

Hardware costs consist of all product costs associated with Square Stand, Square Readers for EMV chip cards and NFC, and third-party peripherals. Product costs include manufacturing-related overhead and personnel costs, certain royalties, packaging, and fulfillment costs.

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### ***Amortization of acquired technology***

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

### ***Marketing Expenses***

Marketing expenses are expensed as incurred and include customer acquisition costs and advertising costs. Customer acquisition costs include manufacturing and distribution costs associated with the Company's credit card readers, which are offered for free on the Company's website and provided through various marketing events and distribution channels. The Company also offers rebates to new sellers for the retail price of the credit card readers purchased. The expected future rebates related to card readers distributed are accrued in other current liabilities on the consolidated balance sheets. These costs are partially offset by amounts received from distribution partners. Customer acquisition costs also include costs associated with the Company's Square Cash app, which enables individuals to initiate peer-to-peer cash transfers free of charge. Customer acquisition costs are expensed as incurred.

Total customer acquisition costs for the years ended December 31, 2012, 2013, and 2014 were \$20.9 million, \$18.5 million, and \$23.7 million, respectively. Total customer acquisition costs for the nine months ended September 30, 2014 and 2015 were \$17.5 million and \$23.5 million, respectively.

Total advertising costs for the years ended December 31, 2012, 2013, and 2014 were \$21.4 million, \$24.8 million, and \$38.2 million, respectively. Total advertising costs for the nine months ended September 30, 2014 and 2015 totaled \$27.7 million and \$31.0 million, respectively.

### ***Share-based Compensation***

The Company measures compensation expense for all share-based payment awards, including stock options granted to employees, directors, and non-employees based on the estimated fair values on the date of each grant. The fair value of each stock option granted is estimated using the Black-Scholes-Merton option valuation model. Share-based compensation is recognized on a straight-line basis over the requisite service period, net of estimated forfeitures.

The Company has historically issued unvested restricted shares to employee stockholders of certain acquired companies. A portion of these awards is generally subject to continued post-acquisition employment, and this portion has been accounted for as post-acquisition share-based compensation expense. The Company recognizes compensation expense equal to the grant date fair value of the common stock on a straight-line basis over the period during which the employee is required to perform service in exchange for the award.

### ***Income Taxes***

The Company reports income taxes in accordance with Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 740, *Income Taxes*, which requires an asset and liability approach in accounting for income taxes. 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

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