain holders of its capital stock, dated as of September 9, 2014.	S-1	333-207411	4.2	October 14, 2015
4.3	Indenture, dated March 6, 2017, between the Registrant and The Bank of New York Mellon Trust Company, N.A.	8-K	001-37622	4.1	March 6, 2017
4.4	Form of 0.375% Convertible Senior Notes due 2022 (included in Exhibit 4.3).	8-K	001-37622	4.2	March 6, 2017
4.5	Indenture, dated May 25, 2018, by and between the Registrant and The Bank of New York Mellon Trust Company, N.A.	8-K	001-37622	4.1	May 25, 2018
4.6	Form of 0.50% Convertible Senior Note due 2023 (included in Exhibit 4.5).	8-K	001-37622	4.2	May 25, 2018
10.1+	Form of Indemnification Agreement between the Registrant and each of its directors and executive officers.	S-1/A	333-207411	10.1	November 6, 2015
10.2+	Square, Inc. 2015 Equity Incentive Plan, as amended and restated, and related form agreements.	10-Q	001-37622	10.1	August 2, 2017
10.3+	Square, Inc. 2015 Employee Stock Purchase Plan, as amended and restated, and related form agreements.	10-K	001-37622	10.3	March 10, 2016
10.4+	Square, Inc. 2009 Stock Plan and related form agreements.	S-1	333-207411	10.4	

					October 14, 2015
10.5+	Square, Inc. Executive Incentive Compensation Plan.	S-1	333-207411	10.5	October 14, 2015
10.6+	Square, Inc. Outside Director Compensation Policy, as amended and restated.				
10.7+	Form of Change of Control and Severance Agreement between the Registrant and certain of its executive officers.	S-1	333-207411	10.7	October 14, 2015
10.8+	Offer Letter between the Registrant and Jack Dorsey, dated as of March 7, 2016.	10-K	001-37622	10.8	March 10, 2016

10.9+	Offer Letter between the Registrant and Alyssa Henry, dated as of October 1, 2015.	S-1/A	333-207411	10.12	November 6, 2015
10.10+	Offer Letter between the Registrant and Jacqueline D. Reses, dated as of October 2, 2015	10-Q	001-37622	10.6	May 4, 2017
10.11+	Offer Letter between the Registrant and Amrita Ahuja, dated as of December 16, 2018	8-K	001-37622	10.1	January 4, 2019
10.12	Office Lease by and between the Registrant and Hudson 1455 Market, LLC, dated as of October 17, 2012, as amended on March 22, 2013, January 22, 2014, June 6, 2014, February 1, 2015, April 27, 2015, June 18, 2015, October 5, 2016, and October 6, 2016.	10-Q	001-37622	10.7	May 4, 2017
10.13	Ninth Amendment to Office Lease by and between the Registrant and Hudson 1455 Market Street, LLC, dated as of December 19, 2017.	10-K	001-37622	10.15	February 27, 2018
10.14	Tenth Amendment to Office Lease by and between the Registrant and Hudson 1455 Market Street, LLC, dated as of May 17, 2018.	10-Q	001-37622	10.5	August 1, 2018
10.15	Eleventh Amendment to Office Lease by and between the Registrant and Hudson 1455 Market Street, LLC, dated as of June 25, 2018.	10-Q	001-37622	10.6	August 1, 2018
10.16	Revolving Credit Agreement dated as of November 2, 2015 among the Registrant, the Lenders Party Thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent.	S-1/A	333-207411	10.14	November 6, 2015
10.17	Commitment Letter dated October 30, 2015 by Goldman Sachs Lending Partners LLC.	S-1/A	333-207411	10.14A	November 16, 2015
10.18	First Amendment to Credit Agreement, dated as of February 27, 2017, among the Registrant, the Lenders Party Thereto, and JPMorgan Chase Bank, N.A., as Administrative Agent	8-K	001-37622	10.1	February 27, 2017
10.19	Second Amendment to Credit Agreement, dated as of May 21, 2018, among the Registrant, the Lenders Party Thereto, and JP Morgan Chase Bank, N.A., as Administrative Agent.	8-K	001-37622	10.1	May 21, 2018
10.20#	Master Development and Supply Agreement by and between the Registrant and TDK Corporation, dated as of October 1, 2013.	S-1	333-207411	10.15	October 14, 2015
10.21#	Master Manufacturing Agreement by and between the Registrant and Cheng Uei Precision Industry Co., Ltd., dated as of June 27, 2012.	S-1	333-207411	10.16	October 14, 2015
10.22#	ASIC Development and Supply Agreement by and between the Registrant, Semiconductor Components Industries, LLC (d/b/a ON Semiconductor) and ON Semiconductor Trading, Ltd., dated as of March 25, 2013.	S-1	333-207411	10.17	October 14, 2015
10.23	Amendment 1 to ASIC Development and Supply Agreement, dated as of January 15, 2019.				
10.24	Warrant Cancellation and Payment Agreement, dated as of February 24, 2017, by and between the Registrant and Starbucks Corporation.	8-K	001-37622	10.1	February 24, 2017
10.25	Purchase Agreement, dated February 28, 2017, by and among the Registrant and Goldman, Sachs & Co. and J.P. Morgan Securities LLC, as representatives of the initial purchasers named therein.	8-K	001-37622	10.1	March 6, 2017
10.26	Form of Convertible Note Hedge Confirmation.	8-K	001-37622	10.2	March 6, 2017
10.27	Form of Warrant Confirmation.	8-K	001-37622	10.3	March 6, 2017
10.28	Purchase Agreement, dated May 22, 2018, by and among the Registrant and Goldman Sachs & Co. LLC.	8-K	001-37622	10.1	May 25, 2018
10.29	Form of Convertible Note Hedge Confirmation.	8-K	001-37622	10.2	May 25, 2018

10.30	Form of Warrant Confirmation.	8-K	001-37622	10.3	May 25, 2018
21.1	List of subsidiaries of the Registrant.				
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm.				
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				

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

+ Indicates management contract or compensatory plan.

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

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

Item 16. FORM 10-K SUMMARY

None.

SIGNATURES

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

Date: February 27, 2019

SQUARE, INC.

By: /s/ Jack Dorsey

Jack Dorsey

President, Chief Executive Officer, and Chairman

POWER OF ATTORNEY

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

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

Signature	Title	Date
/s/ Jack Dorsey Jack Dorsey	President, Chief Executive Officer, and Chairman (Principal Executive Officer)	February 27, 2019
/s/ Amrita Ahuja Amrita Ahuja	Chief Financial Officer (Principal Financial Officer)	February 27, 2019
/s/ Ajmere Dale Ajmere Dale	Chief Accounting Officer (Principal Accounting Officer)	February 27, 2019
/s/ Roelof Botha Roelof Botha	Director	February 27, 2019
/s/ Paul Deighton Paul Deighton	Director	February 27, 2019
/s/ Randy Garutti Randy Garutti	Director	February 27, 2019
/s/ Jim McKelvey Jim McKelvey	Director	February 27, 2019
/s/ Mary Meeker Mary Meeker	Director	February 27, 2019
/s/ Anna Patterson Anna Patterson	Director	February 27, 2019
/s/ Naveen Rao Naveen Rao	Director	February 27, 2019
/s/ Ruth Simmons Ruth Simmons	Director	February 27, 2019
/s/ Lawrence Summers Lawrence Summers	Director	February 27, 2019
/s/ David Viniar David Viniar	Director	February 27, 2019