CINTAS CORP
Form 10-K
July 30, 2010

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

X ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the Fiscal Year Ended May 31, 2010

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

Commission File No. 0-11399

CINTAS CORPORATION
(Exact name of Registrant as specified in its charter)

Incorporated under the Laws of Washington (State or other jurisdiction of incorporation or organization)	6800 Cintas Boulevard P.O. Box 625737 Cincinnati, Ohio 45262-5737 (Address of principal executive offices) Phone: (513) 459-1200 (Telephone number of principal executive offices)	IRS Employer ID No. 31-1188630

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by checkmark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES ü NO ___

Indicate by checkmark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

YES ___ NO ü

Indicate by checkmark 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, and (2) has been subject to such filing requirements for the past 90 days.

YES ü NO ___

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to the Form 10-K. ____

Indicate by a checkmark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files).

YES ____ NO ____

Indicate by checkmark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ü Accelerated Filer ____ Smaller Reporting Company ____ Non-Accelerated Filer ____ (Do not check if a smaller reporting company)

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ____ NO ü

The aggregate market value of the Common Stock held by non-affiliates as of November 30, 2009, was $4,294,096,390 based on a closing sale price of $28.09 per share. As of June 30, 2010, 173,207,493 shares of Common Stock were issued and 152,869,848 shares were outstanding.

Documents Incorporated by Reference

Portions of the Registrant's Proxy Statement to be filed with the Commission for its 2010 Annual Meeting of Shareholders are incorporated by reference in Part III as specified.

Cintas Corporation
Index to Annual Report on Form 10-K

Part IV

Part I

Item 1. Business

Cintas Corporation (Cintas), a Washington corporation, provides highly specialized products and services to businesses of all types primarily throughout North America and Latin America, Europe and Asia. Cintas' products and services are designed to enhance its customers' images and brand identification as well as provide a safe and efficient work place. Cintas was founded in 1968 by Richard T. Farmer, currently the Chairman Emeritus of the Board, when he left his family's industrial laundry business in order to develop uniform programs using an exclusive new fabric. In the early 1970's, Cintas acquired the family industrial laundry business. Over the years, Cintas developed additional products and services that complemented its core uniform business and broadened the scope of products and services available to its customers.

Cintas classifies its businesses into four operating segments. The Rental Uniforms and Ancillary Products operating segment consists of the rental and servicing of uniforms and other garments including flame resistant clothing, mats, mops and shop towels and other ancillary items. In addition to these rental items, restroom cleaning services and supplies and carpet and tile cleaning services are also provided within this operating segment. The Uniform Direct Sales operating segment consists of the direct sale of uniforms and related items and branded promotional products. The First Aid, Safety and Fire Protection Services operating segment consists of first aid, safety and fire protection products and services. The Document Management Services operating segment consists of document destruction, document imaging and document retention services.

We provide our products and services to approximately 800,000 businesses of all types from small service and manufacturing companies to major corporations that employ thousands of people. This diversity in customer base results in no individual customer accounting for greater than one percent of Cintas' total revenue. As a result, the loss of one account would not have a significant financial impact on Cintas.

The following table sets forth Cintas' total revenue and the revenue derived from each operating segment:

Fiscal Year Ended May 31, (in thousands)	**2010**	2009	2008
Rental Uniforms and Ancillary Products	$ 2,569,357	$ 2,755,015	$ 2,834,568
Uniform Direct Sales	386,370	428,369	517,490
First Aid, Safety and Fire Protection Services	338,651	378,097	403,552
Document Management Services	252,961	213,204	182,290
	$ 3,547,339	$ 3,774,685	$ 3,937,900

Additional information is also included in Note 14 entitled Operating Segment Information in "Notes to Consolidated Financial Statements."

The primary markets served by all Cintas operating segments are local in nature and highly fragmented. Cintas competes with national, regional and local providers, and the level of competition varies at each of Cintas' local operations. Product, design, price, quality, service and convenience to the customer are the competitive elements in each of our operating segments.

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Within the Rental Uniforms and Ancillary Products operating segment, Cintas provides its products and services to customers via local delivery routes originating from rental processing plants and branches. Within the Uniform Direct Sales and First Aid, Safety and Fire Protection Services operating segments, Cintas provides its products and services via its distribution network and local delivery routes or local representatives. Within the Document Management Services operating segment, Cintas provides its services via local service routes originating from document management branches and document retention facilities. In total, Cintas has approximately 7,700 local delivery routes, 418 operations and 8 distribution centers. At May 31, 2010, Cintas employed approximately 30,000 employees of which approximately 225 were represented by labor unions.

Cintas sources finished products from many outside suppliers. In addition, Cintas operates 6 manufacturing facilities which provide for standard uniform needs. Cintas purchases fabric, used in its manufacturing process, from several suppliers. Cintas is not aware of any circumstances that would hinder its ability to continue obtaining these materials.

Cintas is subject to various environmental laws and regulations, as are other companies in the uniform rental industry. While environmental compliance is not a material component of our costs, Cintas must incur capital expenditures and associated operating costs, primarily for water treatment and waste removal, on a regular basis. Environmental spending related to water treatment and waste removal was approximately $18 million in fiscal 2010 and approximately $19 million in fiscal 2009. Capital expenditures to limit or monitor hazardous substances were less than $1 million in fiscal 2010 and approximately $2 million in fiscal 2009. Cintas does not expect a material change in the cost of environmental compliance and is not aware of any material non-compliance with environmental laws.

Cintas' corporate website is located at www.cintas.com. Cintas files with or furnishes to the SEC Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports, as well as proxy statements and annual reports to shareholders, and, from time to time, other documents. The reports and other documents filed with or furnished to the SEC are available to investors on or through our corporate website free of charge as soon as reasonably practicable after we electronically file them with or furnish them to the SEC. In addition, the public may read and copy any of the materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site located at http://www.sec.gov that contains reports, proxy and information statements and other information regarding issuers, such as Cintas, that file electronically with the SEC. Cintas' SEC filings and its Code of Business Conduct can be found on the Investor Information page of our website at www.cintas.com/company/investor_information/highlights.aspx. These documents are available in print to any shareholder who requests a copy by writing or calling Cintas as set forth on the Investor Information page.

Item 1A. Risk Factors

The statements in this section describe the most significant risks that could materially and adversely affect our business, financial condition and results of operation and the trading price of our debt or equity securities.

In addition, this section sets forth statements which constitute our cautionary statements under the Private Securities Litigation Reform Act of 1995.

This Annual Report on Form 10-K contains forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a safe harbor from civil litigation for forward-looking statements. Forward-looking statements may be identified by words such as "estimates," "anticipates," "predicts," "projects," "plans," "expects," "intends," "target," "forecast," "believes," "seeks," "could," "should," "may" and "will" or the negative versions thereof and *similar expressions and by the context in which they are used. Such statements are based upon current expectations of Cintas and speak only as of the date made. We cannot guarantee that any forward-looking statement will be realized. These statements are subject to various risks, uncertainties and other factors that could cause actual results to differ from those set forth in or implied by this Annual Report. Factors that might cause such a difference include, but are not limited to, the possibility of greater than anticipated operating costs including energy costs, lower sales volumes, loss of customers due to outsourcing trends, the effects of credit market volatility and changes in our credit ratings, fluctuations in foreign currency exchange, the performance and costs of integration of acquisitions, fluctuations in costs of materials and labor including increased medical costs, costs and possible effects of union organizing activities, failure to comply with government regulations concerning employment discrimination, employee pay and benefits and employee health and safety, uncertainties regarding any existing or newly-discovered expenses and liabilities related to environmental compliance and remediation, asset impairment charges, the cost, results and ongoing assessment of internal controls for financial reporting required by the Sarbanes-Oxley Act of 2002, disruptions caused by the unaccessibility of computer systems data, the initiation or outcome of litigation, higher assumed sourcing or distribution costs of products, the disruption of operations from catastrophic events, changes in federal and state tax and labor laws, the reactions of competitors in terms of price and service and other factors set forth in this Item 1A. "Risk Factors" section. Cintas undertakes no obligation to update any forward-looking statements whether as a result of new information or to reflect events or circumstances arising after the date on which they are made.*

Negative global economic factors may adversely affect our financial performance.
Negative economic conditions, in North America and our other markets, may adversely affect our financial performance. Higher levels of unemployment, inflation, tax rates and other changes in tax laws and other economic factors could adversely affect the demand for Cintas' products and services. Increases in labor costs, including healthcare and insurance costs, labor shortages or shortages of skilled labor, higher material costs for items such as fabrics and textiles, lower recycled paper prices, higher interest rates, inflation, higher tax rates and other changes in tax laws and other economic factors could increase our costs of rental uniforms and ancillary products and other services and selling and administrative expenses. As a result, these factors could adversely affect our sales and results of operation.

Increased competition could adversely affect our financial performance.
We operate in highly competitive industries and compete with national, regional and local providers. Product, design, price, quality, service and convenience to the customer are the competitive elements in these industries. If existing or future competitors seek to gain or retain market share by reducing prices, Cintas may be required to lower prices, which would hurt our results of operation. Cintas' competitors also generally compete with Cintas for acquisition candidates, which can increase the price for acquisitions and reduce the number of available acquisition candidates. In addition, our customers and prospects may decide to perform certain services in-house instead of outsourcing these services to Cintas. These competitive pressures could adversely affect our sales and results of operation.

An inability to open new, cost effective operating facilities may adversely affect our expansion efforts.
We plan to expand our presence in existing markets and enter new markets. The opening of new operating facilities is necessary to gain the capacity required for this expansion. Our ability to open new operating facilities depends on our ability to identify attractive locations, negotiate leases or real estate purchase agreements on acceptable terms, identify and obtain adequate utility and water sources and comply with environmental regulations, zoning laws and other similar factors. Any inability to effectively identify and manage these items may adversely affect our expansion efforts, and, consequently, adversely affect our financial performance.

Risks associated with our acquisition practice could adversely affect our results of operation.
Historically, a portion of our growth has come from acquisitions. We continue to evaluate opportunities for

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acquiring businesses that may supplement our internal growth. However, there can be no assurance that we will be able to locate and purchase suitable acquisitions. In addition, the success of any acquisition depends in part on our ability to integrate the acquired company. The process of integrating acquired businesses may involve unforeseen difficulties and may require a disproportionate amount of our management's attention and our financial and other resources. Although we conduct due diligence investigations prior to each acquisition, there can be no assurance that we will discover or adequately protect against all material liabilities of an acquired business for which we may be responsible as a successor owner or operator. The failure to successfully integrate these acquired businesses or to discover such liabilities could adversely affect our results of operation.

Increases in fuel and energy costs could adversely affect our results of operation and financial condition.
The price of fuel and energy needed to run our vehicles and equipment is unpredictable and fluctuates based on events outside our control, including geopolitical developments, supply and demand for oil and gas, actions by OPEC and other oil and gas producers, war and unrest in oil producing countries, regional production patterns, limits on refining capacities, natural disasters and environmental concerns. Future increases in fuel and energy costs could adversely affect our results of operation and financial condition.

Unionization campaigns could adversely affect our results of operation.
Cintas continues to be the target of a corporate unionization campaign by several unions. These unions are attempting to pressure Cintas into surrendering our employees' rights to a government-supervised election by unilaterally accepting union representation. We continue to vigorously oppose this campaign and defend our employees' rights to a government-supervised election. This campaign could be materially disruptive to our business and could materially adversely affect our results of operation.

Risks associated with the suppliers from whom our products are sourced could adversely affect our results of operation.
The products we sell are sourced from a wide variety of domestic and international suppliers. Global sourcing of many of the products we sell is an important factor in our financial performance. We require all of our suppliers to comply with applicable laws, including labor and environmental laws, and otherwise be certified as meeting our required supplier standards of conduct. Our ability to find qualified suppliers who meet our standards, and to access products in a timely and efficient manner is a significant challenge, especially with respect to suppliers located and goods sourced outside the U.S. Political and economic stability in the countries in which foreign suppliers are located, the financial stability of suppliers, suppliers' failure to meet our supplier standards, labor problems experienced by our suppliers, the availability of raw materials to suppliers, currency exchange rates, transport availability and cost, inflation and other factors relating to the suppliers and the countries in which they are located are beyond our control. In addition, U.S. and foreign trade policies, tariffs and other impositions on imported goods, trade sanctions imposed on certain countries, the limitation on the importation of certain types of goods or of goods containing certain materials from other countries and other factors relating to foreign trade are beyond our control. These and other factors affecting our suppliers and our access to products could adversely affect our results of operation.

Fluctuations in foreign currency exchange could adversely affect our financial condition and results of operation.
We earn revenue, pay expenses, own assets and incur liabilities in countries using currencies other than the U.S. dollar, including the Canadian dollar and the euro. In fiscal years 2010, 2009 and 2008, revenue denominated in currencies other than the U.S. dollar represented less than 10% of our consolidated revenue. Because our consolidated financial statements are presented in U.S. dollars, we must translate revenue, income and expenses, as well as assets and liabilities, into U.S. dollars at exchange rates in effect during or at the end of each reporting period. Therefore, fluctuations in the value of the U.S. dollar against other major currencies, particularly in the event of significant increases in foreign currency revenue, will impact our revenue and operating income and the value of

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balance sheet items denominated in foreign currencies. This impact could adversely affect our financial condition and results of operation.

Failure to comply with the regulations of the U.S. Occupational Safety and Health Administration and other state and local agencies that oversee safety compliance could adversely affect our results of operation.
The Occupational Safety and Health Act of 1970, as amended, or "OSHA", establishes certain employer responsibilities, including maintenance of a workplace free of recognized hazards likely to cause death or serious injury, compliance with standards promulgated by OSHA and various record keeping, disclosure and procedural requirements. Various OSHA standards may apply to our operations. We have incurred, and will continue to incur, capital and operating expenditures and other costs in the ordinary course of our business in complying with OSHA and other state and local laws and regulations. Any failure to comply with these regulations could result in fines by government authorities and payment of damages to private litigants and affect our ability to service our customers and adversely affect our results of operation.

We are subject to legal proceedings that may adversely affect our financial condition and results of operation.
We are party to various litigation claims and legal proceedings. We discuss these lawsuits and other litigation to which we are party in greater detail under the caption "Item 3. Legal Proceedings" and in Note 13 entitled Litigation and Other Contingencies of "Notes to Consolidated Financial Statements." Certain of these lawsuits or potential future lawsuits, if decided adversely to us or settled by us, may result in liability and expense material to our financial condition and results of operation.

Compliance with environmental laws and regulations could result in significant costs that adversely affect our results of operation.
Our operating locations are subject to environmental laws and regulations relating to the protection of the environment and health and safety matters, including those governing discharges of pollutants to the air and water, the management and disposal of hazardous substances and wastes and the clean-up of contaminated sites. The operation of our businesses entails risks under environmental laws and regulations. We could incur significant costs, including clean-up costs, fines and sanctions and claims by third parties for property damage and personal injury, as a result of violations of or liabilities under these laws and regulations. We are currently involved in a limited number of remedial investigations and actions at various locations. While based on information currently known to us, we believe that we maintain adequate reserves with respect to these matters, our liability could exceed forecasted amounts, and the imposition of additional clean-up obligations or the discovery of additional contamination at these or other sites could result in significant additional costs which could adversely affect our results of operation. In addition, potentially significant expenditures could be required to comply with environmental laws and regulations, including requirements that may be adopted or imposed in the future.

Under environmental laws, an owner or operator of real estate may be required to pay the costs of removing or remediating hazardous materials located on or emanating from property, whether or not the owner or operator knew of or was responsible for the presence of such hazardous materials. While Cintas regularly engages in environmental due diligence in connection with acquisitions, we can give no assurance that locations that have been acquired or leased have been operated in compliance with environmental laws and regulations during prior periods or that future uses or conditions will not make us liable under these laws or expose us to third-party actions including tort suits.

We rely extensively on computer systems to process transactions, maintain information and manage our businesses. Disruptions in the availability of our computer systems could impact our ability to service our customers and adversely affect our sales and results of operation.
Our businesses rely on our computer systems to provide customer information, process customer transactions and provide other general information necessary to manage our businesses. We have an active disaster recovery plan in

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place that is frequently reviewed and tested. However, our computer systems are subject to damage or interruption due to system conversions, power outages, computer or telecommunication failures, computer viruses, security breaches, catastrophic events such as fires, tornadoes and hurricanes and usage errors by our employees. If our computer systems are damaged or cease to function properly, we may have to make a significant investment to fix or replace them, and we may have interruptions in our ability to service our customers. This disruption caused by the unavailability of our computer systems could adversely affect our sales and results of operation.

Failure to achieve and maintain effective internal controls could adversely affect our business and stock price.
Effective internal controls are necessary for us to provide reliable financial reports. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to the consolidated financial statement preparation and presentation. While we continue to evaluate our internal controls, we cannot be certain that these measures will ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. If we fail to maintain the adequacy of our internal controls or if we or our independent registered public accounting firm were to discover material weaknesses in our internal controls, as such standards are modified, supplemented or amended, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002. Failure to achieve and maintain an effective internal control environment could cause us to be unable to produce reliable financial reports or prevent fraud. This may cause investors to lose confidence in our reported financial information, which could have a material adverse effect on our stock price.

We may experience difficulties in attracting and retaining competent personnel in key positions.
We believe that a key component of our success is our corporate culture which has been imparted by management throughout our corporate organization. This factor, along with our entire operation, depends on our ability to attract and retain key employees. Competitive pressures within and outside our industry may make it more difficult and expensive for us to attract and retain key employees which could adversely affect our businesses.

Unexpected events could disrupt our operations and adversely affect our results of operation.
Unexpected events, including fires or explosions at facilities, natural disasters such as hurricanes and tornados, war or terrorist activities, unplanned outages, supply disruptions, failure of equipment or systems or changes in laws and/or regulations impacting our businesses, could adversely affect our results of operation. These events could result in customer disruption, physical damage to one or more key operating facilities, the temporary closure of one or more key operating facilities or the temporary disruption of information systems.

We may recognize impairment charges which could adversely affect our results of operation and financial condition.
We assess our goodwill and other intangible assets and our long-lived assets for impairment when required by U.S. generally accepted accounting principles. These accounting principles require that we record an impairment charge if circumstances indicate that the asset carrying values exceed their fair values. The fair value of these assets is impacted by general economic conditions in the locations in which we operate. Deterioration in these general economic conditions may result in: declining revenue which can lead to excess capacity and declining operating cash flow; reductions in management's estimates for future revenue and operating cash flow growth; increases in borrowing rates and other deterioration in factors that impact our weighted average cost of capital; and deteriorating real estate values. If our assessment of goodwill, other intangible assets or long-lived assets indicates an impairment of the carrying value for which we recognize an impairment charge, this may adversely affect our results of operation and financial condition.

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Within our Document Management business, we handle customers' confidential information. Our failure to protect our customers' confidential information against security breaches could damage our reputation, harm our business and adversely impact our results of operation.
Our Document Management Services business includes both document destruction and document retention services. These services involve the handling of our customers' confidential information and the subsequent destruction or retention of this information. Any compromise of security, accidental loss or theft of customer data in our possession could damage our reputation and expose us to risk of liability, which could harm our business and adversely impact our results of operation.

The effects of credit market volatility and changes in our credit ratings could adversely affect our liquidity and results of operation.
Our operating cash flows, combined with access to the credit markets, provide us with significant discretionary funding capacity. However, deterioration in the global credit markets may limit our ability to access credit markets, which could adversely affect our liquidity and/or increase our cost of borrowing. In addition, credit market deterioration and its actual or perceived effects on our results of operation and financial condition, along with deterioration in general economic conditions, may increase the likelihood that the major independent credit agencies will downgrade our credit ratings, which could increase our cost of borrowing. Increases in our cost of borrowing could adversely affect our results of operation.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Cintas occupies 426 facilities located in 281 cities. Cintas leases 224 of these facilities for various terms ranging from monthly to the year 2019. Cintas expects that it will be able to renew or replace its leases on satisfactory terms. Of the 6 manufacturing facilities listed below, Cintas controls the operations of 2 of these manufacturing facilities, but does not own or lease the real estate related to these operations. All other facilities are owned. The principal executive office in Cincinnati, Ohio, provides centrally located administrative functions including accounting, finance, marketing and computer system development and support. Cintas operates rental processing plants that house administrative, sales and service personnel and the necessary equipment involved in the cleaning of uniforms and bulk items, such as entrance mats and shop towels. Branch operations provide administrative, sales and service functions. Cintas operates 8 distribution centers and 6 manufacturing facilities. Cintas also operates first aid, safety and fire protection and document management facilities and direct sales offices. Cintas considers the facilities it operates to be adequate for their intended use. Cintas owns or leases approximately 14,500 vehicles which are used for the route-based services and by the sales and management employee-partners.

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The following chart provides additional information concerning Cintas' facilities:

Type of Facility	# of Facilities
Rental Processing Plants	171
Rental Branches	105
First Aid, Safety and Fire Protection Facilities	59
Document Management Facilities	62
Distribution Centers	8*
Manufacturing Facilities	6
Direct Sales Offices	15
Total	426

Rental processing plants, rental branches, distribution centers and manufacturing facilities are used in Cintas' Rental Uniforms and Ancillary Products operating segment. Rental processing plants, rental branches, distribution centers, manufacturing facilities and direct sales offices are all used in the Uniform Direct Sales operating segment. First aid, safety and fire protection facilities, rental processing facilities and distribution centers are used in the First Aid, Safety and Fire Protection Services operating segment. Document management facilities and rental processing facilities are used in the Document Management Services operating segment.

* Includes the principal executive office, which is attached to the distribution center in Cincinnati, Ohio.

Item 3. Legal Proceedings

We discuss material legal proceedings (other than ordinary routine litigation incidental to our business) pending against us in "Item 8. Financial Statements and Supplementary Data," in Note 13 entitled Litigation and Other Contingencies of "Notes to Consolidated Financial Statements." We refer you to and incorporate by reference into this Item 3 that discussion for important information concerning those legal proceedings, including the basis for such actions and, where known, the relief sought.

Item 4. [Reserved]

Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Cintas' common stock is traded on the NASDAQ Global Select Market under the symbol "CTAS." The following table shows the high and low closing prices of shares of Cintas' common stock by quarter during the last two fiscal years:

Fiscal 2010

Quarter Ended	High	Low
May 2010	$ 28.73	$ 24.86
February 2010	29.68	23.75
November 2009	30.69	26.81
August 2009	28.00	21.61

Fiscal 2009

Quarter Ended	High	Low
May 2009	$ 26.83	$ 18.15
February 2009	25.70	20.06
November 2008	33.05	19.80
August 2008	31.38	25.44

Holders

At May 31, 2010, there were approximately 4,000 shareholders on record of Cintas' common stock. Cintas believes that this represents approximately 72,000 beneficial owners.

Dividends

Dividends on the outstanding common stock have been paid annually and amounted to $0.48 per share, $0.47 per share and $0.46 per share in fiscal 2010, fiscal 2009 and fiscal 2008, respectively.

Stock Performance Graph

The following graph summarizes the cumulative return on $100 invested in Cintas' common stock, the S&P 500 Stock Index and the common stocks of a selected peer group of companies. Because our products and services are diverse, Cintas does not believe that any single published industry index is appropriate for comparing shareholder return. Therefore, the peer group used in the performance graph combines four publicly traded companies in the business services industry that have similar characteristics as Cintas, such as route-based delivery of products and services. The companies included in the peer group are G & K Services, Inc., UniFirst Corporation, ABM Industries and Ecolab, Inc.

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Total shareholder return was based on the increase in the price of the stock and assumed reinvestment of all dividends. Further, total return was weighted according to market capitalization of each company. The companies in the peer group are not the same as those considered by the Compensation Committee of the Board of Directors.

Total Shareholder Returns
Comparison of Five-Year Cumulative Total Return

Purchases of Equity Securities by the Issuer and Affiliated Purchases

On May 2, 2005, Cintas announced that the Board of Directors authorized a $500 million share buyback program at market prices. In July 2006, Cintas announced that the Board of Directors approved the expansion of its share buyback program by an additional $500 million. The Board of Directors did not specify an expiration date for the share buyback program.

Cintas did not purchase any shares of Cintas common stock in fiscal 2010 under the share buyback program. From the inception of the share buyback program through July 30, 2010, Cintas has purchased a total of 20.3 million shares of Cintas' common stock at an average price of $39.31 per share for a total purchase price of approximately $798 million. The maximum approximate dollar value of shares that may yet be purchased under the share buyback program as of July 30, 2010, is approximately $202 million.

During fiscal 2010, Cintas purchased approximately 43,000 shares of Cintas' common stock in trade for employee payroll taxes due on restricted stock options that vested during the fiscal year. These shares were purchased at an average price of $22.71 per share for a total purchase price of approximately $1 million.

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Item 6. Selected Financial Data

Eleven-Year Financial Summary

ds except per share and percentage data)

ed	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	**2010**
	$1,901,991	2,160,700	2,271,052	2,686,585	2,814,059	3,067,283	3,403,608	3,706,900	3,937,900	3,774,685	3,547,339
e	$ 190,386	218,665	229,466	243,191	265,078	292,547	323,382	334,538	335,405	226,357	215,620
	$ 1.14	1.30	1.35	1.43	1.55	1.70	1.93	2.09	2.15	1.48	1.40
S	$ 1.12	1.27	1.33	1.41	1.54	1.69	1.92	2.09	2.15	1.48	1.40
	$ 0.19	0.22	0.25	0.27	0.29	0.32	0.35	0.39	0.46	0.47	0.48
s	$1,581,342	1,752,224	2,519,234	2,582,946	2,810,297	3,059,744	3,425,237	3,570,480	3,808,601	3,720,951	3,969,736
rs'	$1,042,896	1,231,346	1,423,814	1,646,418	1,888,093	2,104,574	2,090,192	2,167,738	2,254,131	2,367,409	2,534,029
	19.9%	19.2%	17.3%	15.8%	15.0%	14.7%	15.4%	15.7%	15.2%	9.8%	8.8%
	$ 254,378	220,940	703,250	534,763	473,685	465,291	794,454	877,074	942,736	786,058	785,444

(1) Return on average equity is computed as net income divided by the average of shareholders' equity. We believe that this calculation gives management and shareholders a good indication of Cintas' historical performance.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

Business Strategy

Cintas provides highly specialized products and services to businesses of all types primarily throughout North America and Latin America, Europe and Asia. We bring value to our customers by helping them provide a cleaner, safer and more pleasant atmosphere for their customers and employees. Our products and services are designed to improve our customers' images. We also help our customers protect their employees and their company by enhancing workplace safety and helping to ensure legal compliance in key areas of their business.

We are North America's leading provider of corporate identity uniforms through rental and sales programs, as well as a significant provider of related business services, including entrance mats, restroom cleaning services and supplies, carpet and tile cleaning services, first aid, safety and fire protection products and services, document management services and branded promotional products.

Cintas' principal objective is "to exceed customers' expectations in order to maximize the long-term value of Cintas for shareholders and working partners," and it provides the framework and focus for our business strategy. This strategy is to achieve revenue growth for all of our products and services by increasing our penetration at existing customers and by broadening our customer base to include business segments to which Cintas has not historically served. We will also continue to identify additional product and service opportunities for our current and future customers.

To pursue the strategy of increasing penetration, we have a highly talented and diverse team of service professionals visiting our customers on a regular basis. This frequent contact with our customers enables us to develop close personal relationships. The combination of our distribution system and these strong customer relationships provides a platform from which we launch additional products and services.

We pursue the strategy of broadening our customer base in several ways. Cintas has a national sales organization introducing all of our products and services to prospects in all business segments. Our broad range of products and services allows our sales organization to consider any type of business a prospect. We also broaden our customer base through geographic expansion, especially in our emerging businesses of first aid and safety, fire protection and document management. Finally, we evaluate strategic acquisitions as opportunities arise.

Results of Operation

The economic downturn that occurred in fiscal 2009 continued throughout most of our fiscal 2010. The U.S. economy, which lost millions of jobs in our fiscal 2009, continued to lose jobs through the first three quarters of our fiscal 2010. These job losses directly affected our business as many of our products and services are dependent on customer employee levels. We were encouraged, though, that the rate of U.S. job loss lessened as we progressed through the first three quarters of fiscal 2010, and U.S. employment levels slightly increased in our fourth fiscal 2010 quarter. As this stabilization occurred in the general U.S. economic environment, our internal growth rate improved.

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Internal growth by quarter is shown in the table below. Internal growth percentages have been adjusted for the appropriate number of workdays, by quarter and for the year, where applicable.

	Internal Growth
First Quarter Ending August 31, 2009	-12.6%
Second Quarter Ending November 30, 2009	-10.2%
Third Quarter Ending February 28, 2010	-3.6%
Fourth Quarter Ending May 31, 2010	1.9%
For the Year Ending May 31, 2010	-6.4%

Despite the lower revenue level for the year, we were able to generate improved cash flow, with net cash provided by operating activities of \$561.6 million representing a 7.3% increase compared to fiscal 2009. We also increased the dividend paid to shareholders to \$0.48 per share, marking the 27th consecutive increase in the dividend paid.

Cintas classifies its businesses into four operating segments. The Rental Uniforms and Ancillary Products operating segment consists of the rental and servicing of uniforms and other garments including flame resistant clothing, mats, mops and shop towels and other ancillary items. In addition to these rental items, restroom cleaning services and supplies and carpet and tile cleaning services are also provided within this operating segment. The Uniform Direct Sales operating segment consists of the direct sale of uniforms and related items and branded promotional products. The First Aid, Safety and Fire Protection Services operating segment consists of first aid, safety and fire protection products and services. The Document Management Services operating segment consists of document destruction, document imaging and document retention services.

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The following table sets forth certain consolidated statements of income data as a percent to revenue by operating segment and in total for the fiscal years ended May 31:

	2010	2009	2008
Revenue:			
Rental Uniforms and Ancillary Products	72.4%	73.0%	72.0%
Uniform Direct Sales	11.0%	11.4%	13.1%
First Aid, Safety and Fire Protection Services	9.5%	10.0%	10.3%
Document Management Services	7.1%	5.6%	4.6%
Total revenue	100.0%	100.0%	100.0%
Cost of sales:			
Rental Uniforms and Ancillary Products	56.4%	56.7%	55.8%
Uniform Direct Sales	69.9%	75.2%	67.5%
First Aid, Safety and Fire Protection Services	61.1%	61.9%	60.1%
Document Management Services	48.6%	49.4%	45.4%
Total cost of sales	57.8%	58.9%	57.3%
Gross margin:			
Rental Uniforms and Ancillary Products	43.6%	43.3%	44.2%
Uniform Direct Sales	30.1%	24.8%	32.5%
First Aid, Safety and Fire Protection Services	38.9%	38.1%	39.9%
Document Management Services	51.4%	50.6%	54.6%
Total gross margin	42.2%	41.1%	42.7%
Selling and administrative expenses	30.6%	28.7%	28.0%
Legal settlements, net of insurance proceeds	0.7%		
Restructuring charges	-0.1%	0.3%	
Impairment of long-lived assets		1.3%	
Interest income	-0.1%	-0.1%	-0.1%
Interest expense	1.4%	1.3%	1.3%
Income before income taxes	9.7%	9.6%	13.5%

Fiscal 2010 Compared to Fiscal 2009

Fiscal 2010 total revenue was $3.5 billion, a decrease of 6.0% compared to fiscal 2009. Total revenue decreased organically by 6.4%. Fiscal 2010 had one more workday than fiscal 2009, and this additional workday in fiscal 2010 accounted for the difference between the total decrease of 6.0% and the organic decrease of 6.4%. As a result of the economic downturn discussed above, we experienced decreases in uniform revenue, both rented and purchased, and revenue for our hygiene products and first aid and safety products. In addition, the continued difficult economic environment in fiscal 2010 caused many of our customers to reduce facility spending on items such as entrance mats and shop towels and delay spending on facility upgrades, resulting in a reduction in our facility services and fire protection revenue.

Rental Uniforms and Ancillary Products operating segment revenue consists predominantly of revenue derived from the rental of corporate identity uniforms and other garments including flame resistant clothing, and the rental and/or sale of mats, mops, shop towels, restroom supplies and other rental services. Revenue from the Rental Uniforms and Ancillary Products operating segment decreased 6.7% compared to fiscal 2009. Rental Uniforms and

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Ancillary Products operating segment revenue decreased organically by 6.9% in fiscal 2010. The decrease in the Rental Uniforms and Ancillary Products operating segment revenue was primarily due to decreased uniform wearers caused in large part by the difficult U.S. economic environment in fiscal 2010. Fiscal 2010 had one more workday than fiscal 2009, which resulted in an increase in revenue of 0.4%.

Other Services revenue, consisting of revenue from the reportable operating segments of Uniform Direct Sales, First Aid, Safety and Fire Protection Services and Document Management Services, decreased 4.1% compared to fiscal 2009. Other Services revenue decreased organically by 5.2%. Decreases in Uniform Direct Sales operating segment revenue and First Aid, Safety and Fire Protection Services operating segment revenue were offset by increased revenue in our Document Management Services operating segment. Acquisitions in our First Aid, Safety and Fire Protection Services operating segment and our Document Management Services operating segment accounted for growth of 0.7% during fiscal 2010. Fiscal 2010 had one more workday than fiscal 2009, which resulted in an increase in revenue of 0.4%.

Cost of rental uniforms and ancillary products decreased 7.2% compared to fiscal 2009. Cost of rental uniforms and ancillary products consists primarily of production expenses, delivery expenses and the amortization of in service inventory, including uniforms, mats, mops, shop towels and other ancillary items. The cost decrease compared to fiscal 2009 was primarily driven by the volume decrease in the Rental Uniforms and Ancillary Products operating segment revenue. We also incurred a loss on inventory valuation of $8.4 million in fiscal 2009 that did not reoccur in fiscal 2010 related to excess inventory levels.

Cost of other services decreased 9.3% compared to fiscal 2009. Cost of other services consists primarily of cost of goods sold (predominantly uniforms and first aid products), delivery expenses and distribution expenses in the Uniform Direct Sales operating segment, the First Aid, Safety and Fire Protection Services operating segment and the Document Management Services operating segment. The decrease from fiscal 2009 was due to the volume decrease in Other Services revenue. We also incurred a loss on inventory valuation of $19.1 million in fiscal 2009 that did not reoccur in fiscal 2010 related to excess inventory levels.

Selling and administrative expenses increased $3.7 million, or 0.3%, compared to fiscal 2009. This increase is primarily due to a $9.6 million increase in medical expenses, an increase of $6.2 million in professional services and depreciation mainly related to the implementation of a new enterprise-wide computer system, and a $3.4 million increase in stock compensation expense, offset by a $15.6 million reduction in bad debt expense.

Legal settlements, net of insurance proceeds, of $23.5 million primarily related to a settlement in principle occurring in the first quarter of fiscal 2010 between Cintas and the plaintiffs involved in the litigation, *Paul Veliz, et al. v. Cintas Corporation.* The principle terms of the settlement provide for an aggregate cash payment of approximately $24 million. The pre-tax impact, net of insurance proceeds, was approximately $19.5 million. This settlement is more fully described in Note 13 entitled Litigation and Other Contingencies in "Notes to Consolidated Financial Statements."

Operating income of $390.8 million in fiscal 2010 decreased $18.3 million, or 4.5%, compared to fiscal 2009. This decrease was primarily due to lower volumes resulting from the difficult U.S. economic environment in fiscal 2010.

Net interest expense (interest expense less interest income) decreased $0.6 million from the prior fiscal year. This decrease was due to a $1.1 million reduction in interest income caused by lower interest rates on Canadian treasury securities during fiscal 2010 compared to fiscal 2009, offset by a decrease of $1.6 million in interest expense caused by lower levels of borrowings in fiscal 2010 compared to fiscal 2009.

Income before income taxes was $343.9 million, a 4.9% decrease compared to fiscal 2009. This change reflects the decrease in operating income described above.

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Cintas' effective tax rate was 37.3% for fiscal 2010 as compared to 37.4% and 36.8% for fiscal 2009 and 2008, respectively (also see Note 8 entitled Income Taxes of "Notes to Consolidated Financial Statements" for more information on income taxes).

Net income for fiscal 2010 of $215.6 million was a 4.7% decrease compared to fiscal 2009, and diluted earnings per share of $1.40 was a 5.4% decrease compared to fiscal 2009. These changes reflect the decrease in operating income described above.

Rental Uniforms and Ancillary Products Operating Segment

As discussed above, Rental Uniforms and Ancillary Products operating segment revenue decreased $185.7 million, or 6.7%, and the cost of rental uniforms and ancillary products decreased $112.7 million, or 7.2%. The operating segment's fiscal 2010 gross margin was 43.6% of revenue compared to 43.3% in fiscal 2009. Excluding a fiscal 2009 loss on inventory valuation of $8.4 million, fiscal 2009 gross margin was 43.6%. Despite the lower volume, we were able to maintain the same gross margin (excluding the loss on inventory) as a percent to revenue due to lower material cost and due to cost reduction initiatives such as reducing both facility and route capacity resulting in lower depreciation, production labor and other facility related expenses.

Selling and administrative expenses for the Rental Uniforms and Ancillary Products operating segment as a percent to revenue, at 30.6%, increased 270 basis points from 27.9% in fiscal 2009. This increase was due to increased medical expense and an increase in selling labor due to the addition of sales representatives.

The restructuring amount of ($2.9) million in fiscal 2010 represents a change in estimate related to restructuring charges taken in fiscal 2009. The change in estimate represents the difference between severance and other exit costs estimated based on information available in fiscal 2009 and severance and other exit costs actually paid in fiscal 2010. See Note 2 entitled Restructuring and Related Activity of "Notes to Consolidated Financial Statements" for more information.

Income before income taxes decreased $34.0 million to $336.5 million for the Rental Uniforms and Ancillary Products operating segment for fiscal 2010 compared to fiscal 2009. This decrease is primarily due to the decrease in revenue described above combined with the increase in selling and administrative expenses.

Uniform Direct Sales Operating Segment

Uniform Direct Sales operating segment revenue decreased $42.0 million, or 9.8%, compared to fiscal 2009. Cost of uniform direct sales decreased $52.3 million, or 16.2%, compared to fiscal 2009. The gross margin as a percent to revenue of 30.1% for fiscal 2010 increased from 24.8% in fiscal 2009. Excluding a fiscal 2009 loss on inventory valuation of $16.1 million, gross margin as a percent to revenue was 28.5% in fiscal 2009. Despite the lower volume in fiscal 2010, we were able to improve the gross margin as a percent to revenue due to cost reduction initiatives such as reducing distribution facility labor to adjust to the lower volumes and by sourcing improvements.

Selling and administrative expenses as a percent to revenue, at 19.7%, decreased from 22.9% in fiscal 2009. This decrease is due to cost reduction initiatives to adjust the selling labor to better align with the current volume level.

Income before income taxes was $40.1 million in fiscal 2010, an increase of $36.9 million compared to fiscal 2009. Fiscal 2009 income before income taxes included a loss on inventory valuation of $16.1 million and a charge of $4.6 million related to restructuring activities. Additionally, the increase in income before income taxes in fiscal 2010 compared to fiscal 2009 is due primarily to cost reduction initiatives to reduce capacity, labor and other resources to better align with the current volume level.

First Aid, Safety and Fire Protection Services Operating Segment

First Aid, Safety and Fire Protection Services operating segment revenue decreased $39.4 million in fiscal 2010, a 10.4% decrease compared to fiscal 2009. This operating segment's revenue decreased organically by 10.6%. The

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difficult U.S. economic environment, which included job losses in fiscal 2010 and reductions in facility spending, directly impacted this operating segment's revenue. Acquisitions accounted for an increase in revenue of 0.2%. Fiscal 2010 had one more workday than fiscal 2009, which resulted in an increase in revenue of 0.4%.

Cost of first aid, safety and fire protection services decreased $27.0 million, or 11.5%, in fiscal 2010, due primarily to decreased First Aid, Safety and Fire Protection Services operating segment volume. Gross margin for the First Aid, Safety and Fire Protection Services operating segment is defined as revenue less cost of goods, warehouse expenses, service expenses and training expenses. The gross margin as a percent to revenue was 38.9% for fiscal 2010 compared to 38.1% in fiscal 2009. Excluding a fiscal 2009 loss on inventory valuation of $3.0 million, gross margin as a percent to revenue was 38.9% in fiscal 2009. Despite the lower volume, we were able to maintain the same gross margin (excluding the loss on inventory) as a percent to revenue due to the elimination of lower margin fire installation business throughout the course of fiscal 2010 and due to cost reduction initiatives resulting in lower labor related expenses.

Selling and administrative expenses decreased by $8.8 million in fiscal 2010 compared to fiscal 2009 primarily due to lower bad debt expense resulting from improved collection efforts. Selling and administrative expenses as a percent to revenue, at 34.9%, increased from 33.6% in fiscal 2009. This increase as a percent to revenue was due to lower volume.

Income before income taxes for the First Aid, Safety and Fire Protection Services operating segment was $13.4 million in fiscal 2010 compared to $15.9 million in fiscal 2009. This decrease was primarily due to the reduced volume in First Aid, Safety and Fire Protection Services operating segment.

Document Management Services Operating Segment

Document Management Services operating segment revenue increased $39.8 million for fiscal 2010, or 18.6%, over fiscal 2009. This operating segment's internal growth for fiscal 2010 was 14.4% over fiscal 2009. The internal growth is primarily due to the sale of destruction services to new customers and an increase in recycled paper revenue. This operating segment derives a portion of its revenue from the sale of shredded paper to paper recyclers. The weighted average price of standard office paper, which accounts for the majority of the recycled paper revenue, increased by 6.4% in fiscal 2010 compared to fiscal 2009. Acquisitions accounted for revenue growth of 3.8%. Fiscal 2010 had one more workday than fiscal 2009, which resulted in an increase in revenue of 0.4%.

Cost of document management services increased $17.7 million, or 16.8%, for fiscal 2010, due to increased Document Management Services operating segment volume. Gross margin for the Document Management Services operating segment is defined as revenue less production and service costs. The gross margin as a percent to revenue was 51.4% for fiscal 2010, an increase from 50.6% in fiscal 2009. This increase from fiscal 2009 is mainly due to the increase in recycled paper prices in fiscal 2010 compared to fiscal 2009.

Selling and administrative expenses as a percent to revenue was 41.8% for fiscal 2010 compared to 41.4% in fiscal 2009. This increase was due to an increase in selling labor due to the addition of sales representatives and increased medical expense.

Income before income taxes for the Document Management Services operating segment was $24.3 million, an increase of $4.9 million compared to fiscal 2009. Income before income taxes was 9.6% of the operating segment's revenue compared to 9.1% in fiscal 2009. This increase is due to the increase in the average price of standard office paper, offset by the increase in selling and administrative expenses.

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Fiscal 2009 Compared to Fiscal 2008

The economic environment in fiscal 2009 presented challenges not experienced in decades. The financial crisis which began in September, 2008, caused many of our customers to immediately reduce spending. As the economic turmoil continued, we saw our customers make dramatic reductions in spending. Significant job losses in North America followed the financial crisis as these economies lost millions of jobs from October 2008 through May 2009.

The suddenness and severity of the economic downturn required us to react quickly to reduce our cost structure. Beginning in the second quarter of fiscal 2009, we closed two manufacturing plants in Kentucky, initiated hiring and wage freezes in many parts of the organization, eliminated many overhead positions and reduced discretionary and capital spending. These initiatives resulted in a reduction to selling and administrative expenses of approximately $60 million when comparing the last six months of fiscal 2009 to the first six months of fiscal 2009.

In addition to the actions described above, we initiated restructuring activities during the fourth quarter of fiscal 2009 to reduce excess capacity and further reduce our cost structure. These activities included closing or converting to branches 16 of our rental processing plants and reducing our workforce by 1,200 employees. These restructuring activities were substantially completed in fiscal 2010. During the fourth quarter of fiscal 2009, we recorded charges of $48.9 million in long-lived asset impairment costs, $7.9 million in employee termination costs and $2.3 million in other exit costs for a total of $59.1 million that will be incurred as a result of this restructuring. The following summarizes these amounts by operating segment:

(In millions) May 31, 2009	Rental Uniforms & Ancillary Products	Uniform Direct Sales	First Aid, Safety & Fire Protection	Document Management	Total
Restructuring charges	$ 8.8	$ 0.5	$ 0.6	$ 0.3	$ 10.2
Impairment of long-lived assets	44.2	4.1	0.6		48.9
Loss before income taxes	$ 53.0	$ 4.6	$ 1.2	$ 0.3	$ 59.1

The significant deterioration of the North American economy, particularly in the last five months of the year ended May 31, 2009, which led to reduced revenue levels in our Rental Uniforms and Ancillary Products operating segment, our Uniform Direct Sales operating segment and our First Aid, Safety and Fire Protection Services operating segment, created excess inventory levels in these operating segments. As a result, we reduced the carrying amount of specific inventory to realizable values and recorded a pre-tax loss in the year ended May 31, 2009, of $27.5 million. The following summarizes this loss by operating segment:

(In millions) May 31, 2009	Rental Uniforms & Ancillary Products	Uniform Direct Sales	First Aid, Safety & Fire Protection	Document Management	Total
Cost of rental uniforms and ancillary products	$ 8.4	$	$	$	$ 8.4
Cost of other services		16.1	3.0		19.1
Loss on inventory valuation	$ 8.4	$ 16.1	$ 3.0	$	$ 27.5

Fiscal 2009 total revenue was $3.8 billion, a decrease of 4.1% compared to fiscal 2008. Acquisitions in our First Aid, Safety and Fire Protection Services operating segment and our Document Management Services operating segment accounted for growth of 0.7% during fiscal 2009.

Information related to acquisitions is discussed in Note 9 entitled Acquisitions of "Notes to Consolidated Financial Statements." Total revenue decreased organically by

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4.5%. The difficult North American economic environment that began with the financial crisis in our second quarter of fiscal 2009 deteriorated in our third and fourth fiscal quarters of fiscal 2009. These economies lost millions of jobs from October, 2008, through May, 2009. Because of customer job losses, we experienced decreases in uniform revenue, both rented and purchased, and revenue for our hygiene products and first aid and safety products. In addition, facility closures by our customers reduced our volume of entrance mats, mops, shop towels and other facility needs such as fire protection services and document management services. Fiscal 2009 had one fewer workday than fiscal 2008, which resulted in a decrease in revenue of 0.3%.

Rental Uniforms and Ancillary Products operating segment revenue consists predominantly of revenue derived from the rental of corporate identity uniforms and other garments including flame resistant clothing, and the rental and/or sale of mats, mops, shop towels, restroom supplies and other rental services. Revenue from the Rental Uniforms and Ancillary Products operating segment decreased 2.8% compared to fiscal 2008. Rental Uniforms and Ancillary Products operating segment revenue decreased organically by 2.4% in fiscal 2009. The decrease in the Rental Uniforms and Ancillary Products operating segment revenue was primarily due to decreased uniform wearers caused in large part by job losses in the U.S. and Canadian economies during fiscal 2009. Fiscal 2009 had one fewer workday than fiscal 2008, which resulted in a decrease in revenue of 0.4%.

Other Services revenue, consisting of revenue from the reportable operating segments of Uniform Direct Sales, First Aid, Safety and Fire Protection Services and Document Management Services, decreased 7.6% compared to fiscal 2008. Acquisitions in our First Aid, Safety and Fire Protection Services operating segment and our Document Management Services operating segment accounted for growth of 2.5% during fiscal 2009. Other Services revenue decreased organically by 9.7%. The turmoil in the U.S. and Canadian economies significantly affected our Other Services revenue, particularly in the Uniform Direct Sales and First Aid, Safety and Fire Protection Services operating segments. The revenue decreases in these operating segments were partially offset by increased revenue in our Document Management Services operating segment. Fiscal 2009 had one fewer workday than fiscal 2008, which resulted in a decrease in revenue of 0.4%.

Cost of rental uniforms and ancillary products decreased 1.2% compared to fiscal 2008. Cost of rental uniforms and ancillary products consists primarily of production expenses, delivery expenses and the amortization of in service inventory, including uniforms, mats, mops, shop towels and other ancillary items. The cost decrease compared to fiscal 2008 was primarily driven by the volume decrease in the Rental Uniforms and Ancillary Products operating segment revenue. The cost decrease due to reduced volume was partially offset by a loss on inventory valuation of $8.4 million, as described above.

Cost of other services decreased 1.9% compared to fiscal 2008. Cost of other services consists primarily of cost of goods sold (predominantly uniforms and first aid products), delivery expenses and distribution expenses in the Uniform Direct Sales operating segment, the First Aid, Safety and Fire Protection Services operating segment and the Document Management Services operating segment. The decrease from fiscal 2008 was due to the volume decrease in other services. The cost decrease due to reduced volume was partially offset by a loss on inventory valuation of $19.1 million, as described above.

Selling and administrative expenses decreased $21.4 million, or 1.9%, compared to fiscal 2008. This decrease is primarily due to a decrease of $18.9 million in labor costs and payroll taxes related to our fiscal 2009 cost reduction efforts.

Operating income of $409.1 million in fiscal 2009 decreased $168.4 million, or 29.2%, compared to fiscal 2008. Excluding the loss on inventory valuation of $27.5 million and the charges of $59.1 million relating to the restructuring activities, operating income decreased by $81.8 million, or 14.2%, compared to fiscal 2008. This decrease was primarily due to lower volumes brought on by the turmoil in the U.S. and Canadian economies in fiscal 2009.

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Net interest expense (interest expense less interest income) of $46.9 million in fiscal 2010 increased $0.7 million from the prior fiscal year. This increase was due to a $3.3 million reduction in interest income caused by lower interest rates on Canadian treasury securities during fiscal 2009 compared to fiscal 2008, offset by a decrease of $2.6 million in interest expense caused by lower levels of borrowings in fiscal 2009 compared to fiscal 2008.

Income before income taxes was $361.6 million, a 31.9% decrease compared to fiscal 2008. This change reflects the decrease in operating income described above.

Cintas' effective tax rate was 37.4% for fiscal 2009 as compared to 36.8% for fiscal 2008 (also see Note 8 entitled Income Taxes of "Notes to Consolidated Financial Statements" for more information on income taxes).

Net income for fiscal 2009 of $226.4 million was a 32.5% decrease compared to fiscal 2008, and diluted earnings per share of $1.48 was a 31.2% decrease compared to fiscal 2008. These changes reflect the decrease in operating income described above.

Rental Uniforms and Ancillary Products Operating Segment

As discussed above, Rental Uniforms and Ancillary Products operating segment revenue decreased $79.6 million, or 2.8%, and the cost of rental uniforms and ancillary products decreased $19.4 million, or 1.2%. The operating segment's gross margin was $1,192.8 million, or 43.3% of revenue. This gross margin percent to revenue of 43.3% decreased from 44.2% in fiscal 2008. Excluding the loss on inventory valuation of $8.4 million in fiscal 2009, the gross margin percent in fiscal 2009 was 43.6%. The decrease of 60 basis points from 44.2% in fiscal 2008 to 43.6% in fiscal 2009 is primarily due to the reduced volume in the Rental Uniforms and Ancillary Products operating segment.

Selling and administrative expenses for the Rental Uniforms and Ancillary Products operating segment as a percent to revenue, at 27.9%, decreased 40 basis points from 28.3% in fiscal 2008. This decrease was due to a reduction in labor costs associated with our cost reduction efforts.

Income before income taxes decreased $80.7 million to $370.5 million for the Rental Uniforms and Ancillary Products operating segment for fiscal 2009 compared to fiscal 2008. Income before income taxes was 13.4% of this operating segment's revenue. Excluding the loss on inventory valuation of $8.4 million and the charges of $53.0 million relating to the restructuring activities, income before income taxes as a percent to revenue was 15.7% in fiscal 2009, which is relatively consistent with the 15.9% in fiscal 2008.

Uniform Direct Sales Operating Segment

Uniform Direct Sales operating segment revenue decreased $89.1 million for fiscal 2009, a 17.2% decrease compared to fiscal 2008. There were no acquisitions in the Uniform Direct Sales operating segment during fiscal 2009.

Cost of uniform direct sales decreased $26.9 million, or 7.7%, for fiscal 2009 due to decreased Uniform Direct Sales operating segment volume, partially offset by a loss on inventory valuation of $16.1 million. The gross margin as a percent to revenue of 24.8% for fiscal 2009 decreased from 32.5% in fiscal 2008. Excluding the loss on inventory valuation of $16.1 million in fiscal 2009, the gross margin percent in fiscal 2009 was 28.5%. The decrease from 32.5% in fiscal 2008 to 28.5% in fiscal 2009 is primarily due to the reduced volume.

Selling and administrative expenses as a percent to revenue, at 22.9%, increased from 20.0% in fiscal 2008. This increase is due to lower volume and an increase in bad debt expense of 70 basis points.

Income before income taxes was $3.2 million in fiscal 2009, a decrease of $61.5 million compared to fiscal 2008. This decrease is primarily due to the reduced volume in the Uniform Direct Sales operating segment, as well as the loss on inventory valuation of $16.1 million and the charges of $4.6 million relating to the restructuring activities.

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Excluding the loss on inventory valuation and the charges relating to the restructuring activities, income before income taxes was $24.0 million in fiscal 2009, a decrease of $40.8 million.

First Aid, Safety and Fire Protection Services Operating Segment

First Aid, Safety and Fire Protection Services operating segment revenue decreased $25.5 million in fiscal 2009, a 6.3% decrease compared to fiscal 2008. This operating segment's revenue decreased organically by 7.6%. The turmoil in the U.S. and Canadian economies during fiscal 2009 affected our First Aid, Safety and Fire Protection Services operating segment revenue. Our customers in this segment reduced their spending at the onset of the financial crisis in September, 2008, resulting in decreased revenue in fiscal 2009 compared to fiscal 2008. Acquisitions accounted for growth of 1.7%. Fiscal 2009 had one fewer workday than fiscal 2008, which resulted in a decrease in revenue of 0.4%.

Cost of first aid, safety and fire protection services decreased $8.8 million, or 3.6%, in fiscal 2009, due to decreased First Aid, Safety and Fire Protection Services operating segment volume, partially offset by a loss on inventory valuation of $3.0 million. Gross margin for the First Aid, Safety and Fire Protection Services operating segment is defined as revenue less cost of goods, warehouse expenses, service expenses and training expenses. The gross margin as a percent to revenue was 38.1% for fiscal 2009. Excluding the loss on inventory valuation of $3.0 million in fiscal 2009, the gross margin percent in fiscal 2009 was 38.9%. The decrease from 39.9% in fiscal 2008 to 38.9% in fiscal 2009 is primarily due to the reduced volume.

Selling and administrative expenses as a percent to revenue, at 33.6%, increased from 31.0% in fiscal 2008. This increase was due to lower volume and an increase in bad debt expense of 130 basis points.

Income before income taxes for the First Aid, Safety and Fire Protection Services operating segment was $15.9 million in fiscal 2009 compared to $35.6 million in fiscal 2008. This decrease of $19.7 million was primarily due to the reduced volume in First Aid, Safety and Fire Protection Services operating segment, as well as the loss on inventory valuation of $3.0 million and the charges of $1.2 million relating to the restructuring activities. Excluding the loss on inventory valuation and the charges relating to the restructuring activities, income before income taxes was $20.1 million, or 5.3% of revenue, in fiscal 2009 compared to 8.8% of revenue in fiscal 2008.

Document Management Services Operating Segment

Document Management Services operating segment revenue increased $30.9 million for fiscal 2009, or 17.0% over fiscal 2008. This operating segment's internal growth for fiscal 2009 was 6.0% over fiscal 2008. The internal growth is primarily due to the sale of destruction services to new customers, offset by a decline in recycled paper revenue. This operating segment derives revenue from the sale of shredded paper to paper recyclers. The weighted average price of standard office paper, which accounts for the majority of the recycled paper revenue, dropped by 24.2% in fiscal 2009 compared to fiscal 2008. Acquisitions accounted for growth of 11.4%. Fiscal 2009 had one fewer workday than fiscal 2008, which resulted in a decrease in revenue of 0.4%.

Cost of document management services increased $22.7 million, or 27.4%, for fiscal 2009, due to increased Document Management Services volume. Gross margin for the Document Management Services operating segment is defined as revenue less production and service costs. The gross margin as a percent to revenue was 50.6% for fiscal 2009, down from 54.6% in fiscal 2008. This decrease from fiscal 2008 is mainly due to the sharp decline in recycled paper prices compared to fiscal 2008. The decrease in the average price of standard office paper resulted in a decrease in gross margin as a percent to revenue of 2.9%.

Selling and administrative expenses as a percent to revenue was 41.4% compared to 40.5% in fiscal 2008. This increase is due to the sharp decline in recycled paper prices compared to fiscal 2008. The decrease in the average price of standard office paper resulted in an increase in selling and administrative expense as a percent to revenue of 2.4%.

Income before income taxes for the Document Management Services operating segment was $19.4 million, a decrease of $6.4 million compared to fiscal 2008. Income before income taxes was 9.1% of the operating segment's revenue compared to 14.1% in fiscal 2008. The decrease in the average price of standard paper resulted in a decrease in income before income taxes as a percent to revenue of 14.5%.

Liquidity and Capital Resources

At May 31, 2010, Cintas had $566.1 million in cash, cash equivalents and marketable securities, representing an increase of $316.0 million from May 31, 2009. This increase is attributable to the improvement in net working capital and lower use of cash for investing activities including capital expenditures. Net working capital (defined as current assets less current liabilities) increased by $171.9 million at May 31, 2010 compared to May 31, 2009. Cash used for financing activities decreased by $177.8 million in fiscal 2010 compared to fiscal 2009 due to a reduction in repayment of debt. As a result of the cash generated in fiscal 2010, we did not have any commercial paper outstanding as of May 31, 2010, under our commercial paper program discussed above.

Net cash provided by operating activities was $561.6 million in fiscal 2010 as compared to $523.5 million generated in fiscal 2009. This $38.1 million increase is primarily a result of increases in working capital, offset by lower net income. Significant uses of cash in fiscal 2010 were capital expenditures of $111.1 million, dividends of $74.0 million and acquisitions of businesses, net of cash acquired, of $50.4 million. Cash, cash equivalents and marketable securities will be used to finance future acquisitions and capital expenditures.

Marketable securities consist primarily of fixed income securities. Cintas believes that its investment policy pertaining to marketable securities is conservative. The criterion used in making investment decisions is the preservation of principal, while earning an attractive yield.

Accounts receivable increased $8.6 million primarily due to higher fourth quarter revenue in fiscal 2010 compared to fiscal 2009. The average collection period in fiscal 2010 of 42 days remained comparable with fiscal 2009.

Inventories and uniforms and other rental items in service decreased $36.2 million, or 6.7%, due to an overall reduction in inventory levels in response to customer demand driven by the current economic environment.

Net working capital increased $171.9 million to $1,141.3 million in fiscal 2010, primarily due to the increased cash balances discussed above offset by reductions in inventory levels.

Net property and equipment decreased $20.1 million in fiscal 2010 versus fiscal 2009 due to normal ongoing property and equipment activity and a reduction in capital expenditures of $49.0 million. Capital expenditures for fiscal 2010 totaled $111.1 million, including $68.2 million for the Rental Uniforms and Ancillary Products operating segment and $27.9 million for the Document Management Services operating segment, while depreciation expense totaled $152.1 million. During fiscal 2010, Cintas completed construction of one new uniform rental facility.

Long-term debt totaled $786.1 million at May 31, 2010. This amount includes $225.0 million of 10-year senior notes at a rate of 6.0% issued in fiscal 2002, $250.0 million of 30-year senior notes issued in fiscal 2007 at a rate of 6.15% and $300.0 million of 10-year senior notes issued in fiscal 2008 at a rate of 6.125%. Cintas has earned credit ratings on these notes of "A" from Standard & Poor's and "A2" from Moody's. Cintas utilizes a $600.0 million commercial paper program, on which it has earned credit ratings of "A-1" from Standard & Poor's and "Prime-1" from Moody's. We believe these ratings reflect our commitment to conservative financial policies, strong financial management and a disciplined integration strategy for acquisitions. The commercial paper program is fully supported by a long-term credit facility that matures in fiscal 2011. As of May 31, 2010, there were no outstanding borrowings under this program. During fiscal 2009, Cintas initiated a $7.5 million loan with PIDC Regional Center, LP for

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funding related to a facility being built in Philadelphia. It is a 5-year note with a 2.75% interest rate. Cintas' total debt to capitalization ratio has decreased from 24.9% at May 31, 2009, to 23.7% at May 31, 2010.

Cintas has certain covenants related to debt agreements. These covenants limit Cintas' ability to incur certain liens, to engage in sale-leaseback transactions and to merge, consolidate or sell all or substantially all of Cintas' assets. These covenants also require Cintas to maintain certain debt to capitalization and interest coverage ratios. Cross default provisions exist between certain debt instruments. Cintas is in compliance with all of the significant debt covenants for all periods presented. If a default of a significant covenant were to occur, the default could result in an acceleration of the maturity of the indebtedness, impair liquidity and limit the ability to raise future capital.

During fiscal 2010, Cintas paid dividends of $74.0 million, or $0.48 per share. On a per share basis, this dividend is an increase of 2.1% over the dividend paid in fiscal 2009. This marks the 27th consecutive year that Cintas has increased its annual dividend, every year since going public in 1983.

On May 2, 2005, Cintas announced that the Board of Directors authorized a $500.0 million share buyback program at market prices. In July 2006, Cintas announced that the Board of Directors approved the expansion of its share buyback program by an additional $500.0 million. During fiscal 2010, Cintas did not make any common stock repurchases under the share buyback program. From the inception of the share buyback program through July 30, 2010, Cintas has purchased 20.3 million shares of Cintas' common stock at an average price of $39.31 per share for a total purchase price of approximately $798 million. The Board of Directors did not specify an expiration date for this program.

During fiscal 2010, Cintas purchased approximately 43,000 shares of Cintas' common stock in trade for employee payroll taxes due on restricted stock options that vested during the fiscal year. These shares were purchased at an average price of $22.71 per share for a total purchase price of approximately $1 million.

Following is information regarding Cintas' long-term contractual obligations and other commitments outstanding as of May 31, 2010:

Long-Term Contractual Obligations

(In thousands)	Payments Due by Period				
	Total	One year or less	Two to three years	Four to five years	After five years
Long-term debt [1]	$ 786,053	$ 609	$ 226,278	$ 8,690	$ 550,476
Operating leases [2]	89,041	27,766	37,348	15,472	8,455
Interest payments [3]	611,555	49,520	85,382	43,918	432,735
Interest swap agreements					
Unconditional purchase obligations					
Total long-term contractual cash obligations	$ 1,486,649	$ 77,895	$ 349,008	$ 68,080	$ 991,666

Cintas also makes payments to defined contribution plans. The amounts of contributions made to the defined contribution plans are made at the discretion of Cintas. Future contributions are expected to increase approximately 3% to 5% annually. Based on that increase, payments due in one year or less would be $21,393, two to three years would be $46,049 and four to five years would be $50,769. Payments for years thereafter are expected to continue increasing by approximately 5% each year.

(1) Long-term debt primarily consists of $775,000 in senior notes. Reference Note 6 entitled Long-Term Debt

and Derivatives of "Notes to Consolidated Financial Statements" for a detailed discussion of long-term debt.

(2) Operating leases consist primarily of building leases.

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(3)

Interest payments include interest on both fixed and variable rate debt. Rates have been assumed to increase 50 basis points in fiscal 2011, increase 150 basis points in fiscal 2012, increase 125 basis points in fiscal 2013, increase 100 basis points in both fiscal 2014 and 2015 and increase an additional 50 basis points in each year thereafter.

Other Commitments

(In thousands)	Amount of Commitment Expiration per Period				
	Total	One year or less	Two to three years	Four to five years	After five years
Lines of credit [1]	$ 504,122	$ 504,122	$	$	$
Standby letters of credit [2]	95,878	95,878			
Guarantees					
Standby repurchase obligations					
Other commercial commitments					
Total other commitments	$ 600,000	$ 600,000	$	$	$

(1)

Back-up facility for the commercial paper program (reference Note 6 entitled Long-Term Debt and Derivatives of "Notes to Consolidated Financial Statements" for further discussion).

(2)

Support certain outstanding debt (reference Note 6 entitled Long-Term Debt and Derivatives of "Notes to Consolidated Financial Statements"), self-insured workers' compensation and general liability insurance programs.

Inflation and Changing Prices

Changes in wages, benefits and energy costs have the potential to materially impact Cintas' financial results. Medical benefit costs increased as a percent to revenue due to increased utilization and rising healthcare industry costs. Medical benefits were 4.0% of total revenue in fiscal 2010 and 3.5% of total revenue in fiscal 2009. Management believes inflation has not had a material impact on Cintas' financial condition or a negative impact on results of operation.

Litigation and Other Contingencies

Cintas is subject to legal proceedings and claims arising from the ordinary course of its business, including personal injury, customer contract, environmental and employment claims. In the opinion of management, the aggregate liability, if any, with respect to such ordinary course of business actions will not have a material adverse effect on the financial position or results of operation of Cintas. Cintas is party to additional litigation not considered in the ordinary course of business. Please refer to "Part I, Item 3. Legal Proceedings" and Note 13 entitled Litigation and Other Contingencies of "Part II, Item 8. Notes to Consolidated Financial Statements" for a detailed discussion of certain specific litigation.

New Accounting Standards

The Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Codification (ASC) effective for financial statements issued for interim and annual periods ending after September 30, 2009. The ASC is an aggregation of previously issued authoritative GAAP in one comprehensive set of guidance organized by subject area. In accordance with the ASC, references to previously issued accounting standards have been removed. Subsequent revisions to GAAP will be incorporated into the ASC through Accounting Standards Updates (ASU). The following is a list of recent pronouncements issued by the FASB impacting Cintas.

Effective June 1, 2009, Cintas adopted fair value measurements guidance for all nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value on a nonrecurring basis. The guidance defines fair value, establishes guidance for measuring fair value and expands disclosures regarding fair value measurements. The adoption did not have a material impact on our consolidated financial statements. See Note 3 entitled Fair Value Measurements of "Notes to Consolidated Financial Statements" for additional information.

Effective June 1, 2009, Cintas adopted new guidance on business combinations, in which an entity is required to recognize assets acquired, liabilities assumed, contractual contingencies and contingent consideration at fair value on the acquisition date. It further requires that acquisition-related costs are recognized separately from the acquisition and expensed as incurred, restructuring costs generally are expensed in periods subsequent to the acquisition date, and changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period impact income tax expense. This adoption did not have a material impact on Cintas' results of operations or financial condition. Any future effects will depend upon the terms and size of future acquisitions.

Effective June 1, 2009, Cintas adopted new guidance for determining whether instruments granted in share-based payment transactions are participating securities. This guidance provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method of determining earnings per share. The adoption did not have a material impact on basic or diluted earnings per share. Cintas' adoption is more fully described in Note 11 entitled Earnings per Share of "Notes to Consolidated Financial Statements."

Effective June 1, 2009, Cintas adopted new guidance on subsequent events. The objective of this guidance is to establish general standards of accounting for and disclosure of events that occur after the consolidated balance sheet date but before the consolidated financial statements are issued or are available to be issued. This adoption did not have a material impact on Cintas' results of operations or financial condition.

Critical Accounting Policies

The preparation of Cintas' consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and judgments that have a significant effect on the amounts reported in the consolidated financial statements and accompanying notes. These critical accounting policies should be read in conjunction with Note 1 entitled Significant Accounting Policies of "Notes to Consolidated Financial Statements." Significant changes, estimates or assumptions related to any of the following critical accounting policies could possibly have a material impact on the consolidated financial statements.

Revenue recognition

Rental revenue, which is recorded in the Rental Uniforms and Ancillary Products operating segment, is recognized when services are performed. Other services revenue, which is recorded in the Uniform Direct Sales, First Aid, Safety and Fire Protection Services and Document Management Services operating segments, is recognized when either services are performed or when products are shipped and the title and risks of ownership pass to the customer.

Allowance for doubtful accounts

Cintas establishes an allowance for doubtful accounts. This allowance includes an estimate based on historical rates of collectability and allowances for specific accounts identified as uncollectible. The allowance that is an estimate based on historical rates of collectability is recorded for overdue amounts, beginning with a nominal percentage and increasing substantially as the account ages. The amount provided as the account ages will differ slightly between the Rental Uniforms and Ancillary Products operating segment and the three other operating segments because of differences in customers served and the nature of each operating segment.

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Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market. Cintas applies a commonly accepted practice of using inventory turns to apply variances between actual and standard costs to the inventory balances. The judgments and estimates used to calculate inventory turns will have an impact on the valuation of inventories at the lower of cost or market. An inventory obsolescence reserve is determined by specific identification, as well as an estimate based on historical rates of obsolescence.

Uniforms and other rental items in service

Uniforms and other rental items in service are valued at cost less amortization, calculated using the straight-line method. Uniforms in service (other than cleanroom and flame resistant clothing) are amortized over their useful life of 18 months. Other rental items including shop towels, mats, cleanroom garments, flame resistant clothing, linens and restroom dispensers are amortized over their useful lives which range from 8 to 48 months. The amortization rates used are based on industry experience, Cintas' specific experience and wear tests performed by Cintas. These factors are critical to determining the amount of in service inventory that is presented in the consolidated financial statements.

Property and equipment

Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, which is typically 30 to 40 years for buildings, 5 to 20 years for building improvements, 3 to 10 years for equipment and 2 to 15 years for leasehold improvements. When events or circumstances indicate that the carrying amount of long-lived assets may not be recoverable, the estimated undiscounted future cash flows are compared to the carrying amount of the assets. If the estimated undiscounted future cash flows are less than the carrying amount of the assets, an impairment loss is recorded based on the excess of the carrying amount of the assets over their respective fair values. Fair value is generally determined by discounted cash flows or based on prices of similar assets, as appropriate. Long-lived assets that are held for sale are reported at the lower of the carrying amount or the fair value, less estimated costs to sell.

Goodwill and impairment

Goodwill, obtained through acquisitions of businesses, is valued at cost less any impairment. Cintas completes an annual impairment test which includes the determination of the fair value of its reporting units. This test includes comparisons to current market values, where available, and discounted cash flow analyses. Significant assumptions include growth rates based on historical trends and margin improvement leveraged from such growth. The methodology used is consistent with prior years. Based on the results of the impairment tests, Cintas has not recognized an impairment of goodwill for the fiscal years ended May 31, 2010, 2009 or 2008.

Service contracts and other assets

Service contracts and other assets, which consist primarily of noncompete and consulting agreements obtained through acquisitions of businesses, are amortized by use of the straight line method over the estimated lives of the agreements, which are generally 5 to 10 years. Certain noncompete agreements, as well as all service contracts, require that a valuation be determined using a discounted cash flow model. The assumptions and judgments used in these models involve estimates of cash flows and discount rates, among other factors. Because of the assumptions used to value these intangible assets, actual results over time could vary from original estimates. Impairment of service contracts and other assets is accomplished through specific identification. No impairment has been recognized by Cintas for the fiscal years ended May 31, 2010, 2009 or 2008.

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Stock-based compensation

Compensation expense is recognized for all share-based payments to employees, including stock options, in the consolidated statements of income based on the fair value of the awards that are granted. The fair value of stock options is estimated at the date of grant using the Black-Scholes option-pricing model. Measured compensation cost, net of estimated forfeitures, is recognized on a straight-line basis over the vesting period of the related share-based compensation award. See Note 12 entitled Stock-Based Compensation of "Notes to Consolidated Financial Statements" for further information.

Litigation and environmental matters

Cintas is subject to legal proceedings and claims related to environmental matters arising from the ordinary course of business. U.S. GAAP requires that a liability for contingencies be recorded when it is probable that a liability has occurred and the amount of the liability can be reasonably estimated. Significant judgment is required to determine the existence of a liability, as well as the amount to be recorded. While a significant change in assumptions and judgments could have a material impact on the amounts recorded for contingent liabilities, Cintas does not believe that they will result in a material adverse effect on the consolidated financial statements.

A detailed discussion of litigation matters is discussed in Note 13 entitled Litigation and Other Contingencies of "Notes to Consolidated Financial Statements."

Income taxes

Deferred tax assets and liabilities are determined by the differences between the consolidated financial statement carrying amounts and the tax basis of assets and liabilities. See Note 8 entitled Income Taxes of "Notes to Consolidated Financial Statements" for the types of items that give rise to significant deferred income tax assets and liabilities. Deferred income taxes are classified as assets or liabilities based on the classification of the related asset or liability for financial reporting purposes. Deferred income taxes that are not related to an asset or liability for financial reporting are classified according to the expected reversal date. Cintas regularly reviews deferred tax assets for recoverability based upon projected future taxable income and the expected timing of the reversals of existing temporary differences. As a result of this review, Cintas has not established a valuation allowance against the deferred tax assets.

Cintas is periodically reviewed by domestic and foreign tax authorities regarding the amount of taxes due. These reviews include questions regarding the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the exposure associated with various filing positions, Cintas records reserves as deemed appropriate. Based on Cintas' evaluation of current tax positions, Cintas believes its accruals are appropriate.

Item 7A. Quantitative and Qualitative Disclosure About Market Risk

Cintas manages interest rate risk by using a combination of variable and fixed rate debt and investing in marketable securities. Earnings are affected by changes in short-term interest rates due to investments in marketable securities and money market accounts and periodic issuances of commercial paper. If short-term rates changed by one-half percent (or 50 basis points), Cintas' income before income taxes would change by approximately $1.5 million. This estimated exposure considers the effects on investments and the change in the cost of variable rate debt. This analysis does not consider the effects of a change in economic activity or a change in Cintas' capital structure.

Through its foreign operations, Cintas is exposed to foreign currency risk. Foreign currency exposures arise from transactions denominated in a currency other than the functional currency and from foreign denominated revenue

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and profit translated into U.S. dollars. Foreign denominated revenue and profit represents less than 10% of Cintas' consolidated revenue and profit. Cintas periodically uses foreign currency hedges such as average rate options and forward contracts to mitigate the risk of foreign currency exchange rate movements resulting from foreign currency revenue and from international cash flows. The primary foreign currency to which Cintas is exposed is the Canadian dollar.

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Item 8. Financial Statements and Supplementary Data

Index to Consolidated Financial Statements

Audited Consolidated Financial Statements for the Fiscal Years Ended May 31, 2010, 2009 and 2008

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Management's Report on Internal Control over Financial Reporting

To the Shareholders of Cintas Corporation:

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15(d)-15(f) under the Securities Exchange Act of 1934) to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. 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. Accordingly, even an effective system of internal control over financial reporting will provide only reasonable assurance with respect to financial statement preparation.

With the supervision of our Chief Executive Officer and our Chief Financial Officer, management assessed our internal control over financial reporting as of May 31, 2010. Management based its assessment on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies and our overall control environment. This assessment is supported by testing and monitoring performed by our internal audit function.

Based on our assessment, management has concluded that our internal control over financial reporting was effective as of May 31, 2010, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States.

We reviewed the results of management's assessment with the Audit Committee of our Board of Directors. Additionally, our independent registered public accounting firm, Ernst & Young LLP, independently assessed the effectiveness of Cintas Corporation's internal control over financial reporting. Ernst & Young LLP has issued an attestation report, which is included in this Annual Report.

/s/ Scott D. Farmer
Scott D. Farmer
Chief Executive Officer
/s/ William C. Gale
William C. Gale
Senior Vice President and Chief Financial Officer

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Cintas Corporation:

We have audited Cintas Corporation's internal control over financial reporting as of May 31, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Cintas Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, Cintas Corporation maintained, in all material respects, effective internal control over financial reporting as of May 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Cintas Corporation as of May 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended May 31, 2010, of Cintas Corporation, and our report dated July 30, 2010, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Cincinnati, Ohio
July 30, 2010

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Cintas Corporation:

We have audited the accompanying consolidated balance sheets of Cintas Corporation as of May 31, 2010 and 2009, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended May 31, 2010. Our audits also included the consolidated financial statement schedule listed in the Index at Item 15(a). These consolidated financial statements and schedule are the responsibility of Cintas Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cintas Corporation at May 31, 2010 and 2009, and the consolidated results of its operations and its cash flows for each of the three years in the period ended May 31, 2010, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Cintas Corporation's internal control over financial reporting as of May 31, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated July 30, 2010, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Cincinnati, Ohio
July 30, 2010

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Consolidated Statements of Income

(In thousands except per share data)	Fiscal Years Ended May 31, 2010	2009	2008
Revenue:			
Rental uniforms and ancillary products	$ 2,569,357	$ 2,755,015	$ 2,834,568
Other services	977,982	1,019,670	1,103,332
	3,547,339	3,774,685	3,937,900
Costs and expenses:			
Cost of rental uniforms and ancillary products	1,449,576	1,562,230	1,581,618
Cost of other services	599,946	661,584	674,682
Selling and administrative expenses	1,086,359	1,082,709	1,104,145
Legal settlements, net of insurance proceeds	23,529		
Restructuring charges	(2,880)	10,209	
Impairment of long-lived assets		48,888	
Operating income	390,809	409,065	577,455
Interest income	(1,695)	(2,764)	(6,072)
Interest expense	48,612	50,236	52,823
Income before income taxes	343,892	361,593	530,704
Income taxes	128,272	135,236	195,299
Net income	$ 215,620	$ 226,357	$ 335,405
Basic earnings per share	$ 1.40	$ 1.48	$ 2.15
Diluted earnings per share	$ 1.40	$ 1.48	$ 2.15
Dividends declared and paid per share	$ 0.48	$ 0.47	$ 0.46

See accompanying notes.

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Consolidated Balance Sheets

	As of May 31,	
(In thousands except share data)	**2010**	2009
Assets		
Current assets:		
Cash and cash equivalents	$ 411,281	$ 129,745
Marketable securities	154,806	120,393
Accounts receivable, principally trade, less allowance of $14,297 and $19,532, respectively	366,301	357,678
Inventories, net	169,484	202,351
Uniforms and other rental items in service	332,106	335,447
Income taxes, current	15,691	25,512
Deferred tax asset	52,415	66,368
Prepaid expenses	13,423	17,035
Assets held for sale	9,437	15,744
Total current assets	1,524,944	1,270,273
Property and equipment, at cost, net	894,522	914,627
Goodwill	1,356,925	1,331,388
Service contracts,	103,445	124,330

net				
Other assets, net		89,900		80,333
	$	3,969,736	$	3,720,951
Liabilities and Shareholders' Equity				
Current liabilities:				
Accounts payable	$	71,747	$	69,965
Accrued compensation and related liabilities		66,924		48,414
Accrued liabilities		244,402		181,892
Long-term debt due within one year		609		598
Total current liabilities		383,682		300,869
Long-term liabilities:				
Long-term debt due after one year		785,444		786,058
Deferred income taxes		150,560		149,032
Accrued liabilities		116,021		117,583
Total long-term liabilities		1,052,025		1,052,673
Shareholders' equity:				
Preferred stock, no par value:				
100,000 shares authorized, none outstanding				
Common stock, no par value:				
425,000,000 shares authorized				
2010: 173,207,493 shares				

issued and 152,869,848 shares outstanding		
2009: 173,085,926 shares issued and 152,790,170 shares outstanding	132,058	129,215
Paid-in capital	84,616	72,364
Retained earnings	3,080,079	2,938,419
Treasury stock:		
2010: 20,337,645 shares		
2009: 20,295,756 shares	(798,857)	(797,888)
Other accumulated comprehensive income (loss):		
Foreign currency translation	42,870	33,505
Unrealized loss on derivatives	(6,997)	(8,207)
Other	287	
Unrealized (loss) gain on available-for-sale securities	(27)	1
Total shareholders' equity	2,534,029	2,367,409
	$ 3,969,736	$ 3,720,951

See accompanying notes.

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Consolidated Statements of Shareholders' Equity

(In thousands)	Common Stock Shares	Common Stock Amount	Paid-In Capital	Retained Earnings	Other Accumulated Comprehensive Income (Loss)	Treasury Stock Shares	Treasury Stock Amount	Total Shareholders' Equity
Balance at June 1, 2007	172,874	$ 120,811	$ 56,909	$ 2,533,459	$ 37,121	(14,197)	$ (580,562)	$ 2,167,738
Net income				335,405				335,405
Equity adjustment for foreign currency translation					19,391			19,391
Change in fair value of derivatives, net of $2,924 of tax					(4,915)			(4,915)
Amortization of interest rate lock agreements					521			521
Change in fair value of available-for-sale securities, net of $98 of tax					162			162
Comprehensive income, net of tax								350,564
FIN 48 adjustment				(13,731)				(13,731)
Dividends				(70,831)				(70,831)
Stock-based compensation			7,456					7,456
Stock options exercised, net of shares surrendered	209	8,371	(3,957)					4,414
Repurchase of common stock						(5,195)	(191,479)	(191,479)
Balance at May 31, 2008	173,083	129,182	60,408	2,784,302	52,280	(19,392)	(772,041)	2,254,131
Net income				226,357				226,357

Equity adjustment for foreign currency translation					(27,701)			(27,701)
Change in fair value of derivatives, net of $94 of tax					(159)			(159)
Amortization of interest rate lock agreements					767			767
Change in fair value of available-for-sale securities, net of $50 of tax					112			112
Comprehensive income, net of tax								199,376
Dividends				(72,207)				(72,207)
Stock-based compensation			11,953					11,953
Stock options exercised, net of shares surrendered	3							
Other		33	3	(33)				3
Repurchase of common stock						(904)	(25,847)	(25,847)
Balance at May 31, 2009	173,086	129,215	72,364	2,938,419	25,299	(20,296)	(797,888)	2,367,409
Net income				215,620				215,620
Equity adjustment for foreign currency translation					9,365			9,365
Change in fair value of derivatives, net of $260 of tax					443			443
Amortization of interest rate lock agreements					767			767
Change in fair value of available-for-sale securities, net of ($14) of tax benefit					(28)			(28)

Comprehensive income, net of tax								226,167
Dividends				(73,960)				(73,960)
Stock-based compensation			15,349					15,349
Vesting of stock-based compensation awards	121	2,843	(2,843)					
Other			(254)		287			33
Repurchase of common stock						(42)	(969)	(969)
Balance at May 31, 2010	173,207	$132,058	$ 84,616	$3,080,079	$ 36,133	(20,338)	$(798,857)	$ 2,534,029

See accompanying notes.

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Consolidated Statements of Cash Flows

	Fiscal Years Ended May 31,		
(In thousands)	**2010**	2009	2008
Cash flows from operating activities:			
Net income	$ 215,620	$ 226,357	$ 335,405
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	152,059	157,572	148,566
Amortization of deferred charges	41,082	42,534	43,337
Impairment of long-lived assets		48,888	
Stock-based compensation	15,349	11,953	7,456
Deferred income taxes	13,295	(1,174)	1,663
Change in current assets and liabilities, net of acquisitions of businesses:			
Accounts receivable, net	1,140	71,149	(14,939)
Inventories, net	30,293	35,136	(6,100)
Uniforms and other rental items in service	4,164	29,661	(23,854)
Prepaid expenses	3,715	(4,949)	3,830
Accounts payable	8,939	(24,560)	30,567
Accrued compensation and related liabilities	18,393	(2,012)	(12,430)
Accrued liabilities and	47,528	(28,991)	20,398

other			
Income taxes payable (receivable)	9,995	(38,042)	8,841
Net cash provided by operating activities	561,572	523,522	542,740
Cash flows from investing activities:			
Capital expenditures	(111,078)	(160,092)	(190,333)
Proceeds from sale or redemption of marketable securities	34,712	116,433	45,791
Purchase of marketable securities and investments	(81,269)	(128,402)	(54,498)
Acquisitions of businesses, net of cash acquired	(50,444)	(30,909)	(111,535)
Other	4,579	(251)	(400)
Net cash used in investing activities	(203,500)	(203,221)	(310,975)
Cash flows from financing activities:			
Proceeds from issuance of debt		7,500	295,000
Repayment of debt	(603)	(164,649)	(232,409)
Stock options exercised			8,371
Dividends paid	(73,960)	(72,207)	(70,831)
Repurchase of common stock	(969)	(25,847)	(191,479)
Other	(977)	855	(11,356)
Net cash used in financing activities	(76,509)	(254,348)	(202,704)
Effect of exchange rate changes on cash and cash equivalents	(27)	(2,432)	1,803
Net increase in cash and cash equivalents	281,536	63,521	30,864
Cash and cash equivalents at	129,745	66,224	35,360

beginning of year						
Cash and cash equivalents at end of year	$	411,281	$	129,745	$	66,224

See accompanying notes.

Notes to Consolidated Financial Statements

(Amounts in thousands except per share and share data)

1. Significant Accounting Policies

Business description. Cintas Corporation (Cintas) provides highly specialized products and services to businesses of all types primarily throughout North America and Latin America, Europe and Asia. Cintas is North America's leading provider of corporate identity uniforms through rental and sales programs, as well as a significant provider of related business services, including entrance mats, restroom cleaning services and supplies, carpet and tile cleaning services, first aid, safety and fire protection products and services, document management services and branded promotional products. Our products and services are designed to enhance our customers' images and to provide additional safety and protection in the workplace.

Cintas classifies its businesses into four operating segments. The Rental Uniforms and Ancillary Products operating segment consists of the rental and servicing of uniforms and other garments including flame resistant clothing, mats, mops and shop towels and other ancillary items. In addition to these rental items, restroom cleaning services and supplies and carpet and tile cleaning services are also provided within this operating segment. The Uniform Direct Sales operating segment consists of the direct sale of uniforms and related items and branded promotional products. The First Aid, Safety and Fire Protection Services operating segment consists of first aid, safety and fire protection products and services. The Document Management Services operating segment consists of document destruction, document imaging and document retention services.

Principles of consolidation. The consolidated financial statements include the accounts of Cintas controlled majority-owned subsidiaries and any entities over which Cintas has control (collectively, Cintas). Intercompany balances and transactions have been eliminated as appropriate.

Use of estimates. The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue recognition. Rental revenue, which is recorded in the Rental Uniforms and Ancillary Products operating segment, is recognized when services are performed. Other Services revenue, which is recorded in the Uniform Direct Sales, First Aid, Safety and Fire Protection Services and Document Management Services operating segments, is recognized when either services are performed or when products are shipped and the title and risks of ownership pass to the customer.

Cost of rental uniforms and ancillary products. Cost of rental uniforms and ancillary products consists primarily of production expenses, delivery expenses and the amortization of in service inventory, including uniforms, mats, mops, shop towels and other ancillary items. The Rental Uniforms and Ancillary Products operating segment inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs and other costs of distribution are included in the cost of rental uniforms and ancillary products.

Cost of other services. Cost of other services consists primarily of cost of goods sold (predominantly uniforms and first aid products), delivery expenses and distribution expenses. Cost of other services includes inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs and other costs of distribution.

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Selling and administrative expenses. Selling and administrative expenses consist primarily of sales labor and commissions, management and administrative labor, payroll taxes, medical expense, insurance expense, legal and professional costs and amortization of finite-lived intangible assets.

Cash and cash equivalents. Cintas considers all highly liquid investments with a maturity of three months or less, at date of purchase, to be cash equivalents.

Marketable securities. Marketable securities are comprised of fixed income securities and are classified as available-for-sale.

Accounts receivable. Accounts receivable is comprised of amounts owed through product shipments and services provided and is presented net of an allowance for doubtful accounts. The allowance is an estimate based on historical rates of collectability and allowances for specific accounts identified as uncollectible. The allowance that is an estimate based on historical rates of collectability is recorded for overdue amounts, beginning with a nominal percentage and increasing substantially as the account ages. The amount provided as the account ages will differ slightly between the Rental Uniforms and Ancillary Products operating segment and the three other operating segments because of differences in customers served and the nature of each operating segment. When an account is considered uncollectible, it is written off against the allowance.

Inventories. Inventories are valued at the lower of cost (first-in, first-out) or market. Inventory is comprised of the following amounts:

	2010	2009
Raw materials	$ 13,058	$ 12,498
Work in process	11,522	10,773
Finished goods	144,904	179,080
	$ 169,484	$ 202,351

Inventories are recorded net of reserves for obsolete inventory of $32,466 and $48,353 as of May 31, 2010 and 2009, respectively.

Uniforms and other rental items in service. These items are valued at cost less amortization, calculated using the straight-line method. Uniforms in service (other than cleanroom and flame resistant clothing) are amortized over their useful life of 18 months. Other rental items, including shop towels, mats, mops, cleanroom garments, flame resistant clothing, linens and restroom dispensers, are amortized over their useful lives which range from 8 to 48 months.

Property and equipment. Property and equipment is stated at cost, less accumulated depreciation. Depreciation is calculated using the straight-line method primarily over the following estimated useful lives, in years:

Buildings	30 to 40
Building improvements	5 to 20
Equipment	3 to 10
Leasehold improvements	2 to 15

Long-lived assets. When events or circumstances indicate that the carrying amount of long-lived assets may not be recoverable, the estimated undiscounted future cash flows are compared to the carrying amount of the assets. If the estimated undiscounted future cash flows are less than the carrying amount of the assets, an impairment loss is recorded based on the excess of the carrying amount of the assets over their respective fair values. Fair value is generally determined by discounted cash flows or based on prices of similar assets, as appropriate. Long-lived assets that are held for sale are reported at the lower of the carrying amount or the fair value, less estimated costs to sell.

Goodwill. Goodwill is separately disclosed from other intangible assets on the consolidated balance sheet and not amortized. Cintas completes an annual goodwill impairment test which includes the determination of the fair value of its reporting units. The methodology used is consistent with prior years. Based on the results of the annual impairment test, Cintas was not required to recognize an impairment of goodwill for the fiscal years ended May 31, 2010, 2009 or 2008. Cintas will continue to perform future impairment tests as of March 1 in future years or when indicators of impairment are noted.

Service contracts and other assets. Service contracts and other assets, which consist primarily of noncompete and consulting agreements obtained through acquisitions of businesses, are amortized by use of the straight-line method over the estimated lives of the agreements, which are generally 5 to 10 years.

Accrued liabilities. Current accrued liabilities are recorded when it is probable that a liability has occurred and the amount of the liability can be reasonably estimated. Current accrued liabilities include the following amounts:

	2010	2009
General insurance liabilities	$ 50,480	$ 48,090
Employee benefit related liabilities	47,754	47,072
Legal settlements	30,448	
Taxes and related liabilities	22,403	8,583
Accrued interest	20,762	20,742
Other	72,555	57,405
	$ 244,402	$ 181,892

Long-term accrued liabilities consists primarily of reserves associated with unrecognized tax benefits, which are described in more detail in Note 8 entitled Income Taxes, and retirement obligations.

Stock-based compensation. Compensation expense is recognized for all share-based payments to employees, including stock options, in the consolidated statements of income based on the fair value of the awards that are granted. The fair value of stock options is estimated at the date of grant using the Black-Scholes option-pricing model. Measured compensation cost, net of estimated forfeitures, is recognized on a straight-line basis over the vesting period of the related share-based compensation award.

Derivatives and hedging activities. Cintas formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. Derivatives are recorded at fair value on the consolidated balance sheet, and gains and losses are recorded as adjustments to earnings or other comprehensive income, as appropriate.

Other accounting pronouncements. The Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Codification (ASC) effective for financial statements issued for interim and annual periods ending after September 30, 2009. The ASC is an aggregation of previously issued authoritative GAAP in one comprehensive set of guidance organized by subject area. In accordance with the ASC, references to previously issued accounting standards have been removed. Subsequent revisions to GAAP will be incorporated into the ASC through Accounting Standards Updates (ASU). The following is a list of recent pronouncements issued by the FASB impacting Cintas.

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Effective June 1, 2009, Cintas adopted fair value measurements guidance for all nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value on a nonrecurring basis. The guidance defines fair value, establishes guidance for measuring fair value and expands disclosures regarding fair value measurements. The adoption did not have a material impact on our consolidated financial statements.

Effective June 1, 2009, Cintas adopted new guidance on business combinations, in which an entity is required to recognize assets acquired, liabilities assumed, contractual contingencies and contingent consideration at fair value on the acquisition date. It further requires that acquisition-related costs are recognized separately from the acquisition and expensed as incurred, restructuring costs generally are expensed in periods subsequent to the acquisition date, and changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period impact income tax expense. This adoption did not have a material impact on Cintas' results of operations or financial condition. Any future effects will depend upon the terms and size of future acquisitions.

Effective June 1, 2009, Cintas adopted new guidance for determining whether instruments granted in share-based payment transactions are participating securities. This guidance provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method of determining earnings per share. The adoption did not have a material impact on basic or diluted earnings per share.

Effective June 1, 2009, Cintas adopted new guidance on subsequent events. The objective of this guidance is to establish general standards of accounting for and disclosure of events that occur after the consolidated balance sheet date but before the consolidated financial statements are issued or are available to be issued. This adoption did not have a material impact on Cintas' results of operations or financial condition.

2. Restructuring and Related Activity

Due to the declining economic conditions which negatively impacted the North American economy and Cintas' businesses, during the fourth quarter of fiscal 2009, management initiated certain restructuring activities to eliminate excess capacity and reduce our cost structure. These activities included closing or converting to branches 16 of our rental processing plants and reducing our workforce by 1,200 employees. We have substantially completed these restructuring activities as of May 31, 2010.

During the fourth quarter of fiscal 2009, Cintas recorded charges of $48,888 in long-lived asset impairment costs, $7,937 in employee termination costs and $2,272 in other exit costs for a total of $59,097 incurred as a result of this restructuring. These charges by operating segment are detailed in Note 14 entitled Operating Segment Information.

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A progression of our restructuring liability balance, primarily recorded in accrued compensation and related liabilities is as follows:

	Employee Termination Costs	Other Exit Costs	Total
Balance as of June 1, 2009	$ 5,915	$ 2,272	$ 8,187
Cash paid fiscal 2010	(3,785)	(297)	(4,082)
Change in estimate	(1,380)	(1,500)	(2,880)
Balance as of May 31, 2010	$ 750	$ 475	$ 1,225

The change in estimate represents the difference between severance and other exit costs estimated based on the information available in fiscal 2009 and severance and other exit costs actually paid in fiscal 2010.

The fiscal 2009 charge of $48,888 in long-lived asset impairment costs included $25,849 in land and buildings of which $10,930 related to assets held for sale, $18,221 in equipment and $4,818 in long-lived other assets. The fair value was determined primarily by using market quoted prices and other prices quoted for similar assets and discounted cash flow models.

Certain assets totaling $9,437 and $15,744 are categorized at May 31, 2010 and 2009, respectively, as assets held for sale at the lower of their carrying value or fair value less cost to sell. These assets are in the Rental Uniform and Ancillary Products operating segment and are comprised of $3,077 and $6,268 of land at May 31, 2010 and 2009, respectively and $6,360 and $9,476 of buildings and improvements at May 31, 2010 and 2009, respectively.

3. Fair Value Measurements

FASB ASC defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. It also establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Cintas' assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

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All financial instruments that are measured at fair value on a recurring basis (at least annually) have been segregated into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value at the consolidated balance sheet date. These financial instruments measured at fair value on a recurring basis are summarized below:

As of May 31, 2010

	Level 1	Level 2				
Basic and diluted	702,135	662,424	604,990		189,510	117,401
Other Financial Information:(2)						
Adjusted EBITDA	$ 751,493	$ 557,807	$ 300,896	$	75,430	$ 21,164
Non-GAAP net income (loss)	$ 405,996	$ 276,629	$ 101,071	$	(34,330)	$ (35,191)

(1) Costs and expenses include stock-based compensation expense as follows:

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(In thousands)				
Cost of revenue	$ 29,502	$ 40,705	$ 50,536	$ 50,942	$ 800
Research and development	335,498	401,537	360,726	379,913	12,622
Sales and marketing	160,935	156,904	157,263	114,440	1,346
General and administrative	89,298	82,972	63,072	55,072	10,973
Total stock-based compensation	$ 615,233	$ 682,118	$ 631,597	$ 600,367	$ 25,741

(2) See the section titled "Non-GAAP Financial Measures" below for additional information and a reconciliation of net loss to Adjusted EBITDA and net loss to non-GAAP net income (loss).

	As of December 31,				
	2016	2015	2014	2013	2012
	(In thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$988,598	$911,471	$1,510,724	$841,010	$203,328
Short-term investments	2,785,981	2,583,877	2,111,154	1,393,044	221,528
Working capital	4,068,175	3,875,753	3,862,059	2,349,249	444,587
Property and equipment, net	783,901	735,299	557,019	332,662	185,574
Total assets	6,870,365	6,442,439	5,583,082	3,366,240	831,568
Convertible notes	1,538,967	1,455,095	1,376,020	—	—
Total liabilities	2,265,430	2,074,392	1,956,679	416,234	207,204
Redeemable convertible preferred stock	—	—	—	—	37,106
Convertible preferred stock	—	—	—	—	835,430
Total stockholders' equity (deficit)	4,604,935	4,368,047	3,626,403	2,950,006	(248,172)

Non-GAAP Financial Measures

To supplement our consolidated financial statements presented in accordance with generally accepted accounting principles in the United States, or GAAP, we consider certain financial measures that are not prepared in accordance with GAAP, including Adjusted EBITDA, Adjusted EBITDA margin, non-GAAP net income (loss), revenue on a constant currency basis and advertising revenue on a constant currency basis. These non-GAAP financial measures are not based on any standardized methodology prescribed by GAAP and are not necessarily comparable to similarly-titled measures presented by other companies.

Adjusted EBITDA

We define Adjusted EBITDA as net loss adjusted to exclude stock-based compensation expense, depreciation and amortization expense, interest and other expenses, provision (benefit) for income taxes and restructuring charges, if any. Adjusted EBITDA margin is calculated by dividing Adjusted EBITDA by revenue.

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

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(In thousands)				
Reconciliation of Net Loss to Adjusted EBITDA					
Net loss	$(456,873)	$(521,031)	$(577,820)	$(645,323)	$(79,399)
Stock-based compensation expense	615,233	682,118	631,597	600,367	25,741
Depreciation and amortization expense	402,172	312,823	208,165	110,894	72,506
Interest and other expense, net	73,626	83,269	39,485	11,315	2,087

Provision (benefit) for income taxes	16,039	(12,274)	(531)	(1,823)	229
Restructuring charges	101,296	12,902	—	—	—
Adjusted EBITDA	$751,493	$557,807	$300,896	$75,430	$21,164

Non-GAAP Net Income (Loss)

We define non-GAAP net income (loss) as net loss adjusted to exclude stock-based compensation expense, amortization of acquired intangible assets, non-cash interest expense related to our convertible notes, non-cash expense related to acquisitions, income tax effects related to acquisitions, and restructuring charges.

The following table presents a reconciliation of net loss to non-GAAP net income (loss) for each of the periods indicated:

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(In thousands)				
Reconciliation of Net Loss to Non-GAAP Net Income (Loss)					
Net loss	$(456,873)	$(521,031)	$(577,820)	$(645,323)	$(79,399)
Stock-based compensation expense	615,233	682,118	631,597	600,367	25,741
Amortization of acquired intangible assets	69,338	54,659	36,563	16,530	18,687
Non-cash interest expense related to convertible notes	74,660	69,185	18,823	—	—
Non-cash expense related to acquisition	—	926	—	—	—
Income tax effects related to acquisitions	2,342	(22,130)	(8,092)	(5,904)	(220)
Restructuring charges	101,296	12,902	—	—	—
Non-GAAP net income (loss)	$405,996	$276,629	$101,071	$(34,330)	$(35,191)

We use the non-GAAP financial measures of Adjusted EBITDA, Adjusted EBITDA margin and non-GAAP net income (loss) in evaluating our operating results and for financial and operational decision-making purposes. We believe that Adjusted EBITDA, Adjusted EBITDA margin and non-GAAP net income (loss) help identify underlying trends in our business that could otherwise be masked by the effect of the expenses that we exclude in Adjusted EBITDA and non-GAAP net income (loss). We believe that Adjusted EBITDA, Adjusted EBITDA margin and non-GAAP net income (loss) provide useful information about our operating results, enhance the overall understanding of our past performance and future prospects and allow for greater transparency with respect to key metrics used by our management in its financial and operational decision-making. We also use these measures to establish budgets and operational goals for managing our business and evaluating our performance.

These non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. There are a number of limitations related to the use of these non-GAAP financial measures rather than net loss, which is the nearest GAAP equivalent of these financial measures. Some of these limitations are:

- These non-GAAP financial measures exclude restructuring charges and certain recurring, non-cash charges such as stock-based compensation expense, amortization of acquired intangible assets and non-cash interest expense related to convertible notes;
- Stock-based compensation expense has been, and will continue to be for the foreseeable future, a significant recurring expense in our business and an important part of our compensation strategy;
- Adjusted EBITDA does not reflect tax payments that reduce cash available to us;
- Adjusted EBITDA excludes depreciation and amortization expense and, although these are non-cash charges, the property and equipment being depreciated and amortized may have to be replaced in the future; and
- The expenses that we exclude in our calculation of these non-GAAP financial measures may differ from the expenses, if any, that our peer companies may exclude from similarly-titled non-GAAP measures when they report their results of operations.

We have attempted to compensate for these limitations by providing the nearest GAAP equivalents of these non-GAAP financial measures and describing these GAAP equivalents under the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations.”

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes thereto included in Item 8 "Financial Statements and Supplemental Data" in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below and those discussed in the section titled "Risk Factors" included elsewhere in this Annual Report on Form 10-K.

Certain revenue information in the section entitled "—Revenue" is presented on a constant currency basis. This information is a non-GAAP financial measure. To calculate revenue on a constant currency basis, we translated revenue for the full year 2016 using 2015 monthly exchange rates for our settlement currencies other than the U.S. dollar. This non-GAAP financial measure is not intended to be considered in isolation or as a substitute for, or superior to, financial information prepared and presented in accordance with GAAP. This measure may be different from non-GAAP financial measures used by other companies, limiting its usefulness for comparison purposes. Moreover, presentation of revenue on a constant currency basis is provided for year-over-year comparison purposes, and investors should be cautioned that the effect of changing foreign currency exchange rates has an actual effect on our operating results. We believe this non-GAAP financial measure provides investors with useful supplemental information about the financial performance of our business, enable comparison of financial results between periods where certain items may vary independent of business performance, and allows for greater transparency with respect to key metrics used by management in operating our business.

FY 2016 Overview and Highlights

Total revenue was $2.53 billion, an increase of 14% compared to 2015.

- Advertising revenue totaled $2.25 billion, an increase of 13% compared to 2015.
- Mobile advertising revenue was 89% of total advertising revenue
- Data licensing and other revenue totaled $281.6 million, an increase of 26% compared to 2015.
- U.S. revenue totaled $1.56 billion, an increase of 8% compared to 2015.
- International revenue totaled $964.8 million, an increase of 25% compared to 2015.
- Total ad engagements were up 152% year-over-year.
- Cost per engagement was down 55% year-over-year.

Net loss was $456.9 million and adjusted EBITDA was $751.5 million, resulting in an adjusted EBITDA margin of 30%, an increase of 5% compared to 2015.

Cash, cash equivalents and short-term investments in marketable securities totaled $3.77 billion as of December 31, 2016.

Average monthly active users (MAUs) were 319 million for the three months ended December 31, 2016, up 4% compared to the three months ended December 31, 2015 (SMS Fast Followers have been excluded from total reported MAUs for the three months ended December 31, 2015 to enable a direct period-to-period comparison). In the three months ended December 31, 2016, approximately 80% of our average MAUs accessed Twitter from a mobile device, roughly stable from the three months ended December 31, 2015.

Average daily active usage (DAU) for the three months ended December 31, 2016 grew 11% year-over-year.

Key Metrics

We review a number of metrics, including the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate business plans and make strategic decisions.

Monthly Active Users (MAUs). We define MAUs as Twitter users who logged in or were otherwise authenticated and accessed Twitter through our website, mobile website, desktop or mobile applications, SMS or registered third-party applications or websites in the 30-day period ending on the date of measurement. Average MAUs for a period represent the average of the MAUs at the end of each month during the period. MAUs are a measure of the size of our logged in or otherwise authenticated active user base. In the three months ended December 31, 2016, we had 319 million average MAUs, which represents an increase of 4% from the three months ended December 31, 2015. The growth in average MAUs was driven primarily by product improvements and organic growth, as well as marketing initiatives. In the three months ended December 31, 2016, we had 67 million average MAUs in the United States and 252 million average MAUs in the rest of the world, which represent increases of 3% and 5%, respectively, from the three months ended December 31, 2015. For additional information on how we calculate MAUs and factors that can affect this metric, see the section titled "Note Regarding Key Metrics."

Changes in Daily Active Users/Daily Active Usage (DAU). We define daily active users or daily active usage as Twitter users who logged in or were otherwise authenticated and accessed Twitter through our website, mobile website or mobile applications on any given day. Average DAU for a period represent the average of the DAU at the end of such period. Changes in DAU are a measure of changes in the size of our daily logged in or otherwise authenticated active user base. Prior to reporting results for the third quarter of 2016, we had discussed DAUs and the ratio of monthly active users (MAUs) to DAUs. In those instances, for comparability and consistency with MAUs, DAUs also included users who accessed Twitter through our desktop applications and third-party properties. For additional information on how we calculate changes in DAUs and factors that can affect this metric, see the section titled "Note Regarding Key Metrics."

Changes in Ad Engagements and Cost Per Ad Engagement. We define an ad engagement as a user interaction with one of our pay-for-performance advertising products. Ad engagements with our advertising products are based on a user completing an objective set out by an advertiser such as expanding, Retweeting, liking or replying to a Promoted Tweet, viewing an embedded video, downloading or engaging with a promoted mobile application, clicking on a website link, signing up for marketing emails from advertisers, following the account that tweets a Promoted Tweet, or completing a transaction on an external website. We believe changes in ad engagements is one way to measure user engagement with our advertising products. We believe changes in cost per ad engagement is one way to measure demand.

In the three months ended December 31, 2016, ad engagements increased 151% from the three months ended December 31, 2015. The increase was primarily driven by growth in video ad engagements and ad engagements on third-party publishers' websites, applications and other offerings, and stronger advertiser demand for our advertising products in the fourth quarter of 2016 compared to the fourth quarter of 2015. In the three months ended December 31, 2016, average cost per ad engagement decreased 60% from the three months ended December 31, 2015. The decrease in cost per ad engagement was primarily driven by a mix shift to auto-play video and decreases in same-format prices for most of our advertising products.

Factors Affecting Our Future Performance

User Growth and Monetization. User growth trends reflected in the number of MAUs, changes in DAUs and monetization trends reflected in advertising engagements are key factors that affect our revenue. As our user base and the level of engagement of our users grow, we believe the potential to increase our revenue grows, although we expect revenue growth to continue to significantly lag audience growth in, and possibly beyond, 2017 due to lead time for sales cycles, continued increased competition and the impact from revenue products that we have or may decide to de-emphasize as we did with our TellApart offering (as described in more detail below). Based on the competitive factors and marketplace challenges in our ability to attract demand from advertisers, which has intensified in the first quarter of 2017, we expect a downturn in our revenue on a year-over-year basis.

User Growth. We have generally experienced growth in our number of users over the last several years. In general, a higher proportion of Internet users in the United States use Twitter than Internet users in other countries. Accordingly, in the future we expect our user growth rate in certain international markets, such as Canada, France, Germany, India, Japan, Mexico, the Philippines, Saudi Arabia, and South Korea, to continue to be higher than our user growth rate in the United States. However, we expect to face challenges in entering some markets, such as China, where access to Twitter is blocked, as well as certain other countries that have intermittently restricted access to Twitter. Restrictions or limitations on access to Twitter may adversely impact our ability to increase the size of our user base and generate additional revenue in certain markets.

We do not separately track whether an MAU has only used Twitter on a desktop or on a mobile device. However, in the three months ended December 31, 2016, approximately 80% of our average MAUs accessed Twitter from a mobile device, roughly stable from the three months ended December 31, 2015.

We may face challenges in increasing the size of our user base, including, among others, competition from alternative products and services, a decline in the number of influential users on Twitter or a perceived decline in the quality of content or user experience available on Twitter. We intend to drive growth in our user base by building and shipping product changes more rapidly to make Twitter safer and investing in our core use case and in new product areas — such as live streaming video, among others — that further strengthen our unique position as the best and fastest place to see and talk about what’s happening in the world. Our user growth rate has slowed over time, and it may continue to slow or decline. To the extent our logged-in user growth or user growth rate continues to slow or the absolute number of logged in users declines, our revenue growth will become increasingly dependent on our ability to increase levels of user engagement on Twitter and monetizing our total audience on logged-out usage and syndicated properties as well as increasing revenue growth from third party publishers’ websites, applications and other offerings.

Monetization. There are many variables that impact the monetization of our platform, such as the number of MAUs, our users’ level of engagement with our platform, ad load (which is a function of the amount of advertising we choose to display), our users’ engagement with our Promoted Products, advertiser demand and cost per ad engagement. Generally, we design our algorithms for our pay-for-performance Promoted Products on Twitter to optimize the overall user experience and the value we deliver to advertisers. We expect advertising revenue growth to continue to significantly lag audience growth in, and possibly beyond, 2017. Advertising revenue growth may be further impacted by escalating competition for digital ad spending and the reevaluation of our revenue product feature portfolio, which could result in the de-emphasis of certain product features. Furthermore, we may see a continuing decline in the number of advertisers on a year-over-year basis, which may also impact overall demand for our ads products. We have, and may in the future, increase ad load to the extent that we are able to continue to reach the right balance of advertiser value and the overall user experience. In order to improve monetization, we plan to increase the value of our advertising services by continuing to increase the size and engagement of our user base as well as improve our ability to target advertising to our users’ interests and the ability of our advertisers to optimize their campaigns and measure the results of their campaigns.

Although the majority of the Promoted Products we sell to our advertisers are placed on Twitter, we have augmented our advertising revenue by selling to advertisers our advertising products that we place on third-party publishers' websites, applications or other offerings. For the latter category of advertising placements, we incur additional costs, particularly traffic acquisition costs, to fulfill our services to advertisers. This mix shift of additional advertising revenue being generated from such third-party placements may continue in the future. As we have chosen to decrease our investment in the product, we have seen a declining trend in revenue from our TellApart offering and expect contributions from our advertising products that we place on third-party publishers' websites and applications to face significant headwinds in 2017 from factors impacting our TellApart offering. In 2017, we expect an even steeper decline in contribution to revenue directly from our TellApart offering.

We intend to continue to increase the monetization of our platform by improving the targeting capabilities of our advertising services to enhance the value of our Promoted Products for advertisers, delivering differentiated products to advertisers, and developing new ad formats for advertisers.

Effectiveness of Our Advertising Services. Advertisers can use Twitter to communicate directly with their followers for free, but many choose to purchase our advertising services to reach a broader audience and further promote their brands, products and services. We believe that increasing the effectiveness of our Promoted Products for advertisers, as well as providing better measurement tools and improving creative capabilities, will increase the amount that advertisers spend with us. We aim to increase the value of our Promoted Products by increasing the size and engagement of our user base, improving our ability to target advertising to our users' interests and improving the ability of our advertisers to optimize their campaigns and measure the results of their campaigns. We may also develop new advertising products and services.

Investment in International Operations. We intend to strategically invest in our international operations in order to expand our user base and advertiser base and increase user engagement and monetization internationally. In the three months ended December 31, 2016, we had 252 million average MAUs internationally compared to 67 million average MAUs in the United States. In addition, our number of users is growing at a faster rate in many international markets, such as Canada, France, Germany India, Japan, Mexico, the Philippines, Saudi Arabia, and South Korea. However, we derive the majority of our advertising revenue from advertisers in the United States.

We face challenges in increasing our advertising revenue internationally, including local competition, differences in advertiser demand, differences in the digital advertising market and conventions, and differences in the manner in which Twitter is accessed and used internationally. We face competition from well-established competitors in certain international markets. In addition, certain international markets are not as familiar with digital advertising in general, or with new forms of digital advertising, such as our Promoted Products. In these jurisdictions we are investing to educate advertisers about the benefits of our advertising services. However, we expect that it may require a significant investment of time and resources to educate advertisers in many international markets. We also face challenges in providing certain advertising products, features or analytics in certain international markets, such as the European Union, due to government regulation. In addition, in certain emerging markets, a significant portion of users still access Twitter through feature phones with limited functionality, rather than through smartphones, our website or desktop applications. This limits our ability to deliver certain features to these users and may limit the ability of advertisers to deliver compelling ads to users in these markets.

Competition. We face increasing competition for users and advertisers. We compete against many companies to attract and engage users and for advertiser spend, including companies with greater financial resources and substantially larger user bases which offer a variety of Internet and mobile device-based products, services and content. In recent years there has been a significant number of acquisitions and consolidation activity by and among our actual and potential competitors. We must compete effectively for users and advertisers in order to grow our business and increase our revenue. We believe that our ability to compete effectively for users depends upon a number of factors, including the quality of our products and services and the actual or perceived return our advertisers receive on their investment in our products and services. Our ability to compete effectively for advertisers also depends upon a number of factors, including our ability to offer attractive advertising products with unique targeting capabilities and the size of our active user base. We have seen escalating competition for digital ad spending and expect this trend to continue. In addition, many advertisers, particularly branded advertisers use marketing mix analyses to determine how to allocate their advertising budgets on an annual or bi-annual basis. As a result, we need to demonstrate to those advertisers during the appropriate time period that we provide a better return on investment than our competitors do in order to secure, increase or sustain our share of the advertising budget allocated for a significant portion of the year until the next budget cycle. We intend to continue to invest in research and development to improve our products and services for users and advertisers and to grow our active user base in order to address the competitive challenges in our industry. As part of our strategy to improve our products and services, we may acquire other companies to add engineering talent or complementary products and technologies.

Investment in Infrastructure. We strive to optimize the capacity and enhance the capability and reliability of our infrastructure. Our infrastructure is critical to providing users, platform partners, advertisers and data partners access to our platform, particularly during major planned and unplanned events, such as elections, sporting events or natural disasters, when activity on our platform increases dramatically. As our user base and the activity on our platform grow, we expect that investments and expenses associated with our infrastructure will continue to grow. These investments and expenses include the expansion of our data center operations and related operating costs, additional servers and networking equipment to increase the capacity of our infrastructure and increased bandwidth costs.

Products and Services Innovation. Our ability to increase the size and engagement of our user base, attract advertisers and increase our revenue will depend, in part, on our ability to improve existing products and services and to successfully develop or acquire new products and services. We plan to continue to make significant investments in research and development and, from time to time, we may acquire companies to enhance our products, services and technical capabilities.

Investment in Talent. We intend to invest in hiring key roles and retaining talented employees to grow our business. In October 2016, we implemented a reduction in force and have also seen high levels of attrition, and as a result, need to focus on hiring and employee retention to be successful. We have also made, and intend to continue to make, acquisitions that add engineers, designers, product managers and other personnel with specific technology expertise. In addition, we must retain our high-performing personnel in order to continue to develop, sell and market our products and services and manage our business.

Seasonality. Advertising spending is traditionally strongest in the fourth quarter of each year. Historically, this seasonality in advertising spending has affected our quarterly results, with higher sequential advertising revenue growth from the third quarter to the fourth quarter compared to sequential advertising revenue growth from the fourth quarter to the subsequent first quarter. For example, our advertising revenue increased 35%, 25% and 17% between the third and fourth quarters of 2014, 2015 and 2016, respectively, while advertising revenue for the first quarter of 2015 and 2016 decreased 10% and 17% compared to the fourth quarter of 2014 and 2015, respectively. The growth in our business may have partially masked seasonality to date and the seasonal impacts may be more pronounced in the future.

Stock-Based Compensation Expense. We have historically utilized, and intend to continue to utilize, various forms of stock-based awards in order to hire and retain talented employees. During the twelve months ended December 31, 2016 and 2015, we recognized $615.2 million and $682.1 million of expense related to stock-based compensation, respectively. As of December 31, 2016, we had unrecognized stock-based compensation expense of approximately $844.0 million related to outstanding equity awards, after giving effect to estimated forfeitures, which we expect to recognize over a weighted-average period of approximately two years. The stock-based compensation expenses related to our outstanding equity awards have a significant impact on our ability to generate net income on a GAAP basis in future periods. We continued to make progress in reducing our annual stock-based compensation expense on both an absolute basis and as a percentage of revenue. We remain committed to reducing stock-based compensation to high single digits as a percentage of revenue over time, bringing us more in line with our peers.

Results of Operations

The following tables set forth our consolidated statement of operations data for each of the periods presented:

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Revenue			
Advertising services	$2,248,052	$1,994,036	$1,255,688
Data licensing and other	281,567	223,996	147,314
Total Revenue	2,529,619	2,218,032	1,403,002
Costs and expenses (1)			
Cost of revenue	932,240	729,256	446,309
Research and development	713,482	806,648	691,543

Sales and marketing	957,829	871,491	614,110
General and administrative	293,276	260,673	189,906
Total costs and expenses	2,896,827	2,668,068	1,941,868
Loss from operations	(367,208)	(450,036)	(538,866)
Interest expense	(99,968)	(98,178)	(35,918)
Other income (expense), net	26,342	14,909	(3,567)
Loss before income taxes	(440,834)	(533,305)	(578,351)
Provision (benefit) for income taxes	16,039	(12,274)	(531)
Net loss	$(456,873)	$(521,031)	$(577,820)

(1) Costs and expenses include stock-based compensation expense as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Cost of revenue	$29,502	$40,705	$50,536
Research and development	335,498	401,537	360,726
Sales and marketing	160,935	156,904	157,263
General and administrative	89,298	82,972	63,072
Total stock-based compensation expense	$615,233	$682,118	$631,597

The following table sets forth our consolidated statement of operations data for each of the periods presented as a percentage of revenue:

	Year Ended December 31,		
	2016	2015	2014
Revenue			
Advertising services	89 %	90 %	90 %
Data licensing and other	11	10	10
Total Revenue	100	100	100
Costs and expenses			
Cost of revenue	37	33	32
Research and development	28	36	49
Sales and marketing	38	39	44
General and administrative	12	12	14
Total costs and expenses	115	120	138
Loss from operations	(15)	(20)	(38)
Interest expense	(4)	(4)	(3)
Other income (expense), net	1	1	(0)
Loss before income taxes	(17)	(24)	(41)
Provision (benefit) for income taxes	1	(1)	(0)
Net loss	(18)%	(23)%	(41)%

Years Ended December 31, 2016, 2015 and 2014

Revenue

We generate the substantial majority of our revenue from the sale of advertising services. We also generate revenue by licensing our data to third parties and providing mobile advertising exchange services.

Advertising Services

We generate most of our advertising revenue by selling our Promoted Products. Currently, our Promoted Products consist of the following:

- Promoted Tweets. Promoted Tweets, which are labeled as "promoted," appear within a user's timeline, search results or profile pages just like an ordinary Tweet regardless of device, whether it be desktop or mobile. Using our proprietary algorithms and understanding of the interests of each user, we can deliver Promoted Tweets that are intended to be relevant to a particular user. We enable our advertisers to target an audience based on our users' Interest Graphs. Our Promoted Tweets are pay-for-performance advertising that is priced through an auction. Our Promoted Tweets include objective-based features that allow advertisers to pay only for the types of engagement selected by the advertisers, such as Tweet engagements (e.g., Retweets, replies and likes), website clicks or conversions, mobile application installs or engagements, obtaining new followers, or video views.

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- Promoted Accounts. Promoted Accounts, which are labeled as “promoted,” provide a way for our advertisers to grow a community of users who are interested in their business, products or services. Our Promoted Accounts are pay-for-performance advertising that is priced through an auction.
- Promoted Trends. Promoted Trends, which are labeled as “promoted,” appear at the top of the list of trending topics for an entire day in a particular country or on a global basis. We sell our Promoted Trends on a fixed-fee-per-day basis.

While the majority of the Promoted Products we sell to our advertisers are placed on Twitter, we also generate advertising revenue by placing advertising products that we sell to advertisers on third-party publishers’ websites, applications or other offerings.

Data Licensing and Other

We generate data licensing and other revenue by (i) offering data products and data licenses that allow our data partners to access, search and analyze historical and real-time data on our platform, which data consists of public Tweets and their content, and (ii) providing mobile advertising exchange services through our MoPub exchange. Our data partners generally purchase licenses to access all or a portion of our data for a fixed period. We recognize data licensing revenue as the licensed data is made available to our data partners. In addition, we operate a mobile ad exchange and receive service fees from transactions completed on the exchange. Our mobile ad exchange enables buyers and sellers to purchase and sell advertising inventory and matches buyers and sellers. We have determined we are not the principal in the purchase and sale of advertising inventory in transactions between third party buyers and sellers on the exchange. Therefore we report revenue related to our ad exchange services on a net basis.

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands)				
Advertising services	$2,248,052	$1,994,036	$1,255,688	13 %	59 %
Data licensing and other	281,567	223,996	147,314	26 %	52 %
Total Revenue	$2,529,619	$2,218,032	$1,403,002	14 %	58 %

2016 Compared to 2015. Revenue in 2016 increased by $311.6 million compared to 2015. On a constant currency basis, revenue in 2016, using the prior year’s monthly exchange rates for our settlement currencies other than the U.S. dollar, would have increased by $318.6 million or 14% compared to 2015.

In 2016, advertising revenue increased by 13% compared to 2015. Foreign exchange effect did not have a material impact on advertising revenue in 2016. The substantial majority of our advertising revenue was generated from our owned and operated platform. Advertising revenue generated from the sale of our advertising products on our owned and operated platform in 2016 was $1.99 billion as compared to $1.80 billion in 2015. Advertising revenue generated from the sale of our advertising products placed on third party publishers’ websites, applications and other offerings in 2016 was $260.2 million as compared to $194.2 million in 2015, which increase was driven, in part, by the acquisition of TellApart in May 2015 and from the growth of sales in our organically-built advertising network, Twitter Audience Platform. The overall increase in advertising revenue was primarily attributable to a 152% increase in the number of ad engagements offset by a 55% decrease in average cost per ad engagement in 2016 compared to 2015. The increase in ad engagements was driven by continued adoption of auto-play video and an increase in ad load. The decrease in average cost per ad engagement was due primarily to the shift to auto-play video, which delivers more engagement at a much lower average cost per engagement than click-to-play video ads and decreases in same-format prices for most of our other advertising products. Advertising revenue continued to be driven by growth in demand for our advertising products, particularly video as well as growth in our advertising base. Strength from our video ad format, however, was offset by year-over-year declines in revenue generated from our traditional Promoted Tweet ad format. We expect contributions from our advertising products that we place on third-party publishers' websites and applications to face significant headwinds in 2017 from factors impacting our TellApart offering.

In 2016, data licensing and other revenue increased by 26% compared to 2015. The increase was primarily attributable to growth in mobile advertising exchange services and to a lesser extent an increase in data licensing fees from the offering of data products.

2015 Compared to 2014. Revenue in 2015 increased by $815.0 million compared to 2014. On a constant currency basis, revenue in 2015, using the prior year's monthly exchange rates for our settlement currencies other than the U.S. dollar, would have increased by $896.7 million or 64% compared to 2014.

In 2015, advertising revenue increased by 59% compared to 2014. On a constant currency basis, advertising revenue in 2015, using the prior year's monthly exchange rates for our settlement currencies other than the U.S. dollar, would have increased 65% compared to 2014. The substantial majority of our advertising revenue was generated from our owned and operated platform. Advertising revenue generated from the sale of our advertising products on our owned and operated platform in 2015 was $1.80 billion as compared to $1.24 billion in 2014. Advertising revenue generated from the sale of our advertising products placed on third party publishers' websites, applications and other offerings in 2015 was $194.2 million as compared to $11.4 million in 2014, which increase was driven, in part, by the acquisition of TellApart. The overall increase in advertising revenue was primarily attributable to a 107% increase in the number of ad engagements offset by a 23% decrease in average cost per ad engagement in 2015 compared to 2014. The increase in ad engagements was primarily the result of our move to auto-play video in late 2015, as well as growth in our advertising revenue generated from third party publishers' websites, applications and other offerings, and an increase in ad load. The decrease in average cost per ad engagement was due primarily to the shift to auto-play video, which delivers more engagement at a much lower average cost per engagement than click-to-play video ads. Advertising revenue continued to be driven by growth in demand for our advertising products, particularly video and website card formats as well as growth in our advertising base.

In 2015, data licensing and other revenue increased by 52% compared to 2014. The increase was primarily attributable to growth in mobile advertising exchange services as well as the increase in data licensing fees from the offering of data products for a full year in 2015 as compared to the partial year in 2014.

Cost of Revenue

Cost of revenue includes infrastructure costs, other direct costs including content costs, amortization of acquired intangible assets and capitalized labor costs, allocated facilities costs, as well as traffic acquisition costs, or TAC. Infrastructure costs consist primarily of data center costs related to our co-located facilities, which include lease and hosting costs, related support and maintenance costs and energy and bandwidth costs; as well as depreciation of our servers and networking equipment; and personnel-related costs, including salaries, benefits and stock-based compensation, for our operations teams. TAC consists of costs we incur with third parties in connection with the sale to advertisers of our advertising products that we place on third-party publishers' websites, applications or other offerings collectively resulting from acquisitions, and from our organically-built advertising network, Twitter Audience Platform. Many of the elements of our cost of revenue are fixed, and cannot be reduced in the near term to offset any decline in our revenue.

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands)				
Cost of revenue	$932,240	$729,256	$446,309	28 %	63 %
Cost of revenue as a percentage of revenue	37 %	33 %	32 %		

2016 Compared to 2015. In 2016, cost of revenue, which included TAC of $141.6 million, increased by $203.0 million compared to 2015. The increase was primarily attributable to a $63.4 million increase in networking, hosting and data center costs related to our co-located facilities, a $54.6 million increase in depreciation expense related to additional server and networking equipment and amortization of acquired intangible assets, a $47.9 million increase in restructuring expenses as a result of lease write-offs, a $40.0 million increase in other direct costs, and a $19.7 million increase in TAC. The increases were offset by a $22.6 million decrease in personnel-related costs, mainly driven by a decrease in average employee headcount and compensation expense.

2015 Compared to 2014. In 2015, cost of revenue, which included TAC of $121.8 million, increased by $282.9 million compared to 2014. The increase was primarily attributable to a $113.7 million increase in TAC, a $79.5 million increase in networking, hosting and data center costs related to our co-located facilities, a $76.3 million increase in depreciation expense related to additional server and networking equipment and amortization of acquired intangible assets, and a $24.1 million increase in other direct costs, offset by a $10.7 million decrease in personnel-related costs, mainly driven by a decrease in average employee headcount and stock-based compensation expense.

We plan to continue to scale the capacity and enhance the capability and reliability of our infrastructure to support user growth and increased activity on our platform. We expect that the amount of revenue generated from the sale of our advertising services on third party publishers' websites, applications and other offerings will vary, which will also result in variability in the amount of TAC that we incur. As a result, we expect that cost of revenue, in particular TAC, will vary in absolute dollar amounts for the foreseeable future and vary in the near term from period to period as a percentage of revenue.

Research and Development

Research and development expenses consist primarily of personnel-related costs, including salaries, benefits and stock-based compensation, for our engineers and other employees engaged in the research and development of our products and services. In addition, research and development expenses include amortization of acquired intangible assets, allocated facilities and other supporting overhead costs.

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands)				
Research and development	$713,482	$806,648	$691,543	(12)%	17 %
Research and development as a percentage of revenue	28 %	36 %	49 %		

2016 Compared to 2015. In 2016, research and development expenses decreased by $93.2 million compared to 2015. The decrease was primarily attributable to a $69.1 million decrease in personnel-related costs, mainly driven by a decrease in compensation expense from a decrease in average employee headcount, a $42.7 million increase in the capitalization of costs associated with developing software for internal use due primarily to an increase in the number of projects as we refine our core services, and a $2.5 million decrease in other expenses. The decreases were offset by a $9.1 million increase in allocated facilities and other supporting overhead expenses, a $7.2 million increase in restructuring expenses and a $4.8 million increase in depreciation expense.

2015 Compared to 2014. In 2015, research and development expenses increased by $115.1 million compared to 2014. The increase was primarily attributable to an $87.0 million increase in personnel-related costs, mainly driven by an increase in compensation and recognition of stock-based compensation expense, and a $41.4 million increase in allocated facilities and other supporting overhead expenses due to the continued expansion of our real estate footprint and increase in support functions. These increases were partially offset by a $13.3 million increase in the capitalization of costs associated with developing software for internal use.

We plan to continue to invest in key areas of our business and ensure that we have the right level of engineering, product management and design teams to support our research and development efforts. We expect that research and development costs will vary in the near term from period to period as a percentage of revenue.

Sales and Marketing

Sales and marketing expenses consist primarily of personnel-related costs, including salaries, commissions, benefits and stock-based compensation for our employees engaged in sales, sales support, business development and media, marketing, corporate communications and customer service functions. In addition, marketing and sales-related expenses also include advertising costs, market research, tradeshows, branding, marketing, public relations costs, amortization of acquired intangible assets, as well as allocated facilities and other supporting overhead costs.

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands)				
Sales and marketing	$957,829	$871,491	$614,110	10 %	42 %
Sales and marketing as a percentage of revenue	38 %	39 %	44 %		

2016 Compared to 2015. In 2016, sales and marketing expenses increased by $86.3 million compared to 2015. The increase was primarily attributable to a $31.9 million increase in allocated facilities and other supporting overhead expenses due to the increase in support functions, a $27.6 million increase in restructuring expenses mainly driven by a reduction in workforce at the end of 2016, a $21.8 million increase in personnel-related costs, mainly driven by an increase in compensation expense, and a $16.5 million increase in amortization of acquired intangible assets, offset by an $11.5 million decrease in marketing and sales-related expenses.

2015 Compared to 2014. In 2015, sales and marketing expenses increased by $257.4 million compared to 2014. The increase was primarily attributable to a $109.2 million increase in marketing and sales-related expenses, mainly driven by an increase in consumer marketing and market research, an $80.5 million increase in personnel-related costs, mainly driven by an increase in average employee headcount from expansion of sales, media, marketing and business development, a $61.0 million increase in allocated facilities and other supporting overhead expenses due to the continued expansion of our real estate footprint and increase in support functions, and a $6.7 million increase in amortization of acquired intangible assets.

We continue to evaluate key areas in our business to ensure we have the right level of sales and marketing to execute on our key priorities and objectives. We expect that sales and marketing expenses will vary in the near term from period to period as a percentage of revenue.

General and Administrative

General and administrative expenses consist primarily of personnel-related costs, including salaries, benefits and stock-based compensation, for our executive, finance, legal, information technology, human resources and other administrative employees. In addition, general and administrative expenses include fees and costs for professional services, including consulting, third-party legal and accounting services and facilities and other supporting overhead costs that are not allocated to other departments.

	Year Ended December 31,			2015 to 2016 % Change	2014 to 2015 % Change
	2016	2015	2014		
	(in thousands)				
General and administrative	$293,276	$260,673	$189,906	13 %	37 %
General and administrative as a percentage of revenue	12 %	12 %	14 %		

2016 Compared to 2015. In 2016, general and administrative expense increased by $32.6 million compared to 2015. The increase was primarily attributable to a $17.1 million increase in personnel-related costs, driven by an increase in compensation expense from an increase in average employee headcount, a $6.8 million increase in facilities and supporting costs not allocated to other functions, a $6.5 million increase in fees and costs for professional services, and a $5.6 million increase in restructuring expenses. The increases were offset by a $3.4 million increase in the capitalization of costs associated with developing software for internal use.

2015 Compared to 2014. In 2015, general and administrative expense increased by $70.8 million compared to 2014. The increase was primarily attributable to a $63.7 million increase in personnel-related costs, mainly driven by an increase in average employee headcount, increase in compensation and recognition of stock-based compensation expense, an increase of $11.0 million in fees and costs for professional services, offset by a $3.9 million decrease in unallocated facilities and supporting costs.

We plan to continue to invest in key areas of our business and ensure that we have the right level of general and administrative support on our key priorities and objectives. We expect that general and administrative expenses will vary in the near term from period to period as a percentage of revenue.

Interest Expense

Interest expense consists primarily of interest expense incurred in connection with the $935.0 million principal amount of 0.25% convertible senior notes due 2019, or the 2019 Notes, and $954.0 million principal amount of 1.00% convertible senior notes due 2021, or the 2021 Notes and together with the 2019 Notes, the Notes, and interest expense related to capital leases and other financing facilities.

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Interest expense	$99,968	$98,178	$35,918

2016 Compared to 2015. In 2016, interest expense increased by $1.8 million compared to 2015. Interest expense in 2016 was comprised of $94.5 million of total interest expense related to the Notes as well as the credit facility and $5.5 million related to capital leases of equipment.

2015 Compared to 2014. In 2015, interest expense increased by $62.3 million compared to 2014. The increase was primarily attributable to a full year of interest expense related to the amortization of the debt discount and accrued coupon interest expense of the Notes as compared to a partial year of interest expense recorded in 2014, as the Notes were issued in the third quarter of 2014. Interest expense in 2015 was comprised of $89.4 million of total interest expense related to the Notes as well as the credit facility and $8.8 million related to capital leases of equipment.

Other Income (Expense), Net

Other income (expense), net, consists primarily of unrealized foreign exchange gains and losses due to re-measurement of monetary assets and liabilities denominated in non-functional currencies as well as realized foreign exchange gains and losses on foreign exchange transactions, and interest income resulting from our short term investments net of the related amortization of premium paid on such investments. We expect our foreign exchange gains and losses will vary depending upon movements in the underlying exchange rates.

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Other income (expense), net	$26,342	$14,909	$(3,567)

2016 Compared to 2015. In 2016, other income, net, increased by $11.4 million compared to 2015. The increase was attributable to an increase in interest income on our short term investments and favorable foreign currency exchange impacts from foreign currency-denominated assets and liabilities as well as derivative financial instruments, offset by an increase in other expenses. Other income, net in 2016 was comprised of $25.3 million of interest and other income and $5.8 million of foreign currency exchange gain, offset by $4.8 million of other expenses.

2015 Compared to 2014. In 2015, other income, net, changed by $18.5 million compared to other expense, net of $3.6 million in 2014. The change was attributable to an increase in interest income on our short term investments and favorable foreign currency exchange impacts from foreign currency-denominated assets and liabilities as well as derivative financial instruments. Other income, net in 2015 was comprised of $13.1 million of interest and other income and $1.8 million of foreign currency exchange gain.

Provision (Benefit) for Income Taxes

Provision (benefit) for income taxes consists of federal and state income taxes in the United States and income taxes in certain foreign jurisdictions which are expected to fluctuate based on the pre-tax results within and outside of the United States and will also be impacted by our allocation of centrally incurred costs to foreign jurisdictions. Our future effective tax rate will also be affected by the changes in tax rates and tax regulations, the impact of tax examinations, the impact of business combinations, and changes in valuation allowance. In addition, the provision is impacted by deferred income taxes and changes in the related valuation allowance reflecting the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Provision (Benefit) for Income Taxes	$16,039	$(12,274)	$(531)

2016 Compared to 2015. Our provision for income taxes in 2016 changed by $28.3 million compared to a benefit of $12.3 million in 2015. The increase was primarily due to a decrease in the income tax benefit arising from acquisitions of $24.2 million, and by an increase in income tax expense in foreign jurisdictions of $4.1 million. The $24.2 million decrease in income tax benefit is related to the release of deferred tax valuation allowance resulting from acquisitions completed within the prior year. The deferred tax liabilities recorded in the prior year, as part of purchase accounting, provided an additional source of taxable income to support the realizability of pre-existing deferred tax assets. In the year ended December 31, 2016, the acquisitions we completed did not result in a release of deferred tax valuation allowance due to acquisitions either in a foreign jurisdiction with no valuation allowance or offsetting acquired deferred tax assets.

2015 Compared to 2014. Our benefit from income taxes in 2015 increased by $11.7 million compared to a benefit of $0.5 million in 2014. The increase was primarily due to the increased income tax benefit arising from acquisitions, partially offset by the increased income tax expense in foreign jurisdictions. The increase in income tax benefit is related to the release of the valuation allowance resulting from acquisitions completed in 2015. The deferred tax liabilities recorded in 2015, as part of purchase accounting, provided an additional source of taxable income to support the realizability of pre-existing deferred tax assets.

On July 27, 2015, the United States Tax Court issued an opinion (Altera Corp. et al. v. Commissioner), which invalidated the 2003 final Treasury rule that requires participants in qualified cost-sharing arrangements to share stock-based compensation costs. A final decision was entered by the U.S. Tax Court on December 28, 2015 and the Internal Revenue Service filed an appeal with the U.S. Court of Appeals for the Ninth Circuit on February 19, 2016. We filed our 2014 and 2015 federal tax return based upon the opinion rendered in this case, which we believe will more likely than not be sustained, and which resulted in additional 2014 and 2015 net operating loss in the U.S. federal jurisdiction with a commensurate decrease in the overall pre-tax loss in foreign jurisdictions. As we maintain a full valuation allowance on our U.S. deferred tax assets, no benefit was realized in the financial statements as a result of this filing position. On an ongoing basis, stock-based compensation will be excluded from intercompany charges.

As of December 31, 2016, we had $3.47 billion of federal and $1.41 billion of state net operating loss carryforwards available to reduce future taxable income. These net operating loss carryforwards will begin to expire for federal income tax purposes and state income tax purposes in 2027 and 2017, respectively. We also have research credit carryforwards of $222.8 million and $184.5 million for federal and state income tax purposes, respectively. The federal research credit carryforward will begin to expire in 2027. The state research credit carryforward has no expiration date. Additionally, we have California Enterprise Zone credit carryforwards of $18.9 million which will begin to expire in 2023. Utilization of the net operating loss carryforwards and research credit carryforwards may be subject to an annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, and similar state provisions. Any annual limitation may result in the expiration of net operating losses and research credits before utilization.

Quarterly Results of Operations

The following table sets forth our unaudited consolidated statement of operations data for each of the eight quarters in the period ended December 31, 2016. The unaudited quarterly statement of operations data set forth below have been prepared on a basis consistent with our audited annual consolidated financial statements in this Annual Report on Form 10-K and include, in our opinion, all normal recurring adjustments necessary for a fair statement of the financial information contained in those statements. Our historical results are not necessarily indicative of the results that may be expected in the future. The following quarterly financial data should be read in conjunction with our audited consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K.

	Three Months Ended							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(Unaudited, in thousands, except per share data)							
Consolidated Statement of Operations Data:								
Revenue								
Advertising services	$637,821	$544,966	$534,524	$530,741	$640,680	$512,867	$452,278	$388,211
Data licensing and other	79,385	70,968	67,434	63,780	69,793	56,370	50,105	47,728
Total revenue	717,206	615,934	601,958	594,521	710,473	569,237	502,383	435,939
Costs and expenses(1)								
Cost of revenue	305,710	225,159	202,966	198,405	217,963	200,195	167,623	143,475
Research and development	202,128	177,049	178,511	155,794	210,058	207,937	198,907	189,746
Sales and marketing	260,603	224,436	236,619	236,171	277,189	208,797	201,948	183,557
General and administrative	92,392	67,379	70,238	63,267	72,442	57,545	64,909	65,777
Total costs and expenses	860,833	694,023	688,334	653,637	777,652	674,474	633,387	582,555
Loss from operations	(143,627)	(78,089)	(86,376)	(59,116)	(67,179)	(105,237)	(131,004)	(146,616)
Interest expense	(25,281)	(24,860)	(24,934)	(24,893)	(24,183)	(25,239)	(24,437)	(24,319)
Other income (expense), net	6,662	6,640	6,734	6,306	4,531	1,948	(695)	9,125
Loss before income taxes	(162,246)	(96,309)	(104,576)	(77,703)	(86,831)	(128,528)	(156,136)	(161,810)
Provision (benefit) for income taxes	4,808	6,562	2,641	2,028	3,405	3,162	(19,473)	632
Net loss	$(167,054)	$(102,871)	$(107,217)	$(79,731)	$(90,236)	$(131,690)	$(136,663)	$(162,442)
Net loss per share attributable to common								

stockholders:								
Basic and diluted	$(0.23)	$(0.15)	$(0.15)	$(0.12)	$(0.13)	$(0.20)	$(0.21)	$(0.25)
Other Financial Information:								
Adjusted EBITDA(2)	$215,107	$181,316	$174,602	$180,468	$191,418	$142,148	$120,188	$104,053
Non-GAAP net income(3)	$118,604	$91,741	$92,928	$102,723	$114,619	$66,984	$48,518	$46,508

(1) In the fourth quarter of 2016 and 2015, we incurred restructuring charges of $101.2 million and $12.9 million, respectively.

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

	Three Months Ended							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(Unaudited, in thousands)							
Cost of revenue	$6,511	$7,165	$7,858	$7,968	$8,360	$8,973	$10,486	$12,886
Research and development	81,840	87,163	90,916	75,579	94,707	100,673	103,121	103,036
Sales and marketing	27,751	41,227	45,856	46,101	36,750	37,889	39,607	42,658
General and administrative	21,993	22,972	23,065	21,268	18,432	18,386	21,929	24,225
Total stock-based compensation expense	$138,095	$158,527	$167,695	$150,916	$158,249	$165,921	$175,143	$182,805

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

	Three Months Ended Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(Unaudited, in thousands)							
Reconciliation of Net Loss to Adjusted EBITDA:								
Net loss	$(167,054)	$(102,871)	$(107,217)	$(79,731)	$(90,236)	$(131,690)	$(136,663)	$(162,442)
Stock-based compensation expense	138,095	158,527	167,695	150,916	158,249	165,921	175,143	182,805
Depreciation and amortization expense	119,390	100,878	93,283	88,621	87,446	81,464	76,049	67,864
Interest and other expense (income)	18,619	18,220	18,200	18,587	19,652	23,291	25,132	15,194
Provision (benefit) for income taxes	4,808	6,562	2,641	2,028	3,405	3,162	(19,473)	632
Restructuring charges	101,249	—	—	47	12,902	—	—	—
Adjusted EBITDA	$215,107	$181,316	$174,602	$180,468	$191,418	$142,148	$120,188	$104,053

(3) The following table presents a reconciliation of net loss to non-GAAP net income for each of the periods indicated:

	Three Months Ended Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(Unaudited, in thousands)							
Reconciliation of Net Loss to Non-GAAP Net Income:								
Net loss	$(167,054)	$(102,871)	$(107,217)	$(79,731)	$(90,236)	$(131,690)	$(136,663)	$(162,442)
Stock-based compensation expense	138,095	158,527	167,695	150,916	158,249	165,921	175,143	182,805
Amortization of acquired intangible assets	27,220	16,572	12,816	12,730	15,418	14,481	13,965	10,795
	19,070	18,650	18,570	18,370	18,046	17,495	17,006	16,638

Non-cash interest expense related to convertible notes								
Non-cash expense related to acquisitions	—	—	—	—	—	—	926	—
Income tax effects related to acquisitions	24	863	1,064	391	240	777	(21,859)	(1,288)
Restructuring charges	101,249	—	—	47	12,902	—	—	—
Non-GAAP net income	$118,604	$91,741	$92,928	$102,723	$114,619	$66,984	$48,518	$46,508

Credit Facility

In October 2013, we entered into a revolving credit agreement with certain lenders which provides for a $1.0 billion revolving unsecured credit facility maturing on October 22, 2018. Loans under the credit facility bear interest, at our option, at (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 plus 1.00%, in each case plus a margin ranging from 0.00% to 0.75% or (ii) an adjusted LIBOR rate plus a margin ranging from 1.00% to 1.75%. This margin is determined based on our total leverage ratio for the preceding four fiscal quarter period. We are also obligated to pay other customary fees for a credit facility of this size and type, including an upfront fee and an unused commitment fee. Our obligations under the credit facility are guaranteed by one of our wholly-owned subsidiaries. In addition, the credit facility contains restrictions on payments including cash payment of dividends.

The revolving credit agreement was amended in September 2014 to increase the amount of indebtedness that we may incur and increase the amount of restricted payments that we may make. This amendment to the revolving credit agreement also provides that if our total leverage ratio exceeds 2.5:1.0 and if the amount outstanding under the credit facility exceeds $500.0 million, or 50% of the amount that may be borrowed under the credit facility, the credit facility will become secured by substantially all of our and certain of our subsidiaries' assets, subject to limited exceptions. As of December 31, 2016, no amounts were drawn under the credit facility.

Liquidity and Capital Resources

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Consolidated Statements of Cash Flows Data:			
Net loss	$(456,873)	$(521,031)	$(577,820)
Net cash provided by operating activities	763,055	383,066	81,796
Net cash used in investing activities	(598,008)	(902,421)	(1,097,272)
Net cash provided by (used in) financing activities	(83,975)	(62,998)	1,691,722

Our principal sources of liquidity are our cash, cash equivalents, and short-term investments in marketable securities. Our cash equivalents and marketable securities are invested primarily in short-term fixed income securities, including government and investment-grade debt securities and money market funds. In 2014, we also received net proceeds of approximately $1.86 billion from the issuance of the Notes, after deducting the initial purchasers' discount and debt issuance costs. Concurrently with the sales of the Notes, we entered into privately-negotiated convertible note hedge transactions with respect to our common stock for which we paid approximately $407.2 million and sold warrants for which we received approximately $289.3 million. We expect that we will continue to incur cash interest expense for the term of the Notes.

As of December 31, 2016, we had $3.77 billion of cash, cash equivalents and short-term investments in marketable securities, of which $180.6 million was held by our foreign subsidiaries. Under the current tax laws, if these funds are needed for our operations in the U.S., we would be required to accrue and pay U.S. taxes to repatriate certain of these funds. However, our intent is to indefinitely reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations. In addition, we have a revolving unsecured credit facility available to borrow up to $1.0 billion. We believe that our existing cash, cash equivalents and short-term investment balance, and our credit facility, together with cash generated from operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months.

Operating Activities

Cash provided by operating activities consists of net loss adjusted for certain non-cash items including depreciation and amortization, stock-based compensation, amortization of discount on our Notes, deferred income taxes, non-cash restructuring charges, as well as the effect of changes in working capital and other activities.

Cash provided by operating activities in 2016 was $763.1 million, an increase in cash inflow of $380.0 million compared to 2015. Cash provided by operating activities was driven by a net loss of $456.9 million, as adjusted for the exclusion of non-cash expenses and other adjustments totaling $1.14 billion, of which $615.2 million was related to stock-based compensation expense, and the effect of changes in working capital and other carrying balances that resulted in cash outflow of $82.6 million.

Cash provided by operating activities in 2015 was $383.1 million, an increase in cash inflow of $301.3 million compared to 2014. Cash provided by operating activities was driven by a net loss of $521.0 million, as adjusted for the exclusion of non-cash expenses and other adjustments totaling $1.04 billion, of which $678.9 million was related to stock-based compensation expense, and the effect of changes in working capital and other carrying balances that resulted in cash outflow of $135.9 million.

Cash provided by operating activities in 2014 was $81.8 million, an increase in cash inflow of $80.4 million compared to 2013. Cash provided by operating activities was driven by a net loss of $577.8 million, as adjusted for the exclusion of non-cash expenses totaling $861.6 million, of which $631.6 million was related to stock-based compensation expense, and the effect of changes in working capital and other carrying balances that resulted in cash outflow of $202.0 million.

Investing Activities

Our primary investing activities consist of purchases of property and equipment, particularly purchases of servers and networking equipment, leasehold improvements for our facilities, purchases and disposal of marketable securities, strategic investments in privately-held companies, acquisitions of businesses and other activities.

Cash used in investing activities in 2016 was $598.0 million, a decrease in cash outflow of $304.4 million compared to 2015. The decrease in cash outflow was due to decreased purchases of marketable securities of $774.9 million, property and equipment of $128.6 million and other investments of $8.7 million, offset by a decrease in sales and maturities of marketable securities of $503.4 million, an increase in purchase of investments in privately-held companies of $71.0 million, and an increase in use of cash as acquisition consideration of $33.4 million.

Cash used in investing activities in 2015 was $902.4 million, a decrease in cash outflow of $194.9 million compared to 2014. The decrease in cash outflow was due to the increase in sales and maturities of marketable securities of $987.6 million and a reduction in use of cash as acquisition consideration of $111.8 million. Such increases in cash inflow were partially offset by increased purchases of marketable securities of $746.4 million, property and equipment of $145.7 million and other investments of $12.4 million.

Cash used in investing activities in 2014 was $1.10 billion, a decrease in cash outflow of $208.8 million compared to 2013. The decrease in cash outflow was due to an increase in the proceeds from maturities and sales of marketable securities of $1.82 billion offset by an increase in the purchases of marketable securities of $1.36 billion and a $247.2 million increase in expenditures on other investing activities, including business combinations, purchases of intangible assets, purchases of property and equipment and restricted cash.

We anticipate making capital expenditures in 2017 of approximately $300 million to $400 million, a portion of which we may finance through capital leases, as we continue to expand our co-located data centers.

Financing Activities

Our primary financing activities consist of issuances of securities (including the Notes, common stock issued under employee stock purchase plan, common stock issued in connection with our initial public offering and, in the past, private sales of convertible preferred stock), capital lease financing and stock option exercises by employees and other service providers.

Cash used in financing activities in 2016 was $84.0 million, an increase in cash outflow of $21.0 million compared to 2015. The increase in cash outflow was due to a $14.9 million decrease in proceeds from the issuance of shares of stock from ESPP, a net $13.3 million increase in tax payments related to net share settlements of equity awards and other activities, and a net $9.8 million decrease in proceeds from option exercises, offset by a reduction in repayments of capital lease obligations of $17.0 million.

Cash used in financing activities in 2015 was $63.0 million compared to $1.69 billion cash provided by financing activities in 2014. The decrease in cash inflow was due to the absence of any financing transactions in 2015 similar to the issuance of the Notes in 2014.

Cash provided by financing activities in 2014 was $1.69 billion, a decrease of $250.5 million in cash inflow compared to 2013. The decrease in cash inflow was primarily due to net proceeds of $1.86 billion from the issuance of convertible senior notes net of initial issuance discount reduced by the net cash outflow of $117.9 million from the purchase of convertible note hedges and sale of warrants closed in connection with the issuance of Notes in 2014 compared to net proceeds of $2.02 billion from issuance of common stock in connection with our initial public offering in 2013. In addition, we recorded an increase of $62.4 million in proceeds from option exercises and issuance of common stock under our employee stock purchase plan, partially offset by a $32.7 million increase in repayments of capital lease obligations.

Off Balance Sheet Arrangements

We do not have any off-balance sheet arrangements and did not have any such arrangements in 2016, 2015 or 2014.

Contractual Obligations

Our principal commitments consist of obligations under the Notes (including principal and coupon interest), capital and operating leases for equipment, office space and co-located data center facilities, as well as non-cancellable contractual commitments. The following table summarizes our commitments to settle contractual obligations in cash as of December 31, 2016.

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
	(In thousands)				
2019 Notes	$942,013	$2,338	$939,675	$—	$—
2021 Notes	1,001,726	9,540	19,080	973,106	—
Operating lease obligations (1)	733,019	156,757	264,346	148,601	163,315
Capital lease obligations	152,932	85,886	67,046	—	—
Other contractual commitments (2)	138,410	100,160	38,250	—	—
Total contractual obligations	$2,968,100	$354,681	$1,328,397	$1,121,707	$163,315

(1) During the year ended December 31, 2016, we entered into several sublease agreements for office space that we are not fully utilizing. Under the sublease agreements, we will receive approximately $82.4 million in sublease income over the next five years.

(2) Other contractual commitments are non-cancelable contractual commitments primarily related to our infrastructure services, bandwidth and other services arrangements.

As of December 31, 2016, we had recorded liabilities of $5.8 million related to uncertain tax positions. Due to uncertainties in the timing of potential tax audits, the timing of the resolution of these positions is uncertain and we are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months. As a result, this amount is not included in the above table.

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with GAAP. In doing so, we have to make estimates and assumptions that affect our reported amounts of assets, liabilities, revenue and expenses, as well as related disclosure of contingent assets and liabilities. To the extent that there are material differences between these estimates and actual results, our financial condition or operating results would be affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies and estimates, which we discuss further below.

Revenue Recognition

We generate the substantial majority of our revenue from the sale of advertising services with the balance coming from data licensing and other arrangements. We generate our advertising revenue primarily from the sale of our three Promoted Products: (i) Promoted Tweets, (ii) Promoted Accounts and (iii) Promoted Trends. Promoted Tweets and Promoted Accounts are pay-for-performance advertising products priced through an auction. Promoted Trends are featured by geography and offered on a fixed-fee-per-day basis. Advertisers are obligated to pay when a user engages with a Promoted Tweet or follows a Promoted Account or when a Promoted Trend is displayed. These products may be sold in combination as a multiple element arrangement or separately on a stand-alone basis.

We also generate advertising revenue by selling to advertisers advertising products which we place on third party publishers' websites, applications or other offerings. To fulfill these transactions, we purchase advertising inventory from third party publishers' websites and applications where we have identified the advertisers' targeted audience and therefore incur traffic acquisition costs. In such transactions, we remain the primary obligor to our advertisers for the advertising services and products delivered, have pricing latitude, have discretion in the selection of third party publishers and bear credit risk. We might not generate advertising revenue in excess of traffic acquisition costs incurred. Therefore, we report advertising revenue generated from these transactions on a gross basis.

Fees for these advertising services are recognized in the period when advertising is delivered as evidenced by a user engaging with a Promoted Tweet in a manner satisfying the types of engagement selected by the advertisers, such as Tweet engagements (e.g., retweets, replies and likes), website clicks or conversions, mobile application installs or engagements, obtaining new followers, or video views, following a Promoted Account, through the display of a Promoted Trend on our platform, or completion of a transaction on an external website.

Data licensing revenue is generated based on monthly service fees charged to the data partners over the period in which Twitter data and data products are made available to them. Other revenue is primarily generated from service fees from transactions completed on our mobile ad exchange. Our mobile ad exchange enables buyers and sellers to purchase and sell advertising inventory and matches buyers and sellers. We have determined we are not the principal in the purchase and sale of advertising inventory in transactions between third party buyers and sellers on the exchange. Therefore, we report revenue related to our ad exchange services on a net basis.

Revenue is recognized only when (1) persuasive evidence of an arrangement exists; (2) the price is fixed or determinable; (3) the service is performed; and (4) collectability of the related fee is reasonably assured. While the majority of our revenue transactions are based on standard business terms and conditions, we also enter into sales agreements with advertisers and data partners that sometimes involve multiple elements.

For arrangements involving multiple deliverables, judgment is required to determine the appropriate accounting, including developing an estimate of the stand-alone selling price of each deliverable. When neither vendor-specific objective evidence nor third-party evidence of selling price exists, we use our best estimate of selling price (BESP) to allocate the arrangement consideration on a relative selling price basis to each deliverable. The objective of BESP is to determine the selling price of each deliverable when it is sold to advertisers on a stand-alone basis. In determining BESPs, we take into consideration various factors, including, but not limited to, prices we charge for similar offerings, sales volume, geographies, pricing strategies and market conditions. Multiple deliverable arrangements primarily consist of combinations of our pay-for-performance products, Promoted Tweets and Promoted Accounts, which are priced through an auction, and Promoted Trends, which are priced on a fixed-fee-per day per geography basis. For arrangements that include a combination of these products, we develop an estimate of the selling price for these products in order to allocate any potential discount to all advertising products in the arrangement. The estimate of selling price for pay-for-performance products is determined based on the winning bid price; the estimate of selling price for Promoted Trends is based on Promoted Trends sold on a stand-alone basis and/or separately priced in a bundled arrangement by reference to a list price by geography which is approved periodically. We believe the use of BESP results in revenue recognition in a manner consistent with the underlying economics of the transaction and allocates the arrangement consideration on a relative selling price basis to each deliverable.

Income Taxes

We are subject to income taxes in the United States and several foreign jurisdictions. Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes.

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit. To the extent that the final outcome of these matters is different than the amounts recorded, such differences may impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as any related interest or penalties.

Our effective tax rates have differed from the statutory rate primarily due to the tax impact of foreign operations, state taxes, certain benefits realized in recording the tax effects of business combinations, and the recording of U.S.

valuation allowance. Our future provision for income taxes could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory tax rates, changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws, regulations or accounting principles. In addition, we are subject to examination of our income tax returns by tax authorities in the United States and foreign jurisdictions. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

Stock-Based Compensation

We account for stock-based compensation expense under the fair value recognition and measurement provisions in accordance with the applicable accounting standards which require all stock-based awards granted to employees to be measured based on the grant-date fair value.

The fair value of stock options granted and stock purchase rights provided under the employee stock purchase plan is estimated based on the Black-Scholes option pricing model which requires inputs of judgmental assumptions including the expected term of the award and stock price volatility. If any of the assumptions used in the fair value determination change significantly, stock-based compensation expense may differ materially.

We recognize the compensation expense only for those awards expected to meet the performance and service vesting condition on a straight-line basis over the requisite service period which is generally one year for performance vesting condition awards and four years for service vesting condition awards.

Through 2016, we estimated the forfeiture rate based on historical forfeitures of our stock-based awards and our expectations regarding future pre-vesting termination behavior of our employees. While the forfeiture rate used represents our best estimate, this estimate involves inherent uncertainties. To the extent the actual forfeitures differ from our estimates, stock-based compensation expense will be adjusted accordingly and may have a significant effect on our stock-based compensation expense.

Business Combinations

We account for acquisitions of entities that include inputs and processes and have the ability to create outputs as business combinations. The purchase price of the 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 the purchase price over those fair values is recorded as goodwill. During the measurement period, which may be up to one year from the acquisition date, we 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 are recorded to the consolidated statements of operations.

Accounting for business combinations requires our management to make significant estimates and assumptions at the acquisition date, including estimated fair value of acquired intangible assets, estimated fair value of stock awards assumed from the acquirees that are included in the purchase price, estimated income tax assets and liabilities assumed from the acquirees, and determination of the fair value of contractual obligations, where applicable. The estimates of fair value require management to also make estimates of, among other things, future expected cash flows, discount rates or expected costs to reproduce an asset. Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, these estimates are based on historical experience and information obtained from the management of the acquired companies and are inherently uncertain.

Impact of Recently Issued Accounting Standards

The impact of recently issued accounting standards is set forth in Note 2, Summary of Significant Accounting Policies, of the Notes to Consolidated Financial Statements under Item 8 of this Annual Report on Form 10-K.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have operations both within the United States and internationally, and we are exposed to market risks in the ordinary course of our business. These risks include primarily interest rate and foreign exchange risks.

Interest Rate Fluctuation Risk

Our investment portfolio mainly consists of short-term fixed income securities, including government and investment-grade debt securities and money market funds. These securities are classified as available-for-sale and, consequently, are recorded in the consolidated balance sheets at fair value with unrealized gains or losses, net of tax reported as a separate component of accumulated other comprehensive loss. Our investment policy and strategy is focused on the preservation of capital and supporting our liquidity requirements. We do not enter into investments for trading or speculative purposes.

A rise in interest rates could have a material adverse impact on the fair value of our investment portfolio. Based on our investment portfolio balance as of December 31, 2016, a hypothetical increase in interest rates of 100 basis points would result in a decrease of approximately $14.6 million in the fair value of our available-for-sale securities. We currently do not hedge these interest rate exposures.

In 2014, we issued Notes with an aggregate principal amount of $1.89 billion. We carry the Notes at face value less amortized discount on the consolidated balance sheet. Since the Notes bear interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the fair value of the Notes changes when the market price of our stock fluctuates or interest rates change.

Foreign Currency Exchange Risk

Transaction Exposure

We transact business in various foreign currencies and have international revenue, as well as costs denominated in foreign currencies, primarily the Euro, British Pound and Japanese Yen. This exposes us to the risk of fluctuations in foreign currency exchange rates. Accordingly, changes in exchange rates, and in particular a continuing strengthening of the U.S. dollar, would negatively affect our revenue and other operating results as expressed in U.S. dollars.

We have experienced and will continue to experience fluctuations in our net loss as a result of transaction gains or losses related to revaluing and ultimately settling certain asset and liability balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. Net realized and unrealized foreign currency gains were immaterial in 2016, 2015 and 2014. We currently utilize foreign currency forward contracts with financial institutions to reduce the risk that our earnings may be adversely affected by the impact of exchange rate fluctuations on monetary assets or liabilities denominated in currencies other than the local currency of a subsidiary. These contracts are not designated as hedging instruments. We may in the future enter into other derivative financial instruments if it is determined that such hedging activities are appropriate to further reduce our foreign currency exchange risk. Based on our foreign currency exposures from monetary assets and liabilities net of our open hedge position, we estimated that a 5% change in exchange rates against the U.S. dollars would have resulted in a gain or loss of approximately $1.7 million as of December 31, 2016.

Translation Exposure

We are also exposed to foreign exchange rate fluctuations as we translate the financial statements of our foreign subsidiaries into U.S. dollars in consolidation. If there is a change in foreign currency exchange rates, the translating adjustments resulting from the conversion of our foreign subsidiaries' financial statements into U.S. dollars would result in a gain or loss recorded as a component of accumulated other comprehensive loss which is part of stockholders' equity.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

The supplementary financial information required by this Item 8 is included in Item 7 under the caption “Quarterly Results of Operations.”

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Twitter, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of comprehensive loss, of stockholders’ equity and of cash flows present fairly, in all material respects, the financial position of Twitter, Inc. and its subsidiaries at December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15.2 presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. 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.

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 (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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/ PricewaterhouseCoopers LLP

San Francisco, California

February 27, 2017

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TWITTER, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	December 31, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$988,598	$911,471
Short-term investments	2,785,981	2,583,877
Accounts receivable, net of allowance for doubtful accounts of $7,216 and $8,121 as of December 31, 2016 and December 31, 2015, respectively	650,650	638,694
Prepaid expenses and other current assets	226,967	247,750
Total current assets	4,652,196	4,381,792
Property and equipment, net	783,901	735,299
Intangible assets, net	95,334	141,015
Goodwill	1,185,315	1,122,728
Other assets	153,619	61,605
Total assets	$6,870,365	$6,442,439
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$122,236	$134,081
Accrued and other current liabilities	380,937	283,792
Capital leases, short-term	80,848	88,166
Total current liabilities	584,021	506,039
Convertible notes	1,538,967	1,455,095
Capital leases, long-term	66,837	59,695
Deferred and other long-term tax liabilities, net	7,556	2,978
Other long-term liabilities	68,049	50,585
Total liabilities	2,265,430	2,074,392
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, $0.000005 par value-- 200,000 shares authorized; none issued and outstanding	—	—
Common stock, $0.000005 par value-- 5,000,000 shares authorized; 721,572 and 694,132 shares issued and outstanding as of December 31, 2016 and December 31, 2015, respectively	4	3
Additional paid-in capital	7,224,534	6,507,087
Accumulated other comprehensive loss	(69,253)	(45,566)
Accumulated deficit	(2,550,350)	(2,093,477)
Total stockholders' equity	4,604,935	4,368,047
Total liabilities and stockholders' equity	$6,870,365	$6,442,439

The accompanying notes are an integral part of these consolidated financial statements.

TWITTER, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31, 2016	2015	2014
Revenue	$2,529,619	$2,218,032	$1,403,002
Costs and expenses			
Cost of revenue	932,240	729,256	446,309
Research and development	713,482	806,648	691,543
Sales and marketing	957,829	871,491	614,110
General and administrative	293,276	260,673	189,906
Total costs and expenses	2,896,827	2,668,068	1,941,868
Loss from operations	(367,208)	(450,036)	(538,866)
Interest expense	(99,968)	(98,178)	(35,918)
Other income (expense), net	26,342	14,909	(3,567)
Loss before income taxes	(440,834)	(533,305)	(578,351)
Provision (benefit) for income taxes	16,039	(12,274)	(531)
Net loss	$(456,873)	$(521,031)	$(577,820)
Net loss per share attributable to common stockholders:			
Basic	$(0.65)	$(0.79)	$(0.96)
Diluted	$(0.65)	$(0.79)	$(0.96)
Weighted-average shares used to compute net loss per share attributable to common stockholders:			
Basic	702,135	662,424	604,990
Diluted	702,135	662,424	604,990

The accompanying notes are an integral part of these consolidated financial statements.

TWITTER, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Net loss	$(456,873)	$(521,031)	$(577,820)
Other comprehensive income (loss):			
Change in unrealized gain (loss) on investments in available-for-sale securities, net of tax	1,685	(3,019)	(877)
Change in foreign currency translation adjustment	(25,372)	(32,523)	(8,824)
Net change in accumulated other comprehensive loss	(23,687)	(35,542)	(9,701)
Comprehensive loss	$(480,560)	$(556,573)	$(587,521)

The accompanying notes are an integral part of these consolidated financial statements.

TWITTER, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

	Year Ended December 31,					
	2016		2015		2014	
	Shares	Amount	Shares	Amount	Shares	Amount
Common stock						
Balance, beginning of period	694,132	$3	642,385	$3	569,922	$3
Issuance of common stock in connection with RSU vesting	26,909	1	24,002	-	42,748	-
Issuance of common stock in connection with acquisitions	41	-	13,613	-	3,326	-
Issuance of restricted stock in connection with acquisitions accounted for as stock-based compensation	3,364	-	2,533	-	2,337	-
Exercise of stock options	2,864	-	10,992	-	22,447	-
Issuance of common stock upon purchases under employee stock purchase plan	2,039	-	1,525	-	1,887	-
Shares withheld related to net share settlement of equity awards	(878)	-	(281)	-	(307)	-
Cancellation of shares contributed by the CEO	(6,814)	-	-	-	-	-
Other activities	(85)	-	(637)	-	25	-
Balance, end of period	721,572	$4	694,132	$3	642,385	$3
Additional paid-in capital						
Balance, beginning of period	-	$6,507,087	-	$5,208,870	-	$3,944,952
Issuance of common stock in connection with acquisitions	-	735	-	516,538	-	147,958
Exercise of stock options	-	7,714	-	17,914	-	28,881
Issuance of common stock upon purchases under employee stock purchase plan	-	24,431	-	39,295	-	42,402
Shares withheld related to net share settlement of equity awards	-	(15,598)	-	(11,101)	-	(17,053)
Stock-based compensation	-	695,525	-	729,193	-	672,371
Equity component of the convertible note issuance, net	-	-	-	-	-	505,982
Purchase of convertible note hedge	-	-	-	-	-	(407,169)
Issuance of warrants	-	-	-	-	-	289,272
Other activities	-	4,640	-	6,378	-	1,274
Balance, end of period	-	$7,224,534	-	$6,507,087	-	$5,208,870
Accumulated other comprehensive loss						

Balance, beginning of period	-	$(45,566)	-	$(10,024)	-	$(323)
Other comprehensive income (loss)	-	(23,687)	-	(35,542)	-	(9,701)
Balance, end of period	-	$(69,253)	-	$(45,566)	-	$(10,024)
Accumulated deficit						
Balance, beginning of period	-	$(2,093,477)	-	$(1,572,446)	-	$(994,626)
Net loss	-	(456,873)	-	(521,031)	-	(577,820)
Balance, end of period	-	$(2,550,350)	-	$(2,093,477)	-	$(1,572,446)
Total stockholders' equity	721,572	$4,604,935	694,132	$4,368,047	642,385	$3,626,403

The accompanying notes are an integral part of these consolidated financial statements.

TWITTER, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Cash flows from operating activities			
Net loss	$(456,873)	$(521,031)	$(577,820)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	402,172	312,823	208,165
Stock-based compensation expense	615,233	682,118	631,597
Amortization of discount on convertible notes	74,660	69,185	18,823
Changes in bad debt provision	3,958	5,765	4,632
Deferred income tax	(4,775)	(28,125)	(9,609)
Non-cash restructuring	25,934	(3,194)	—
Other adjustments	20,150	1,438	7,983
Changes in assets and liabilities, net of assets acquired and liabilities assumed from acquisitions:			
Accounts receivable	(22,969)	(216,585)	(177,583)
Prepaid expenses and other assets	7,101	(50,170)	(165,395)
Accounts payable	(7,112)	76,355	18,059
Accrued and other liabilities	105,576	54,487	122,944
Net cash provided by operating activities	763,055	383,066	81,796
Cash flows from investing activities			
Purchases of property and equipment	(218,657)	(347,280)	(201,630)
Purchases of marketable securities	(2,908,611)	(3,683,488)	(2,937,033)
Proceeds from maturities of marketable securities	2,518,631	2,821,745	2,029,518
Proceeds from sales of marketable securities	183,154	383,413	188,092
Changes in restricted cash	(4,760)	(3,549)	(11,042)
Purchases of investments in privately-held companies	(81,502)	(10,500)	—
Business combinations, net of cash acquired	(85,082)	(51,644)	(163,477)
Other investing activities	(1,181)	(11,118)	(1,700)
Net cash used in investing activities	(598,008)	(902,421)	(1,097,272)
Cash flows from financing activities			
Proceeds from issuance of convertible notes	—	—	1,889,000
Convertible notes initial issuance discount	—	—	(28,810)
Purchases of convertible note hedges	—	—	(407,169)
Proceeds from issuance of warrants	—	—	289,272
Taxes paid related to net share settlement of equity awards	(15,598)	(11,101)	(17,053)
Repayments of capital lease obligations	(100,558)	(117,535)	(103,135)
Proceeds from exercise of stock options	7,540	17,361	28,658
Proceeds from issuances of common stock under employee stock purchase plan	24,431	39,295	42,402
Other financing activities	210	8,982	(1,443)

Net cash provided by (used in) financing activities	(83,975)	(62,998)	1,691,722
Net increase (decrease) in cash and cash equivalents	81,072	(582,353)	676,246
Foreign exchange effect on cash and cash equivalents	(3,945)	(16,900)	(6,532)
Cash and cash equivalents at beginning of period	911,471	1,510,724	841,010
Cash and cash equivalents at end of period	$988,598	$911,471	$1,510,724
Supplemental cash flow data			
Interest paid in cash	$12,953	$15,985	$10,000
Taxes paid in cash	$14,532	$8,229	$14,895
Supplemental disclosures of non-cash investing and financing activities			
Common stock issued in connection with acquisitions	$1,341	$516,538	$147,958
Equipment purchases under capital leases	$100,281	$31,215	$140,685
Changes in accrued property and equipment purchases	$5,738	$3,902	$6,562

The accompanying notes are an integral part of these consolidated financial statements.

TWITTER, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company

Twitter, Inc. (“Twitter” or the “Company”) was incorporated in Delaware in April 2007, and is headquartered in San Francisco, California. Twitter offers products and services for users, advertisers and data partners.

Note 2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the Company’s consolidated financial statements in conformity with generally accepted accounting principles in the United States of America (“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 materially 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 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. Certain prior period amounts have been reclassified to conform to the current period presentation.

Revenue Recognition

The Company generates the substantial majority of its revenue from the sale of advertising services and, to a lesser extent, from entering into data licensing and other arrangements.

The Company’s advertising services include three primary products: (i) Promoted Tweets, (ii) Promoted Accounts and (iii) Promoted Trends. Promoted Tweets and Promoted Accounts are pay-for-performance advertising products priced through an auction. Promoted Trends are featured by geography and offered on a fixed-fee-per-day basis. Advertisers are obligated to pay when a user engages with a Promoted Tweet or follows a Promoted Account or when a Promoted Trend is displayed. These products may be sold in combination as a multiple element arrangement or separately on a stand-alone basis.

The Company also generates advertising revenue by selling to advertisers advertising products which it places on third party publishers’ websites, applications or other offerings. To fulfill these transactions, the Company purchases advertising inventory from third party publishers’ websites and applications where it has identified the advertisers’ targeted audience and therefore incurs traffic acquisition costs. In such transactions, the Company remains the primary obligor to its advertisers for the advertising services and products delivered, has pricing latitude, has discretion in the selection of third party publishers and bears credit risk. The Company might not generate advertising revenue in excess of traffic acquisition costs incurred. Therefore, the Company reports advertising revenue generated from these transactions on a gross basis.

Fees for these advertising services are recognized in the period when advertising is delivered as evidenced by a user engaging with a Promoted Tweet in a manner satisfying the types of engagement selected by the advertisers, such as Tweet engagements (e.g., retweets, replies and likes), website clicks or conversions, mobile application installs or engagements, obtaining new followers, or video views, following a Promoted Account, through the display of a Promoted Trend on the Company’s platform, or completion of a transaction on an external website. Data licensing revenue is generated based on monthly service fees charged to the data partners over the period in which the Company’s data and data products are made available to them. Other revenue is primarily generated from service fees from transactions completed on the Company’s mobile ad exchange. The Company’s mobile ad exchange enables buyers and sellers to purchase and sell advertising inventory and matches buyers and sellers. The Company has determined it is not the principal in the purchase and sale of advertising inventory in transactions between third party buyers and sellers on the exchange. Therefore, the Company reports revenue related to its ad exchange services on a net basis.

Revenue is recognized only when (1) persuasive evidence of an arrangement exists; (2) the price is fixed or determinable; (3) the service is performed; and (4) collectability of the related fee is reasonably assured. While the majority of the Company's revenue transactions are based on standard business terms and conditions, the Company also enters into sales agreements with advertisers and data partners that sometimes involve multiple elements.

For arrangements involving multiple deliverables, judgment is required to determine the appropriate accounting, including developing an estimate of the stand-alone selling price of each deliverable. When neither vendor-specific objective evidence nor third-party evidence of selling price exists, the Company uses its best estimate of selling price (BESP) to allocate the arrangement consideration on a relative selling price basis to each deliverable. The objective of BESP is to determine the selling price of each deliverable when it is sold to advertisers on a stand-alone basis. In determining BESPs, the Company takes into consideration various factors, including, but not limited to, prices the Company charges for similar offerings, sales volume, geographies, pricing strategies and market conditions. Multiple deliverable arrangements primarily consist of combinations of the Company's pay-for-performance products, Promoted Tweets and Promoted Accounts, which are priced through an auction, and Promoted Trends, which are priced on a fixed-fee-per day per geography basis. For arrangements that include a combination of these products, the Company develops an estimate of the selling price for these products in order to allocate any potential discount to all advertising products in the arrangement. The estimate of selling price for pay-for-performance products is determined based on the winning bid price; the estimate of selling price for Promoted Trends is based on Promoted Trends sold on a stand-alone basis and/or separately priced in a bundled arrangement by reference to a list price by geography which is approved periodically. The Company believes the use of BESP results in revenue recognition in a manner consistent with the underlying economics of the transaction and allocates the arrangement consideration on a relative selling price basis to each deliverable.

Cost of Revenue

Cost of revenue includes infrastructure costs, other direct costs including content costs, amortization expense of technology acquired through acquisitions and capitalized labor costs, allocated facilities costs, as well as traffic acquisition costs ("TAC"). Infrastructure costs consist primarily of data center costs related to the Company's co-located facilities, which include lease and hosting costs, related support and maintenance costs and energy and bandwidth costs, as well as depreciation of its servers and networking equipment, and personnel-related costs, including salaries, benefits and stock-based compensation, for its operations teams. TAC consists of costs incurred with third parties in connection with the sale to advertisers of advertising products that the Company places on third-party publishers' websites, applications or other offerings collectively resulting from acquisitions and from the Company's organically-built advertising network, Twitter Audience Platform.

Stock-Based Compensation Expense

The Company accounts for stock-based compensation expense under the fair value recognition and measurement provisions of GAAP. Stock-based awards granted to employees are measured based on the grant-date fair value.

The Company recognizes the compensation expense only for those awards expected to meet the performance and service vesting condition on a straight-line basis over the requisite service period which is generally one year for performance vesting condition awards and four years for service vesting condition awards.

The Company estimates the fair value of stock options granted and stock purchase rights provided under the Company's employee stock purchase plan using the Black-Scholes option pricing model on the dates of grant. Calculating the fair value using the Black-Scholes model requires various judgmental assumptions including the expected term and stock price volatility. The Company estimates the expected term of stock options granted based on the simplified method. The Company estimates the expected volatility of its common stock on the dates of grant based on a combination of the Company's historical stock price volatility and implied volatility in the Company's traded options when such information is available. When the Company's historical and implied volatility data are not available for the related awards' expected term, an average of volatility rates including the historical volatility of a group of comparable, publicly-traded companies is used. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Expected dividend yield is zero percent as the Company has not paid and does not anticipate paying dividends on its common stock. The compensation expense related to stock options and employee stock purchase rights is recognized on a straight-line basis over the requisite service period.

The Company issues restricted stock subject to a lapsing right of repurchase to continuing employees of certain acquired companies. Since these issuances are subject to post-acquisition employment, the Company accounts for them as post-acquisition stock-based compensation expense. The grant-date fair value of restricted stock granted in connection with acquisitions is recognized as stock-based compensation expense on a straight-line basis over the requisite service period.

Stock-based compensation expense is recorded net of estimated forfeitures. Through 2016, the Company estimated the forfeiture rate based on historical forfeitures of stock-based awards and adjusted the rate to reflect changes in facts and circumstances, if any.

Acquisitions

The Company accounts for acquisitions of entities that include inputs and processes and have the ability to create outputs as business combinations. The purchase price of the 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 the purchase price over those fair values 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 are recorded to the consolidated statements of operations.

Investments in Privately-Held Companies

The Company makes strategic investments in privately-held companies and assesses the accounting for these investments under the equity or cost method. The Company also evaluates each investee to determine if the investee is a variable interest entity and, if so, whether the Company is the primary beneficiary of the variable interest entity.

The Company periodically evaluates the carrying value of the investments in privately-held companies, when events and circumstances indicate that the carrying amount of the investment may not be recovered. The Company estimates the fair value of the investments to assess whether impairment losses shall be recorded using Level 3 inputs. These investments include the Company's holdings in privately-held companies that are not exchange traded and therefore not supported with observable market prices; hence, the Company determines the fair value by reviewing equity valuation reports, current financial results and long-term plans of the private companies.

Restructuring and Other Charges

The Company records charges associated with management-approved restructuring plans to reduce headcount and for leases. Restructuring costs are recognized when the related liability is incurred and measured at fair value. The Company accrues a liability for employee terminations when all of the following conditions have been met: management, having the authority to approve the action, commits to a plan of termination; the plan identifies the number of employees to be terminated, their job classifications and their locations, and the expected completion date; the plan establishes the terms of the benefit arrangement in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated; and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

The Company accrues for costs to terminate an operating lease or other contract when it terminates the contract in accordance with the contract terms.

A liability for costs that will continue to be incurred under a contract for the remaining term without economic benefits to the Company is recognized and measured when the entity meets the cease-use date. In recording liabilities for cease-use facilities, the Company makes various assumptions, including the time period over which the facilities are expected to be vacant, expected sublease terms and expected sublease rates. The estimates involve a number of risks and uncertainties, some of which are beyond the Company’s control, including future real estate market conditions and the Company’s ability to successfully enter into sublease agreements with terms as favorable as those assumed when arriving at the estimates. The Company regularly evaluates a number of factors to determine the appropriateness and reasonableness of the restructuring and lease loss accruals including the various assumptions noted above. If actual results differed significantly from its estimates, the Company may be required to adjust the restructuring and lease loss accruals in the future.

Operating and Capital Leases

The Company leases office space and data center facilities under operating leases. Certain lease agreements contain free or escalating rent payment provisions. The Company recognizes rent expense under such leases on a straight-line basis over the term of the lease. Lease renewal periods are considered on a lease-by-lease basis in determining the lease term.

The Company also has entered into server and networking equipment lease arrangements with original lease terms ranging from three to four years. The Company's server and networking equipment leases typically are accounted for as capital leases as they meet one or more of the four capital lease classification criteria. Assets acquired under capital leases are amortized over their estimated useful life. As of December 31, 2016 and 2015, the Company had capital lease obligations included in short-term and long-term capital lease obligations in the consolidated balance sheets of $147.7 million and $147.9 million, respectively. In the years ended December 31, 2016, 2015 and 2014, the Company recorded approximately $5.5 million, $8.8 million and $10.2 million, respectively, of interest expense in relation to these capital lease arrangements.

Cash, Cash Equivalents and Investments

The Company invests its excess cash primarily in short-term fixed income securities, including government and investment-grade debt securities and money market funds. The Company classifies all liquid investments with stated maturities of three months or less from date of purchase as cash equivalents. The Company classifies all marketable securities for use in current operations, even if the security matures beyond 12 months, and presents them as short-term investments in the consolidated balance sheets.

As of December 31, 2016 and 2015, the Company has recorded restricted cash balances of $9.4 million and $3.0 million, respectively, within prepaid expenses and other current assets and $29.6 million and $31.1 million, respectively, in other assets on the accompanying consolidated balance sheets based upon the term of the remaining restrictions. These restricted cash balances are primarily cash deposits to back letters of credit related to certain property leases.

The Company determines the appropriate classification of its investments in marketable securities at the time of purchase and reevaluates such designation at each balance sheet date. The Company has classified and accounted for its marketable securities as available-for-sale. After considering the Company's capital preservation objectives, as well as its liquidity requirements, the Company may sell securities prior to their stated maturities. The Company carries its available-for-sale securities at fair value, and reports the unrealized gains and losses, net of taxes, as a component of stockholders' equity, except for unrealized losses determined to be other-than-temporary which are recorded as other income (expense), net. The Company determines any realized gains or losses on the sale of marketable securities on a specific identification method and records such gains and losses as a component of other income (expense), net. Interest earned on cash, cash equivalents, and marketable securities was $24.3 million, $9.1 million, and $1.9 million during the years ended December 31, 2016, 2015 and 2014, respectively. These balances are recorded in other income (expense), net in the accompanying consolidated statements of operations.

The Company evaluates the investments periodically for possible other-than-temporary impairment. A decline in fair value below the amortized costs of debt securities is considered an other-than-temporary impairment if the Company has the intent to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of the entire amortized cost basis. In those instances, an impairment charge equal to the difference between the fair value and the amortized cost basis is recognized in earnings. Regardless of the Company's intent or requirement to sell a debt security, impairment is considered other-than-temporary if the Company does not expect to recover the entire amortized cost basis.

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Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash, cash equivalents, short-term investments and accounts receivable. The primary focus of the Company's investment strategy is to preserve capital and meet liquidity requirements. The Company's investment policy addresses the level of credit exposure by limiting the concentration in any one corporate issuer or sector and establishing a minimum allowable credit rating. To manage the risk exposure, the Company invests cash equivalents and short-term investments in a variety of fixed income securities, including government and investment-grade debt securities and money market funds. The Company places its cash primarily in checking and money market accounts with reputable financial institutions. Deposits held with these financial institutions may exceed the amount of insurance provided on such deposits, if any.

The Company's accounts receivable are typically unsecured and are derived from customers around the world in different industries. The Company performs ongoing credit evaluations of its customers and maintains allowances for potential credit losses. Historically, such losses have been within management's expectations. As of December 31, 2016 and 2015, no single customer accounted for more than 10% of the Company's net accounts receivable balance. No single customer accounted for more than 10% of the Company's revenue in the years ended December 31, 2016, 2015 and 2014.

The Company's note hedge transactions, entered into in connection with the Notes, as defined and further described in Note 4—Fair Value Measurements, and its derivative financial instruments expose the Company to credit risk to the extent that its counterparties may be unable to meet the terms of the transactions. The Company mitigates this risk by limiting its counterparties to major financial institutions.

Accounts Receivable, Net

The Company records accounts receivable at the invoiced amount. The Company maintains an allowance for doubtful accounts to reserve for potentially uncollectible receivable amounts. In evaluating the Company's ability to collect outstanding receivable balances, the Company considers various factors including the age of the balance, the creditworthiness of the customer, which is assessed based on ongoing credit evaluations and payment history, and the customer's current financial condition.

Property and Equipment, Net

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life. The estimated useful lives of property and equipment are described below:

Property and Equipment	Estimated Useful Life
Computer hardware, networking and office equipment	Three to five years
Computer software	One to four years
Furniture and fixtures	Five years
Leasehold improvements	Lesser of estimated useful life or remaining lease term

Costs of maintenance and repairs that do not improve or extend the lives of the respective assets are expensed as incurred. Upon retirement or sale, the cost and related accumulated depreciation are removed from the balance sheet and the resulting gain or loss is reflected in operating expenses.

Capitalization of Interest

Interest costs is capitalized for assets that are constructed for the Company's own internal use, this includes internally developed software and property and equipment, for the period of time to get them ready for its intended use. During the years ended December 31, 2016 and 2015, the Company capitalized $4.3 million and $5.0 million of interest expense, respectively. Capitalized interest was not material in 2014.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired in a business combination. Goodwill is not amortized, but is tested for impairment at least annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. The Company's impairment tests are based on a single operating segment and reporting unit structure. If the carrying value of the reporting unit exceeds its fair value, the second step of the test is performed by comparing the carrying value of the goodwill in the reporting unit to its implied fair value. An impairment charge is recognized for the excess of the carrying value of goodwill over its implied fair value.

The Company conducted its annual goodwill impairment test during the fourth quarter of 2016 and determined that goodwill was not impaired. As such, no impairment charge was recorded in any of the periods presented in the accompanying consolidated financial statements.

Intangible Assets

Intangible assets are carried at cost and amortized on a straight-line basis over their estimated useful lives of up to eleven years. The Company reviews identifiable amortizable intangible assets to be held and used for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Determination of recoverability is based on the lowest level of identifiable estimated undiscounted cash flows resulting from use of the asset and its eventual disposition. Measurement of any impairment loss is based on the excess of the carrying value of the asset over its fair value. There has been no impairment charges recorded in any of the periods presented in the accompanying consolidated financial statements.

Fair Value Measurements

The Company classifies and discloses assets and liabilities measured at fair value on a recurring basis, as well as fair value measurements of assets and liabilities measured on a nonrecurring basis in periods subsequent to initial measurement, in a three-tier fair value hierarchy as described below. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs that may be used to measure fair value are as follows:

Level 1—Observable inputs, such as quoted prices in active markets for identical assets or liabilities.

Level 2—Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Internal Use Software and Website Development Costs

The Company capitalizes certain costs incurred in developing software programs or websites for internal use. In the years ended December 31, 2016, 2015 and 2014, the Company capitalized costs totaling approximately $139.0

million, $92.8 million and $79.5 million, respectively. Capitalized internal use software development costs are included in property and equipment, net. Included in the capitalized amounts above are $73.9 million, $50.3 million and $40.8 million of stock-based compensation expense in the years ended December 31, 2016, 2015 and 2014, respectively.

The estimated useful life of costs capitalized is evaluated for each specific project and is one to four years. In the years ended December 31, 2016, 2015 and 2014, the amortization of capitalized costs included in cost of revenue totaled approximately $74.6 million, $37.8 million and $15.2 million, respectively.

Income Taxes

The Company accounts for its income taxes using the asset and liability method whereby deferred tax assets and liabilities are determined based on temporary differences between the bases used for financial reporting and income tax reporting purposes, as well as for operating loss and tax credit carryforwards. Deferred income taxes are provided based on the enacted tax rates expected to be in effect at the time such temporary differences are expected to reverse. A valuation allowance is provided for deferred tax assets if it is more-likely-than-not that the Company will not realize those tax assets through future operations.

The Company evaluates and accounts for uncertain tax positions using a two-step approach. Recognition (step one) occurs when the Company concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustainable upon examination. Measurement (step two) determines the amount of benefit that is greater than 50% likely to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. De-recognition of a tax position that was previously recognized would occur when the Company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained.

Although the Company believes that it has adequately reserved for uncertain tax positions, the Company can provide no assurance that the final tax outcome of these matters will not be materially different. The Company makes adjustments to these reserves when facts and circumstances change, such as the closing of a tax audit, the lapsing of a statute, or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made and could have a material impact on the Company’s financial position and results of operations.

Foreign Currency

The functional currency of the Company's foreign subsidiaries is generally the local currency. The financial statements of these subsidiaries are translated into U.S. dollars using period-end rates of exchange for assets and liabilities, historical rates of exchange for equity, and average rates of exchange for revenue and expenses. Translation gains (losses) are recorded in accumulated other comprehensive income (loss) as a component of stockholders’ equity. Unrealized foreign exchange gains and losses due to re-measurement of monetary assets and liabilities denominated in non-functional currencies as well as realized foreign exchange gains and losses on foreign exchange transactions are recorded in other income (expense), net in the accompanying consolidated statements of operations.

Advertising Costs

Advertising costs are expensed when incurred and are included in sales and marketing expense in the accompanying consolidated statements of operations. Advertising expense totaled $114.3 million, $119.7 million and $46.6 million for the years ended December 31, 2016, 2015 and 2014 respectively.

Comprehensive Loss

Comprehensive loss consists of two components, net loss and other comprehensive income (loss). Other comprehensive income (loss) refers to gains and losses that are recorded as an element of stockholders’ equity and are excluded from net loss. The Company’s other comprehensive income (loss) is comprised of unrealized gains or losses on available-for-sale securities, net of tax, and foreign currency translation adjustments.

Recent Accounting Pronouncements

Recently adopted accounting pronouncement

In June 2014, the Financial Accounting Standards Board (“FASB”) issued a new accounting standard update on stock-based compensation when the terms of an award provide that a performance target could be achieved after the requisite service period. The new guidance requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. The Company adopted this guidance prospectively during the year ended December 31, 2016, and the adoption had no impact to the Company’s financial statements.

In February 2015, the FASB issued a new accounting standard update on consolidation analysis. The new guidance amends the current consolidation guidance with respect to the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This guidance became effective for reporting periods beginning after December 15, 2015. The Company adopted this guidance retrospectively during the year ended December 31, 2016, and the adoption had no impact on the Company's financial statements.

In April 2015, the FASB issued a new accounting standard update on the presentation of debt issuance costs. The new guidance requires the debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. The Company adopted this guidance retrospectively during the year ended December 31, 2016 and the adoption had an immaterial impact on the Company's financial statements.

In September 2015, the FASB issued a new accounting standard update on simplifying the accounting for measurement-period adjustments in business combinations. The new guidance requires that the adjustments to provisional amounts that are identified during the measurement period be recognized in the reporting period when the adjustments are determined. In addition, the effect on earnings of changes as a result of the change to the provisional amounts is required to be recorded in the same period's financial statements. The Company adopted this guidance prospectively on January 1, 2016, and the adoption had no impact on the Company's financial statements.

Recently issued accounting pronouncements not yet adopted

In May 2014, the FASB issued a new accounting standard update on revenue recognition from contracts with customers. The new guidance will replace all current GAAP guidance on this topic and eliminate industry-specific guidance. According to the new guidance, revenue is recognized when promised goods or services are transferred to customers in an amount that reflects the consideration for which the Company expects to be entitled in exchange for those goods or services. The guidance will be effective for fiscal years and interim periods with those fiscal years, beginning after December 15, 2017 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. In March 2016, April 2016, May 2016 and December 2016, the FASB further amended the guidance to clarify the implementation on principal versus agent considerations, the identification of performance obligation and the licensing implementation guidance, to provide narrow-scope improvements and practical expedients, and technical corrections and improvements. The Company will adopt this standard effective January 1, 2018 and currently anticipates adopting the standard using the modified retrospective method. The Company is still in the process of completing its analysis of the impact this standard will have on the consolidated financial statements. Specifically, while the Company has not yet finalized its analysis of the recognition impact this standard will have on advertising revenue, the Company does not expect the impact to be material; the Company is still assessing the recognition impact of adopting this standard on data licensing and other revenue; and the Company has not completed its assessment of the presentation impact of adoption of the new principal versus agent guidance on its arrangements.

In January 2016, the FASB issued a new accounting standard update on the classification and measurement of financial instruments. The new guidance principally affects accounting standards for equity investments, financial liabilities where the fair value option has been elected, and the presentation and disclosure requirements for financial instruments. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company is evaluating the impact of adopting this new accounting standard update on the financial statements and related disclosures.

In February 2016, the FASB issued a new accounting standard update on leases. The new guidance requires lessees to recognize right-of-use assets and lease liabilities for operating leases, initially measured at the present value of the lease payments, on the balance sheet. In addition, it requires lessees to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, generally on a straight-line basis. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company is evaluating the impact of adopting this new accounting standard update on the financial statements and related disclosures and anticipates this new guidance will materially impact the Company’s financial statements given the Company has a significant number of operating leases.

In March 2016, the FASB issued a new accounting standard update on simplifying the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The new guidance also allows an entity to account for forfeitures when they occur. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company will adopt this new guidance during the three months ending March 31, 2017. Adoption will require all tax benefits in excess of stock-based compensation costs to be recorded in the consolidated statements of operations as a component of the provision for income taxes, whereas they are currently recorded in equity. This change is required to be applied prospectively to excess tax benefits resulting from settlements after the date of adoption. For excess tax benefits not previously recognized, the Company will be required to apply the modified retrospective method with a cumulative-effect adjustment to opening accumulated deficit. In the quarter ending March 31, 2017, the Company will recognize deferred tax assets for its accumulated net operating losses related to excess tax benefits as of December 31, 2016 not previously recognized. However, given the valuation allowance placed on substantially all of the deferred tax assets, the recognition upon adoption is not expected to have a material impact on the Company’s accumulated deficit. Additionally, the consolidated statements of cash flows will include excess tax benefits as an operating activity, with the prior periods adjusted accordingly, as a result of the adoption. Finally, the Company will elect to account for forfeitures as they occur, rather than estimate expected forfeitures.

In June 2016, the FASB issued a new accounting standard update on the measurement of credit losses on financial instruments. The new guidance requires financial assets measured at amortized cost to be presented at the net amount expected to be collected and available-for-sale debt securities to record credit losses through an allowance for credit losses. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted as early as of the fiscal years beginning after December 15, 2018. The Company is evaluating the impact of adopting this new accounting standard update on the financial statements and related disclosures.

In August 2016, the FASB issued a new accounting standard update on the statement of cash flows. The new guidance clarifies classification of certain cash receipts and cash payments in the statement of cash flows. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company is evaluating the impact of adopting this new accounting standard update on the financial statements and related disclosures.

In October 2016, the FASB issued a new accounting standard update on simplifying the accounting for income taxes related to intra-entity asset transfers. The new guidance requires an entity to recognize the tax expense from the sale of an asset in the seller’s tax jurisdiction when the transfers occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. The modified retrospective approach will be required for transition to the new guidance, with a cumulative-effect adjustment recorded in retained earnings as of the period of adoption. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted only in the first quarter of 2017. The Company is evaluating the impact of adopting this new accounting standard update on the financial statements and related disclosures.

In November 2016, the FASB issued a new accounting standard update on the presentation of restricted cash in the statement of cash flows. The new guidance requires an entity to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows, and an entity will no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company is evaluating the impact of adopting this new accounting standard update on the financial statements and related disclosures.

In January 2017, the FASB issued a new accounting standard update on narrowing the definition of a business. The new guidance requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of transferred assets and activities is not a business. The guidance also requires a business to include at least one substantive process and narrows the definition of outputs. This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company plans to early adopt this new accounting standard update during the three months ended March 31, 2017. Adoption is expected to have no impact on the Company's financial statements.

In January 2017, the FASB issued a new accounting standard update on simplifying the accounting for goodwill impairment. The new guidance eliminates the requirement to calculate the implied fair value of goodwill (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. This guidance will be effective in fiscal year 2020 and will be applied prospectively. Early adoption is permitted for any impairment tests performed after January 1, 2017. The Company plans to early adopt this new accounting standard update during fiscal year 2017. Adoption is not expected to have a material impact on the Company's financial statements.

Note 3. Cash, Cash Equivalents and Short-term Investments

Cash, cash equivalents and short-term investments consist of the following (in thousands):

	December 31, 2016	December 31, 2015
Cash and cash equivalents:		
Cash	$253,808	$300,363
Money market funds	422,515	141,700
U.S. government and agency securities including treasury bills	12,639	—
Corporate notes, commercial paper and certificates of deposit	299,636	469,408
Total cash and cash equivalents	$988,598	$911,471
Short-term investments:		
U.S. government and agency securities including treasury bills	$1,183,768	$1,156,418
Corporate notes, commercial paper and certificates of deposit	1,602,213	1,427,459
Total short-term investments	$2,785,981	$2,583,877

The following tables summarize unrealized gains and losses related to available-for-sale securities classified as short-term investments on the Company's consolidated balance sheets as of December 31, 2016 and 2015 (in thousands):

	December 31, 2016			
	Gross Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Aggregated Estimated Fair Value
U.S. government and agency securities including treasury bills	$1,185,274	$ 136	$ (1,642)	$1,183,768

Corporate notes, commercial paper and certificates of deposit	1,603,048	114	(949)	1,602,213
Total available-for-sale securities classified as short-term investments	$2,788,322	$ 250	$ (2,591)	$2,785,981

	December 31, 2015			
	Gross Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Aggregated Estimated Fair Value
U.S. government and agency securities including treasury bills	$1,158,479	$ 6	$ (2,067)	$1,156,418
Corporate notes, certificates of deposit and commercial paper	1,429,374	21	(1,936)	1,427,459
Total available-for-sale securities classified as short-term investments	$2,587,853	$ 27	$ (4,003)	$2,583,877

The available-for-sale securities classified as cash and cash equivalents on the consolidated balance sheets are not included in the tables above as the gross unrealized gains and losses were immaterial for each period and their carrying value approximates fair value because of the short maturity period of these instruments.

The contractual maturities of securities classified as available-for-sale as of December 31, 2016 were as follows (in thousands):

	December 31, 2016	
Due within one year	$	1,990,083
Due after one year through two years		795,898
Total	$	2,785,981

The gross unrealized loss on securities in a continuous loss position for 12 months or longer was not material as of December 31, 2016 and there were no securities in a continuous loss position for 12 months or longer as of December 31, 2015.

Investments are reviewed periodically to identify possible other-than-temporary impairments. No impairment loss has been recorded on the securities included in the tables above as the Company believes that the decrease in fair value of these securities is temporary and expects to recover at least up to the initial cost of investment for these securities.

Note 4. Fair Value Measurements

The Company measures its cash equivalents, short-term investments and derivative financial instruments at fair value. The Company classifies its cash equivalents, short-term investments and derivative financial instruments within Level 1 or Level 2 because the Company values these investments using quoted market prices or alternative pricing sources and models utilizing market observable inputs. The fair value of the Company’s Level 1 financial assets is based on quoted market prices of the identical underlying security. The fair value of the Company’s Level 2 financial assets is based on inputs that are directly or indirectly observable in the market, including the readily-available pricing sources for the identical underlying security that may not be actively traded.

The following tables set forth the fair value of the Company's financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015 based on the three-tier fair value hierarchy (in thousands):

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents:				
Money market funds	$422,515	$—	$ —	$422,515
Treasury bills	12,639	—	—	12,639
Corporate notes	—	7,387	—	7,387
Commercial paper	—	292,249	—	292,249
Short-term investments:				
U.S. government securities	—	657,502	—	657,502
Agency securities	—	526,266	—	526,266
Corporate notes	—	689,986	—	689,986
Commercial paper	—	311,238	—	311,238
Certificates of deposit	—	600,989	—	600,989
Other current assets:				
Foreign currency contracts	—	1,955	—	1,955
Total	$435,154	$3,087,572	$ —	$3,522,726
Liabilities				
Other current liabilities:				
Foreign currency contracts	—	500	—	500
Total	$—	$500	$ —	$500

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents:				
Money market funds	$141,700	$—	$ —	$141,700
Commercial paper	—	419,110	—	419,110
Certificates of deposit	—	50,298	—	50,298
Short-term investments:				
Treasury bills	29,953	—	—	29,953
U.S. government securities	—	537,168	—	537,168
Agency securities	—	589,297	—	589,297
Corporate notes	—	693,593	—	693,593
Commercial paper	—	229,965	—	229,965
Certificates of deposit	—	503,901	—	503,901
Other current assets:				
Foreign currency contracts	—	6,804	—	6,804
Total	$171,653	$3,030,136	$ —	$3,201,789
Liabilities				

Other current liabilities:				
Foreign currency contracts	—	3,005	—	3,005
Total	$—	$3,005	$ —	$3,005

In 2014, the Company issued $935.0 million principal amount of 0.25% convertible senior notes due in 2019 (the "2019 Notes") and $954.0 million principal amount of 1.00% convertible senior notes due in 2021 (the "2021 Notes" and together with the 2019 Notes, the "Notes") in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. Refer to Note 9 – Convertible Senior Notes for further details on the Notes. The estimated fair value of the 2019 Notes and 2021 Notes based on a market approach as of December 31, 2016 was approximately $879.0 million and $880.4 million respectively, which represents a Level 2 valuation. The estimated fair value was determined based on the estimated or actual bids and offers of the Notes in an over-the-counter market on the last business day of the period.

Derivative Financial Instruments

The Company enters into foreign currency forward contracts with financial institutions to reduce the risk that its earnings may be adversely affected by the impact of exchange rate fluctuations on monetary assets or liabilities denominated in currencies other than the functional currency of a subsidiary. These contracts do not subject the Company to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the hedged foreign currency denominated assets and liabilities. These foreign currency forward contracts are not designated as hedging instruments.

The Company recognizes these derivative instruments as either assets or liabilities in the consolidated balance sheets at fair value based on a Level 2 valuation. The Company records changes in the fair value (i.e., gains or losses) of the derivatives as other income (expense), net in the consolidated statements of operations. The notional principal of foreign currency contracts outstanding was equivalent to $536.9 million and $522.4 million at December 31, 2016 and 2015, respectively.

The fair values of outstanding derivative instruments for the periods presented on a gross basis are as follows (in thousands):

	Balance Sheet Location	December 31, 2016	December 31, 2015
Assets			
Foreign currency contracts not designated as hedging instruments	Other current assets	$ 1,955	6,804
Liabilities			
Foreign currency contracts not designated as hedging instruments	Other current liabilities	500	3,005
Total fair value of derivative instruments		$ 1,455	$ 3,799

The Company recognized $1.6 million and $0.4 million net gains on the foreign currency contracts in the year ended December 31, 2016 and 2015, respectively. The Company did not have any derivative financial instruments in the year ended December 31, 2014.

Note 5. Property and Equipment, Net

The following table presents the detail of property and equipment, net for the periods presented (in thousands):

	December 31, 2016	December 31, 2015
Property and equipment, net		
Equipment	$909,797	$720,421
Furniture and leasehold improvements	304,613	297,274
Capitalized software	353,163	211,241
Construction in progress	74,255	85,073
Total	1,641,828	1,314,009
Less: Accumulated depreciation and amortization	(857,927)	(578,710)
Property and equipment, net	$783,901	$735,299

The gross carrying amount of property and equipment includes $361.1 million and $370.3 million of server and networking equipment acquired under capital leases as of December 31, 2016 and 2015, respectively. The accumulated depreciation of the equipment under capital leases totaled $207.0 million and $226.9 million as of December 31, 2016 and 2015, respectively.

Depreciation expense totaled $332.8 million, $257.2 million and $171.6 million for the years ended December 31, 2016, 2015 and 2014, respectively. Included in these amounts were depreciation expense for server and networking equipment acquired under capital leases in the amount of $100.8 million, $118.7 million and $108.7 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Note 6. Goodwill and Intangible Assets

The following table presents the goodwill activities for the periods presented (in thousands):

Goodwill	
Balance as of December 31, 2014	$622,570
TellApart acquisition	394,989
Other acquisitions	106,198
Foreign currency translation adjustment	(1,029)
Balance as of December 31, 2015	$1,122,728
Acquisitions	74,186
Foreign currency translation adjustment	(11,599)
Balance as of December 31, 2016	$1,185,315

For each of the periods presented, gross goodwill balance equaled the net balance since no impairment charges have been recorded. Refer to Note 8—Acquisitions for further details about goodwill.

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

	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
December 31, 2016:			
Patents and developed technologies	$122,611	$ (47,160)	$75,451
Publisher and advertiser relationships	53,100	(33,217)	19,883
Total	$175,711	$ (80,377)	$95,334
December 31, 2015:			
Patents and developed technologies	$132,444	$ (43,991)	$88,453
Publisher and advertiser relationships	75,300	(23,803)	51,497
Assembled workforce	1,960	(1,714)	246

Other intangible assets	2,100	(1,281)	819
Total	$211,804	$ (70,789)	$141,015

Patents and developed technologies are amortized over a period of up to eleven years from the respective purchase dates. Publisher and advertiser relationships are amortized over a period ranging from two to five years, and assembled workforce and other intangible assets are amortized over a period of one to four years. Amortization expense associated with intangible assets for the years ended December 31, 2016, 2015 and 2014 was $69.3 million, $54.7 million and $36.6 million, respectively. During the year ended December 31, 2016, $59.5 million in gross carrying value and accumulated amortization related to fully amortized intangible assets was eliminated.

Estimated future amortization expense as of December 31, 2016 is as follows (in thousands):

Years ending December 31,	
2017	$43,810
2018	18,855
2019	8,796
2020	6,523
2021	6,126
Thereafter	11,224
Total	$95,334

Note 7. Accrued and other current liabilities

The following table presents the detail of accrued and other current liabilities for the periods presented (in thousands):

	December 31, 2016	December 31, 2015
Accrued compensation	$82,354	$90,906
Accrued restructuring	55,942	396
Accrued publisher, content and ad network costs	44,362	23,486
Deferred revenue	33,659	23,674
Accrued tax liabilities	29,558	25,880
Accrued sales and marketing expenses	22,431	27,948
Accrued other	112,631	91,502
Total	$380,937	$283,792

Note 8. Acquisitions and Other Investments

2016 Acquisitions

During the year ended December 31, 2016, the Company acquired several companies, each of which was accounted for as a business combination. The total purchase price of $91.4 million (paid in shares of the Company's common stock having a total fair value of $1.3 million and cash of $90.1 million) for these acquisitions was allocated as follows: $14.4 million to developed technologies, $5.0 million to cash acquired, $0.2 million to net tangible assets acquired based on their estimated fair value on the acquisition date, $2.4 million to deferred tax liability, and the excess $74.2 million of the purchase price over the fair value of net assets acquired to goodwill. The goodwill from the acquisitions are mainly attributable to assembled workforce, expected synergies and other benefits. Tax deductible goodwill resulting from certain of these acquisitions was $63.8 million. The remaining goodwill is not tax deductible for U.S. income tax purposes. Developed technologies will be amortized on a straight-line basis over their estimated useful lives of up to 24 months.

The results of operations for each of these acquisitions have been included in the Company's consolidated statements of operations since the date of acquisition. Actual and pro forma revenue and results of operations for these acquisitions have not been presented because they do not have a material impact on the consolidated revenue and results of operations, either individually or in the aggregate.

2015 Acquisitions

In May 2015, the Company completed its acquisition of TellApart, Inc. ("TellApart"), a privately held marketing technology company with unique retargeting capabilities headquartered in Burlingame, California. The acquisition was expected to bring the power of retargeting to the Company to help advertisers reach their users. Under the terms of the acquisition, the Company agreed to pay $22.6 million in cash and issue approximately 12.2 million shares of its common stock in consideration for all of the issued and outstanding shares of capital stock of TellApart. In addition, the Company agreed to issue an aggregate of 1.2 million shares of the Company's common stock and 1.3 million stock options as a result of assumed TellApart equity awards held by individuals, who will continue to provide services to the Company.

The fair value of the total consideration of $479.1 million (paid in shares of the Company's common stock having a total fair value of $456.5 million and cash of $22.6 million) for the acquisition of TellApart was allocated to the acquired tangible and intangible assets and assumed liabilities based on their estimated fair values at closing as follows: $21.4 million to developed technology, $43.3 million to advertiser relationships, $2.1 million to trade name, $29.6 million to cash acquired, $19.7 million to account receivables acquired, $2.2 million to other tangible assets acquired, $11.8 million to liabilities assumed, $22.4 million to deferred tax liability recorded, and the excess $395.0 million of the purchase price over the fair value of net assets acquired was recorded as goodwill. This goodwill is primarily attributable to the expected synergies from potential monetization opportunities and from integrating the retargeting technologies into the Company's mobile platforms, and the value of acquired talent. Goodwill is not deductible for U.S. income tax purposes. Developed technology, advertiser relationships and trade names were amortized over their estimated useful lives of 12 to 72 months. The discounted cash flow method, which calculates the fair value of an asset based on the value of cash flows that the asset is expected to generate in the future, was used to estimate the fair value of the amortizable intangible assets acquired.

During the year ended December 31, 2015, the Company acquired other companies, which were accounted for as business combinations. The total purchase price of $118.9 million (paid in shares of the Company's common stock having a total fair value of $60.1 million and cash of $58.8 million) for these acquisitions was allocated as follows: $12.9 million to developed technologies, $3.2 million to net tangible assets acquired based on their estimated fair value on the acquisition date, $3.4 million to deferred tax liability, and the excess $106.2 million of the purchase price over the fair value of net assets acquired to goodwill. Tax deductible goodwill resulting from certain of these acquisitions was $4.1 million. The remaining goodwill is not tax deductible for U.S. income tax purposes. Developed technologies will be amortized on a straight-line basis over their estimated useful lives of 12 to 60 months.

In connection with all of the acquisitions completed during the year ended December 31, 2015, the Company also agreed to pay cash and issue shares of its common stock with a total fair value up to $102.9 million, which is to be paid to certain employees of the acquired entities contingent upon their continued employment with the Company. The Company will recognize compensation expense related to the equity consideration over the requisite service periods of up to 48 months from the respective acquisition dates on a straight-line basis. In addition, the Company will recognize approximately $37.2 million of stock-based compensation expense in relation to assumed stock options over the remaining requisite service periods of up to 45 months from the respective acquisition dates on a straight-line basis, excluding the fair value of the assumed stock options that was allocated and recorded as part of the purchase price for the portion of the service period completed prior to the closing of the applicable acquisition.

The results of operations for each of these acquisitions have been included in the Company's consolidated statements of operations since the date of acquisition. Actual and pro forma revenue and results of operations for these acquisitions have not been presented because they do not have a material impact to the consolidated revenue and results of operations, either individually or in aggregate.

2014 Acquisitions

In May 2014, the Company completed its acquisition of privately held Gnip, Inc. ("Gnip"), a leading provider of social data and analytics headquartered in Boulder, Colorado. The acquisition was made to allow the Company to further enhance its data analytics capabilities. Under the terms of the acquisition, the Company agreed to pay $107.3 million in cash and issue a total of 0.6 million shares of its common stock, including shares of restricted stock subject to continued employment, in consideration for all of the issued and outstanding shares of capital stock of Gnip. In addition, the Company agreed to issue up to 0.4 million shares of the Company's common stock as a result of assumed Gnip equity awards held by individuals, who will continue to provide services to the Company. The fair value of the total consideration of $134.1 million, including the earned portion of assumed stock options and other equity awards, was allocated to the acquired tangible and intangible assets and assumed liabilities based on their estimated fair values at closing as follows: $23.2 million to developed technology, $9.3 million to customer relationships, $9.1 million to tangible assets acquired, $5.8 million to liabilities assumed, $6.4 million to deferred tax liability recorded, and the excess $104.7 million of the purchase price over the fair value of net assets acquired was recorded as goodwill. This goodwill is primarily attributable to the potential expansion and future development of the Company’s data products, expected synergies arising from the acquisition and the value of acquired talent. Goodwill is not deductible for U.S. income tax purposes. Both developed technology and customer relationships were amortized on a straight-line basis over their estimated useful life of 60 months. The discounted cash flow method, which calculates the fair value of an asset based on the value of cash flows that the asset is expected to generate in the future, was used to estimate the fair value of these intangible assets acquired.

During the year ended December 31, 2014, the Company acquired other companies, which were accounted for as business combinations. The total purchase price of $188.1 million (paid in shares of the Company's common stock having a total fair value of $121.2 million and cash of $66.9 million) for these acquisitions was preliminarily allocated as follows: $28.1 million to developed technologies, $1.6 million to customer relationships, $6.5 million to net tangible assets acquired based on their estimated fair value on the acquisition date, $3.2 million to deferred tax liability, and the excess $155.1 million of the purchase price over the fair value of net assets acquired to goodwill. Tax deductible goodwill resulting from certain of these acquisitions was $21.9 million as of December 31, 2014, the remaining amounts are not tax deductible for U.S. income tax purposes. Developed technologies and customer relationships will be amortized on a straight-line basis over their estimated useful lives of 12 to 48 months.

In connection with all of the acquisitions completed during the year ended December 31, 2014, the Company also agreed to pay cash and shares of the Company's common stock with a total fair value up to $97.7 million, which is to be paid to certain employees of the acquired entities contingent upon their continued employment with the Company. In addition, the fair value of assumed stock options determined to be part of post-acquisition stock-based compensation amounted to approximately $16.9 million. The Company recognizes compensation expense in relation to these cash and equity consideration and assumed stock options over the remaining requisite service periods of up to 48 months from the respective acquisition dates on a straight-line basis.

The results of operations for each of these acquisitions have been included in the Company's consolidated statements of operations since the date of acquisition. Actual and pro forma revenue and results of operations for these acquisitions have not been presented because they do not have a material impact to the consolidated revenue and results of operations, either individually or in aggregate.

Investments in Privately-Held Companies

The Company has determined, as of December 31, 2016, there were no variable interest entities required to be consolidated in the Company's Consolidated Financial Statements. The Company's investments in privately-held companies are primarily accounted for using the cost method which had a carrying value of $90.2 million and $14.2 million as of December 31, 2016 and 2015, respectively. The maximum loss the Company can incur for its investments is their carrying value. These investments in privately-held companies are included within Other Assets on the consolidated balance sheets.

Note 9. Convertible Notes

In September 2014, the Company issued $900.0 million principal amount of 2019 Notes and $900.0 million principal amount of 2021 Notes in a private placement to qualified institutional buyers pursuant to Rule144A under the Securities Act of 1933, as amended. In October 2014, pursuant to the exercise of the overallotment option by the initial purchasers, the Company issued an additional $35.0 million principal amount of 2019 Notes and $54.0 million principal amount of 2021 Notes. The total net proceeds from this offering were approximately $1.86 billion, after deducting $28.3 million of initial purchasers' discount and $0.5 million debt issuance costs in connection with the 2019 Notes and the 2021 Notes.

The interest rates are fixed at 0.25% and 1.00% per annum and are payable semi-annually in arrears on March 15 and September 15 of each year, commencing on March 15, 2015. During the years ended December 31, 2016, 2015 and 2014, the Company recognized $4.9 million, $5.1 million and $1.4 million, respectively, of interest expense related to the amortization of initial purchasers' discount and debt issuance costs. The Company recognized $11.9 million of coupon interest expense in each of the years ended December 31, 2016 and 2015, and $3.3 million in the year ended December 31, 2014.

Each $1,000 of principal of these Notes will initially be convertible into 12.8793 shares of the Company’s common stock, which is equivalent to an initial conversion price of approximately $77.64 per share, subject to adjustment upon the occurrence of specified events. Holders of these notes may convert their notes at their option at any time until close of business on the second scheduled trading day immediately preceding the relevant maturity date which is March 15, 2019 for the 2019 Notes and March 15, 2021 for the 2021 Notes. Further, holders of each of these notes may convert their notes at their option prior to the respective dates above, only under the following circumstances:

1) during any calendar quarter commencing after the calendar quarter ending on December 31, 2014 (and only during such calendar quarters), if the last reported sale price of Twitter’s 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 for the relevant series of notes 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 related Indenture) per $1,000 principal amount of 2019 notes or 2021 notes, as applicable, for each trading day of the measurement period was less than 98% of the product of the last reported sale price of Twitter’s common stock and the conversion rate for the notes of the relevant series on each such trading day; or
3) upon the occurrence of certain specified corporate events.

Upon conversion of the 2019 Notes and 2021 Notes, the Company will pay or deliver, as the case may be, cash, shares of its common stock or a combination of cash and shares of its common stock, at the Company’s election. If the Company satisfies its conversion obligation solely in cash or through payment and delivery, as the case may be, of a combination of cash and shares of its common stock, the amount of cash and shares of common stock, if any, due upon conversion will be based on a daily conversion value (as described herein) calculated on a proportionate basis for each trading day in a 30 trading day observation period.

If a fundamental change (as defined in the relevant indenture governing the applicable series of Notes) occurs prior to the maturity date, holders of the 2019 Notes and 2021 Notes may require the Company to repurchase all or a portion of their notes for cash at a repurchase price equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest to, but excluding, the repurchase date. In addition, if specific corporate events occur prior to the applicable maturity date, the Company will be required to increase the conversion rate for holders who elect to convert their notes in certain circumstances.

In accordance with accounting guidance on embedded conversion features, the Company valued and bifurcated the conversion option associated with the 2019 Notes and 2021 Notes from the respective host debt instrument, which is referred to as debt discount, and initially recorded the conversion option of $222.8 million for the 2019 Notes and $283.3 million for the 2021 Notes in stockholders’ equity. The resulting debt discounts on the 2019 Notes and 2021 Notes are being amortized to interest expense at an effective interest rate of 5.75% and 6.25%, respectively, over the contractual terms of the notes. The Company allocated $0.1 million of debt issuance costs to the equity component, and the remaining debt issuance costs of $0.4 million are being amortized to interest expense.

During the years ended December 31, 2016, 2015 and 2014, the Company recognized $79.0 million, $74.2 million and $18.8 million, respectively, of interest expense related to the amortization of the debt discount prior to capitalization of interest. As of December 31, 2016, the net carrying value, net of the initial purchasers’ discount and debt discount, of 2019 Notes and 2021 Notes was $798.6 million and $740.3 million, respectively.

The Notes consisted of the following (in thousands):

	December 31, 2016		December 31, 2015	
	2019 Notes	2021 Notes	2019 Notes	2021 Notes
Principal amounts:				
Principal	$935,000	$954,000	$935,000	$954,000
Unamortized initial purchasers' discount and debt discount [(1)]	(136,376)	(213,657)	(181,994)	(251,911)
Net carrying amount	$798,624	$740,343	$753,006	$702,089
Carrying amount of the equity component [(2)]	$222,826	$283,283	$222,826	$283,283

(1) Included in the consolidated balance sheets within convertible notes and amortized over the remaining lives of the Notes.
(2) Included in the consolidated balance sheets within additional paid-in capital.
As of December 31, 2016, the remaining life of the 2019 Notes and 2021 Notes is approximately 32 months and 56 months, respectively.

Concurrently with the offering of these Notes in September and October 2014, the Company entered into convertible note hedge transactions with certain bank counterparties whereby the Company has the option to purchase initially (subject to adjustment for certain specified events) a total of approximately 24.3 million shares of its common stock at a price of approximately $77.64 per share. The total cost of the convertible note hedge transactions was $407.2 million. In addition, the Company sold warrants to certain bank counterparties whereby the holders of the warrants have the option to purchase initially (subject to adjustment for certain specified events) a total of approximately 24.3 million shares of the Company’s common stock at a price of $105.28. The Company received $289.3 million in cash proceeds from the sale of these warrants.

Taken together, the purchase of the convertible note hedges and the sale of warrants are intended to offset any actual dilution from the conversion of these notes and to effectively increase the overall conversion price from $77.64 to $105.28 per share. As these transactions meet certain accounting criteria, the convertible note hedges and warrants are recorded in stockholders’ equity and are not accounted for as derivatives. The net cost incurred in connection with the convertible note hedge and warrant transactions was recorded as a reduction to additional paid-in capital in 2014.

Note 10. Net Loss per Share

The Company computes net loss per share of common stock in conformity with the two-class method required for participating securities. The Company considers the shares issued upon the early exercise of stock options subject to repurchase to be participating securities, because holders of such shares have non-forfeitable dividend rights in the event a dividend is paid on common stock. The holders of early exercised shares subject to repurchase do not have a contractual obligation to share in the losses of the Company. As such, the Company’s net losses for the years ended December 31, 2016, 2015 and 2014 were not allocated to these participating securities.

Basic net loss per share is computed by dividing total net loss attributable to common stockholders by the weighted-average common shares outstanding. The weighted-average common shares outstanding is adjusted for shares subject to repurchase such as unvested restricted stock granted to employees in connection with acquisitions, contingently returnable shares and escrowed shares supporting indemnification obligations that are issued in connection with acquisitions and unvested stock options exercised. Diluted net loss per share is computed by dividing the net loss attributable to common stockholders by the weighted-average number of common shares outstanding including potential dilutive common stock instruments. In the years ended December 31, 2016, 2015 and 2014, the Company’s potential common stock instruments such as stock options, RSUs, shares to be purchased under the 2013 Employee Stock Purchase Plan, shares subject to repurchases, conversion feature of the Notes and the warrants were not included in the computation of diluted loss per share as the effect of including these shares in the calculation would have been anti-dilutive.

The following table presents the calculation of basic and diluted net loss per share for periods presented (in thousands, except per share data).

	Year Ended December 31,		
	2016	2015	2014
Net loss	$(456,873)	$(521,031)	$(577,820)
Basic shares:			
Weighted-average common shares outstanding	708,010	670,132	613,944
Weighted-average restricted stock subject to repurchase	(5,875)	(7,708)	(8,954)
Weighted-average shares used to compute basic net loss per share	702,135	662,424	604,990
Diluted shares:			
Weighted-average shares used to compute diluted net loss per share	702,135	662,424	604,990
Net loss per share attributable to common stockholders:			
Basic	$(0.65)	$(0.79)	$(0.96)
Diluted	$(0.65)	$(0.79)	$(0.96)

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

	Year Ended December 31,		
	2016	2015	2014
RSUs	48,069	43,170	64,135
Warrants	24,329	24,329	24,329
Stock options	8,723	11,177	20,420
Shares subject to repurchase and others	6,637	9,146	9,335

Since the Company expects to settle the principal amount of the outstanding Notes in cash, the Company uses the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread of 24.3 million shares will have a dilutive impact on diluted net income per share of common stock when the average market price of the Company’s common stock for a given period exceeds the conversion price of $77.64 per share for the Notes.

If the average market price of the common stock exceeds the exercise price of the warrants, $105.28, the warrants will have a dilutive effect on the earnings per share assuming that the Company is profitable. Since the average market price of the common stock is below $105.28, the warrants are anti-dilutive.

Note 11. Preferred Stock

Prior to the initial public offering, the Company had outstanding shares of Class A junior preferred stock and several series of convertible preferred stock. Each share of preferred stock was convertible to one share of common stock. Upon the closing of the Company’s initial public offering on November 13, 2013, all shares of outstanding redeemable convertible preferred stock and outstanding convertible preferred stock were automatically converted to shares of the Company’s common stock.

The Company has the authority to issue up to 200,000,000 shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the stockholders. As of December 31, 2016 and 2015, there was no preferred stock outstanding.

Note 12. Common Stock and Stockholders' Equity

Common Stock

As of December 31, 2016, the Company is authorized to issue 5.0 billion shares of $0.000005 par value common stock in accordance with the Certificate of Incorporation, as amended and restated.

Each share of common stock is entitled to one vote. The holders of common stock are also entitled to receive dividends whenever funds are legally available and when and if declared by the Board of Directors, subject to the prior rights of holders of all classes of stock outstanding. As of December 31, 2016, no dividends have been declared.

Restricted Common Stock

The Company has granted restricted common stock to certain continuing employees in connection with the acquisitions. Vesting of this stock is dependent on the respective employee's continued employment at the Company during the requisite service period, which is up to four years from the issuance date, and the Company has the right to repurchase the unvested shares upon termination of employment. The fair value of the restricted common stock issued to employees is recorded as compensation expense on a straight-line basis over the requisite service period.

The activities for the restricted common stock issued to employees for the year ended December 31, 2016 are summarized as follows (in thousands, except per share data):

	Number of Shares	Weighted-Average Grant-Date Fair Value Per Share
Unvested restricted common stock at December 31, 2015	4,540	$ 33.88
Granted	3,320	$ 16.63
Vested	(2,371)	$ 32.94
Canceled	(392)	$ 34.46
Unvested restricted common stock at December 31, 2016	5,097	$ 23.04

Equity Incentive Plans

The Company's 2013 Equity Incentive Plan became effective upon the completion of the Company's initial public offering and serves as the successor to the 2007 Equity Incentive Plan. Initially, 68.3 million shares were reserved under the 2013 Equity Incentive Plan and any shares subject to options or other similar awards granted under the 2007 Equity Incentive Plan that expire, are forfeited, are repurchased by the Company or otherwise terminate unexercised will become available under the 2013 Equity Incentive Plan. The number of shares of the Company's common stock available for issuance under the 2013 Equity Incentive Plan were and will be increased on the first day of each fiscal year beginning with the 2014 fiscal year, in an amount equal to the least of (i) 60,000,000 Shares, (ii) 5% of the outstanding Shares on the last day of the immediately preceding fiscal year or (iii) such number of Shares determined by the Company's Board of Directors. As of December 31, 2016, the total number of options and RSUs outstanding under the 2013 Equity Incentive Plan was 46.3 million shares, and 123.0 million shares were available for future issuance. There were 9.1 million shares of options and RSUs outstanding under the 2007 Equity Incentive Plan as of December 31, 2016. No additional shares have been issued under the 2007 Equity Incentive Plan since 2013. Options granted under the Company's Equity Incentive Plans generally expire 10 years after the grant date. The Company issues new shares to satisfy stock option exercises.

On May 25, 2016, the Company's stockholders approved the 2016 Equity Incentive Plan. A total of 6,814,085 shares were reserved under the 2016 Equity Incentive Plan, which equals the number of shares that the Jack Dorsey Revocable Trust dated December 8, 2010 (the "Jack Dorsey Trust"), for which Jack Dorsey, the Company's Chief Executive Officer, serves as trustee, gave back and contributed to the Company without any cost or charge to the Company. All such shares have been retired and cancelled by the Company. A maximum aggregate number of 6,814,085 shares were reserved under the 2016 Equity Incentive Plan and are available for grants.

The Company also assumed stock options of acquired entities in connection with certain acquisitions. While the respective stock plans were terminated on the closing of each acquisition, they continue to govern the terms of stock options assumed in the respective acquisition.

Employee Stock Purchase Plan

On November 7, 2013, the Company's 2013 Employee Stock Purchase Plan (the "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 twelve-month offering periods, and each offering period will include purchase periods, which will be the approximately six-month period commencing with one exercise date and ending with the next exercise date. 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 on the exercise date. The number of shares available for sale under the 2013 Employee Stock Purchase Plan were and will be increased annually on the first day of each fiscal year, equal to the least of i) 11.3 million shares; ii) 1% of the outstanding shares of the Company's common stock as of the last day of the immediately preceding fiscal year; or iii) such other amount as determined by the Board of Directors.

During the years ended December 31, 2016 and 2015, employees purchased an aggregate of 2.0 million and 1.5 million shares, respectively, under this plan at a weighted average price of $11.98 and $25.78 per share, respectively.

Stock Option Activity

A summary of stock option activity for the year ended December 31, 2016 is as follows (in thousands, except years and per share data):

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2015	11,177	$ 6.55	5.86	$ 199,576
Options granted and assumed in connection with acquisitions	557	$ 3.23		
Options exercised	(2,864)	$ 2.56		
Options canceled	(147)	$ 3.50		
Outstanding at December 31, 2016	8,723	$ 7.71	4.25	$ 98,240
Vested and expected to vest at December 31, 2016 [1]	8,147	$ 6.97	3.94	$ 94,712
Exercisable at December 31, 2016	6,962	$ 5.37	3.24	$ 85,916

[1] The expected to vest options are the result of applying pre-vesting forfeiture rate assumptions to unvested options outstanding.

The aggregate intrinsic value in the table above represents the difference between the fair value of common stock and the exercise price of outstanding, in-the-money stock options.

The total intrinsic values of stock options exercised in the years ended December 31, 2016, 2015 and 2014 were $41.4 million, $337.2 million and $872.8 million, respectively.

Performance Restricted Stock Units ("PRSUs") Activity

In 2016, the Company granted PRSUs to certain of its executive officers and established the 2016 annual performance goals for these PRSUs. The PRSUs will vest based on the Company's attainment of the annual financial performance goals and the executives' continued employment through the vesting date, approximately one year. The number of shares that ultimately vest for 2016 was estimated to be 70 percent of the annual target amount, based on the Company's performance, subject to the Compensation Committee of the Board of Director's approval. During the year ended December 31, 2016, the Company granted 165,833 PRSUs, at the 100% target level, for the 2016 performance goals with a weighted grant date fair value of $17.90 per share. In addition, there are 1,687,833 additional PRSUs that will vest based on performance goals in 2017 to 2019, if achieved at target levels. Since the performance targets for those additional PRSUs have not been established, they are not considered granted nor are presented as outstanding.

RSU Activity

The following table summarizes the activity related to the Company's RSUs for the year ended December 31, 2016. For purposes of this table, vested RSUs represent the shares for which the service condition had been fulfilled as of each respective date (in thousands, except per share data):

	RSUs Outstanding	
	Shares	Weighted-Average Grant-Date Fair Value Per Share
Unvested and outstanding at December 31, 2015	43,170	$ 32.46
Granted	51,231	$ 16.15
Vested	(26,918)	$ 23.70
Canceled	(19,414)	$ 25.88
Unvested and outstanding at December 31, 2016	48,069	$ 22.64

The total fair value of RSUs vested during the years ended December 31, 2016 and December 31, 2015 was approximately $466.4 million and $849.8 million, respectively.

Stock-Based Compensation Expense

Stock-based compensation expense is allocated based on the cost center to which the award holder belongs. Total stock-based compensation expense by function for the years ended December 31, 2016, 2015 and 2014 is as follows (in thousands):

Year Ended December 31,		
2016	2015	2014

Cost of revenue	$29,502	$40,705	$50,536
Research and development	335,498	401,537	360,726
Sales and marketing	160,935	156,904	157,263
General and administrative	89,298	82,972	63,072
Total stock-based compensation expense	$615,233	$682,118	$631,597

During 2014, the Company modified the terms of stock options and RSUs for certain employees upon their termination or change in employment status. The Company recorded incremental stock-based compensation in relation to the modification of stock-based awards of approximately $32.6 million in the year ended December 31, 2014. The amount of incremental stock-based compensation recorded in relation to the modification of stock-based awards was not material for the years ended December 31, 2016 and 2015.

Income tax benefits recognized for stock-based compensation arrangements during the years ended December 31, 2016, 2015 and 2014 were not material.

The Company capitalized $73.9 million, $50.3 million and $40.8 million of stock-based compensation expense associated with the cost for developing software for internal use in the years ended December 31, 2016, 2015 and 2014, respectively.

As of December 31, 2016, there was $844.0 million of unamortized stock-based compensation expense related to unvested awards which is expected to be recognized over a weighted-average period of 2.18 years.

Note 13. Income Taxes

The domestic and foreign components of pre-tax loss for the years ended December 31, 2016, 2015 and 2014 are as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Domestic	$(237,325)	$(201,628)	$(164,854)
Foreign	(203,509)	(331,677)	(413,497)
Loss before income taxes	$(440,834)	$(533,305)	$(578,351)

The components of the provision (benefit) for income taxes for the years ended December 31, 2016, 2015 and 2014 are as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Current:			
Federal	$1,087	$—	$—
State	(143)	1,226	720
Foreign	19,870	14,625	8,358
Total current provision for income taxes	20,814	15,851	9,078
Deferred:			
Federal	293	(23,208)	(8,972)
State	17	(852)	(128)
Foreign	(5,085)	(4,065)	(509)
Total deferred benefit for income taxes	(4,775)	(28,125)	(9,609)
Provision (benefit) for income taxes	$16,039	$(12,274)	$(531)

The following is a reconciliation of the statutory federal income tax rate to the Company's effective tax rate for the years ended December 31, 2016, 2015 and 2014:

	Year Ended December 31,		
	2016	2015	2014
Tax at federal statutory rate	35.0 %	35.0 %	35.0 %
State taxes, net of federal benefit	0.0	(0.1)	(0.1)
Stock-based compensation	(2.3)	(2.9)	(4.2)
Research and development credits	6.6	7.2	25.2
Valuation Allowance	(7.0)	3.1	(9.4)
Nondeductible expenses	(7.0)	(5.6)	(4.5)
Foreign rate differential	(19.5)	(23.7)	(26.4)
Change in tax positions	(9.5)	(10.7)	(15.9)
Other	0.1	0.0	0.4
Effective tax rate	(3.6)%	2.3 %	0.1 %

The tax effects of temporary differences and related deferred tax assets and liabilities as of December 31, 2016 and 2015 are as follows (in thousands):

	December 31,	
	2016	2015
Deferred tax assets:		
Net operating loss carryforwards	$235,668	$242,987
Accruals and reserves	61,594	36,133
Stock-based compensation expense	64,136	80,106
Research and development credits	251,808	209,425
California Enterprise Zone Credit	12,266	11,710
Fixed assets and intangible assets	2,631	1,457
Other	11,980	7,059
Total deferred tax assets	640,083	588,877
Valuation allowance	(439,993)	(378,448)
Total deferred tax assets, net of valuation allowance	200,090	210,429
Deferred tax liabilities:		
Fixed assets and intangible assets	(168,223)	(174,007)
Convertible notes	(24,303)	(30,002)
Other	(1,612)	(1,577)
Total deferred tax liabilities	(194,138)	(205,586)
Net deferred tax assets	$5,952	$4,843

Based on the available objective evidence, management believes it is more-likely-than-not that the net U.S. and Brazil deferred tax assets were not fully realizable as of the year ended December 31, 2016. Accordingly, the Company has established a full valuation allowance against its U.S. and Brazil deferred tax assets. As of December 31, 2016, the Company has net $6.6 million of deferred tax assets in foreign jurisdictions which it believes are more-likely-than-not to be fully realized given the expectation of future earnings in these jurisdictions.

For the year ended December 31, 2016, the Company has not provided for income taxes on $157.1 million of its undistributed earnings for certain foreign subsidiaries because these earnings are intended to be indefinitely reinvested in operations outside the U.S. Determining the unrecognized deferred tax liabilities associated with these earnings is not practicable.

At December 31, 2016, the Company had $3.47 billion of federal and $1.41 billion of state net operating loss carryforwards available to reduce future taxable income, which will begin to expire in 2027 for federal and 2017 for state tax purposes.

Pursuant to authoritative guidance, effective through December 31, 2016, the excess benefit from stock-based compensation was recorded to stockholders' equity when cash taxes payable were reduced. As of December 31, 2016, the portion of net operating loss carryforwards related to the excess tax benefit from stock-based compensation was approximately $3.42 billion. The income tax benefits resulting from stock awards that were credited to stockholders' equity for the year ended December 31, 2016 were $0.2 million.

The Company also has research credit carryforwards of $222.8 million and $184.5 million for federal and state income tax purposes, respectively. The federal credit carryforward will begin to expire in 2027. The state research tax credits have no expiration date. Additionally, the Company has California Enterprise Zone Credit carryforwards of $18.9 million which will begin to expire in 2023.

Utilization of the net operating loss carryforwards and credits may be subject to an annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended (the "Code"), and similar state provisions. Any annual limitation may result in the expiration of net operating losses and credits before utilization.

As of December 31, 2016, the unrecognized tax benefit was $269.5 million, including $263.7 million of unrecognized tax benefits which, if recognized, will not affect the annual effective tax rate as these unrecognized tax benefits would increase deferred tax assets which would be subject to a full valuation allowance, and the remaining $5.8 million of unrecognized tax benefits which, if recognized, would affect the annual effective tax rate. A reconciliation of the beginning and ending amount of unrecognized tax benefit is as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Balance at the beginning of the year	$209,443	$182,484	$43,061
Additions related to prior year tax positions	3,682	1,820	—
Reductions related to prior year tax positions	—	(45,305)	(50)
Additions related to current year tax positions	56,383	70,444	139,473
Balance at the end of the year	$269,508	$209,443	$182,484

Total unrecognized tax benefits are recorded on the Company's consolidated balance sheets as follows (in thousands):

	December 31,	
	2016	2015
Total unrecognized tax benefits balance	$269,508	$209,443
Amounts netted against related deferred tax assets	(263,696)	(208,307)
Unrecognized tax benefits recorded on consolidated balance sheets	$5,812	$1,136

The net unrecognized tax benefit of $5.8 million and $1.1 million as of December 31, 2016 and 2015, respectively, was included in the deferred and other long-term tax liabilities, net on the Company's consolidated balance sheets. The Company does not believe that its unrecognized tax benefits will significantly change within the next 12 months.

The Company recognizes interest and/or penalties related to income tax matters as a component of income tax expense. As of December 31, 2016 there were no significant accrued interest and penalties related to uncertain tax positions.

On July 27, 2015, the United State Tax Court issued an opinion (Altera Corp. et al. v. Commissioner), which invalidated the 2003 final Treasury rule that requires participants in qualified cost-sharing arrangements to share stock-based compensation costs. As such, the Company filed its 2014 and 2015 federal tax returns based upon the opinion rendered in this case, which resulted in an increase in the 2014 and 2015 net operating losses in the U.S jurisdiction. As the Company maintains a full valuation allowance on its US deferred tax assets, no benefit was realized in the financial statements as a result of this filing position.

The Company is subject to taxation in the United States and various state and foreign jurisdictions. Earnings from non-US activities are subject to local country income tax. The material jurisdictions in which the Company is subject to potential examination by taxing authorities include the United States, California and Ireland. The Company is currently under a Federal income tax examination by the Internal Revenue Service (IRS) for tax years 2011, 2012 and 2013. The Company believes that adequate amounts have been reserved in these jurisdictions. The Company's 2007 to

2016 tax years remain subject to examination by the United States and California, and its 2011 to 2016 tax years remain subject to examination in Ireland. The Company remains subject to possible examination in various other jurisdictions that are not expected to result in material tax adjustments.

Note 14. Commitments and Contingencies

Credit Facility

The Company entered into a revolving credit agreement with certain lenders in 2013, which provided for a $1.0 billion revolving unsecured credit facility maturing on October 22, 2018. Loans under the credit facility bear interest, at the Company's option, at (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 plus 1.00%, in each case plus a margin ranging from 0.00% to 0.75% or (ii) an adjusted LIBOR rate plus a margin ranging from 1.00% to 1.75%. This margin is determined based on the total leverage ratio for the preceding four fiscal quarter period. The Company is obligated to pay other customary fees for a credit facility of this size and type, including an upfront fee and an unused commitment fee. Obligations under the credit facility are guaranteed by one of the Company's wholly-owned subsidiaries. In addition, the credit facility contains restrictions on payments including cash payments of dividends.

The revolving credit agreement was amended in September 2014 to increase the amount of indebtedness that the Company may incur and increase the amount of restricted payments that the Company may make. This amendment to the revolving credit agreement also provides that if the Company's total leverage ratio exceeds 2.5:1.0 and if the amount outstanding under the credit facility exceeds $500.0 million, or 50% of the amount that may be borrowed under the credit facility, the credit facility will become secured by substantially all of the Company's and certain of its subsidiaries' assets, subject to limited exceptions. As of December 31, 2016, no amounts were drawn under the credit facility.

Operating and Capital Leases

The Company has entered into various non-cancelable operating lease agreements for certain offices and data center facilities with contractual lease periods expiring between 2017 and 2028. During the year ended December 31, 2016, the Company entered into several sublease agreements for the office space that the Company not fully utilizing. The Company also has lease arrangements for certain server and networking equipment.

A summary of gross lease commitments and sublease income as of December 31, 2016 is as follows (in thousands):

	Operating Leases	Sublease Income	Capital Leases
Years ending December 31,			
2017	$156,757	$(24,101)	$85,886
2018	148,157	(23,712)	45,984
2019	116,189	(16,577)	21,062
2020	90,664	(9,038)	—
2021	57,937	(8,969)	—
Thereafter	163,315	—	—
	$733,019	$(82,397)	152,932
Less: Amounts representing interest			5,247
Total capital lease obligation			147,685
Less: Short-term portion			80,848
Long-term portion			$66,837

Rent expense, net of sublease income, under the Company's operating leases, including co-location arrangements for the Company's data centers, was $155.7 million, $119.8 million and $73.9 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Non-cancelable Obligations

The Company also had $138.4 million of non-cancelable contractual commitments as of December 31, 2016, primarily related to its infrastructure services, bandwidth and other services arrangements. These commitments are generally due within one to three years.

Legal Proceedings

The Company is currently involved in, and may in the future be involved in, legal proceedings, claims and governmental investigations in the normal course of business. These proceedings, in the form of both individual and class action litigation, have included, but are not limited to matters involving intellectual property, defamation, privacy, securities, employment and contractual rights. Legal fees and other costs associated with such actions are expensed as incurred. The Company assesses, in conjunction with its legal counsel, the need to record a liability for litigation and contingencies. Litigation accruals are recorded when and if it is determined that a loss related matter is both probable and reasonably estimable. Material loss contingencies that are reasonably possible of occurrence, if any, are subject to disclosure. As of December 31, 2016, there was no litigation or contingency with at least a reasonable possibility of a material loss. No material losses have been recorded during the years ended December 31, 2016, 2015 and 2014 with respect to litigation or loss contingencies.

Indemnification

In the ordinary course of business, the Company often includes standard indemnification provisions in its arrangements with its customers, partners, suppliers and vendors. Pursuant to these provisions, the Company may be obligated to indemnify such parties for losses or claims suffered or incurred in connection with its service, breach of representations or covenants, intellectual property infringement or other claims made against such parties. These provisions may limit the time within which an indemnification claim can be made. It is not possible to determine the maximum potential amount under these indemnification obligations due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. The Company has never incurred significant expense defending its licensees against third party claims, nor has it ever incurred significant expense under its standard service warranties or arrangements with its customers, partners, suppliers and vendors. Accordingly, the Company had no liabilities recorded for these provisions as of December 31, 2016 and 2015.

Note 15. Related Party Transactions

In September 2015, the Company entered into a partnership agreement for no consideration with Square, Inc., for which Jack Dorsey (the Company’s Chief Executive Officer) serves as Chief Executive Officer, to enable U.S. political donations through Tweets. Neither Square, Inc. nor the Company will pay each other any amounts in connection with the agreement. The agreement has no impact on the Company’s financial statements.

On October 22, 2015, the Company and the Jack Dorsey Revocable Trust dated December 8, 2010 (the “Jack Dorsey Trust”), for which Jack Dorsey (the Company’s Chief Executive Officer) serves as trustee, entered into a Contribution Agreement that the Jack Dorsey Trust will give back and contribute to Twitter, without any cost or charge, an aggregate of 6,814,085 shares of Twitter’s common stock upon the Company’s stockholders approval of an equity incentive plan. On May 25, 2016, the Company’s stockholders approved the 2016 Equity Incentive Plan with the same number of shares to be granted over time to employees, non-employee directors and consultants. All the shares contributed from the Jack Dorsey Trust have been retired and cancelled by the Company.

Note 16. Employee Benefit Plan

The Company adopted a 401(k) Plan that qualifies as a deferred compensation arrangement under Section 401 of the Code. Under the 401(k) Plan, participating employees may defer a portion of their pretax earnings not to exceed the maximum amount allowable. The Company made discretionary matching contributions to those participating employees who met certain employment criteria. The matching contributions made by the Company to date was not material.

Note 17. Segment Information and Operations by Geographic Area

The Company has a single operating segment and reporting unit structure. The Company’s chief operating decision-maker is the chief executive officer who reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance.

Revenue

Revenue by geography is based on the billing addresses of the customers. The following tables set forth revenue by services and revenue by geographic area (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Revenue by services:			
Advertising services	$2,248,052	$1,994,036	$1,255,688
Data licensing and other	281,567	223,996	147,314
Total revenue	$2,529,619	$2,218,032	$1,403,002

	Year Ended December 31,		
	2016	2015	2014
Revenue by geographic area:			
United States	$1,564,776	$1,443,240	$945,720
International	964,843	774,792	457,282
Total revenue	$2,529,619	$2,218,032	$1,403,002

Japan accounted for $268.5 million, or 11% of total revenue for the year ended December 31, 2016. No individual country from the international markets contributed in excess of 10% of the total revenue for the year ended December 31, 2015. The United Kingdom accounted for $140.3 million or 10% of the total revenue for the years ended December 31, 2014.

Property and Equipment, net

The following table sets forth property and equipment, net by geographic area (in thousands):

	December 31, 2016	December 31, 2015
Property and equipment, net:		
United States	$728,429	$683,176
International	55,472	52,123
Total property and equipment, net	$783,901	$735,299

Note 18. Restructuring Charges

On October 25, 2016, the Board of Directors of the Company approved a reduction in force plan (“2016 Plan”) of up to approximately 9% of the Company’s positions globally. The reduction in force was undertaken to eliminate investment in noncore areas and drive toward greater efficiency, while allowing the Company to continue to invest in its highest priorities. The Company expects the reduction in force to be completed in 2017.

On December 17, 2016, the Board of Directors of the Company approved a lease abandonment plan (“2016 Lease Plan”) to abandon excess office space with lease terms expiring through 2028.

For the year ended December 31, 2015, the Company incurred total restructuring expense of $12.9 million in connection with the reduction in force plan, which was substantially completed in 2015.

The following table summarizes the restructuring charges for the year ended December 31, 2016 and related liabilities as of December 31, 2016 (in thousands):

	2016 Employee Termination Plan	2016 Lease Plan
Charges	$ 21,611	$79,685
Cash payment	(11,629)	(3,562)
Non-cash and other adjustments	(6,357)	(19,577)
Accrued as of December 31, 2016	$ 3,625	$56,546
Cost of revenue	$ 13	$49,006
Research and development	4,246	11,693
Sales and marketing	17,310	13,072
General and administrative	42	5,914
Total costs incurred in 2016	$ 21,611	$79,685
Reflected in consolidated balance sheets: (1)		
Accrued and other current liabilities	$ 3,625	$52,317
Other long-term liabilities	$ —	$4,229

(1) As of December 31, 2016, the Company’s restructuring accrual included approximately $56.5 million related to the 2016 Lease Plan. This amount is also included the gross operating lease commitment table under Note 14 – Commitments and Contingencies.

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. The design of disclosure controls and procedures and internal control over financial reporting must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2016, 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 quarter ended December 31, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

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

Item 9B. OTHER INFORMATION

None.

Part III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information called for by this item will be set forth in our Proxy Statement for the Annual Meeting of Stockholders to be filed with the SEC within 120 days of the fiscal year ended December 31, 2016 and is incorporated herein by reference.

Our board of directors has adopted a code of business conduct and ethics that applies to all of our employees, officers and directors, including our Chief Executive Officer, Chief Financial Officer and other executive and senior financial officers. The full text of our code of business conduct and ethics is posted on the investor relations page on our website which is located at http://investor.twitterinc.com. We will post any amendments to our code of business conduct and ethics, or waivers of its requirements, on our website.

Item 11. EXECUTIVE COMPENSATION

The information called for by this item will be set forth in our Proxy Statement and is incorporated herein by reference.

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

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

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

The information, if any, required by this item will be set forth in our Proxy Statement and is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

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

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PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

The following documents are filed as 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

SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

FOR THE YEARS ENDED DECEMBER 31, 2016, 2015 AND 2014

	Balance at Beginning of Year	Charged to Expenses	Charged/ Credited to Other Accounts	Balance at End of Year
	(In thousands)			
Allowance for Deferred Tax Assets:				
Year ended December 31, 2016	$378,448	$ 57,529	$ 4,016	$439,993
Year ended December 31, 2015	$351,249	$ 27,175	$ 24	$378,448
Year ended December 31, 2014	$227,878	$ 155,111	$ (31,740)	$351,249

	Balance at Beginning of Year	Additions (Reductions)	Write-off/ Adjustments	Balance at End of Year
	(In thousands)			
Allowance for Doubtful Accounts:				
Year ended December 31, 2016	$8,121	$ 3,958	$ (4,863)	$7,216
Year ended December 31, 2015	$5,507	$ 5,765	$ (3,151)	$8,121
Year ended December 31, 2014	$2,020	$ 4,632	$ (1,145)	$5,507

All other financial statement schedules have been omitted because they are not required, not applicable, not present in amounts sufficient to require submission of the schedule, or the required information is shown in our Consolidated

Financial Statements or Notes thereto.

3. Exhibits

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

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, 2017.

TWITTER, INC.

By: /s/ Jack Dorsey
Jack Dorsey
Chief Executive Officer

POWER OF ATTORNEY

Each person whose signature appears below constitutes and appoints Jack Dorsey and Anthony Noto, 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 to 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 or his substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below 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	Chief Executive Officer and Director (Principal Executive Officer)	February 27, 2017
/s/ Anthony Noto Anthony Noto	Chief Financial Officer Chief Operating Officer (Principal Financial Officer and Operating Officer)	February 27, 2017
/s/ Robert Kaiden Robert Kaiden	Chief Accounting Officer (Principal Accounting Officer)	February 27, 2017
/s/ Omid Kordestani Omid Kordestani	Executive Chairman and Director	February 27, 2017
/s/ Peter Fenton Peter Fenton	Director	February 27, 2017
/s/ Hugh Johnston Hugh Johnston	Director	February 27, 2017
/s/ Martha Lane Fox Martha Lane Fox	Director	February 27, 2017
/s/ Debra L. Lee Debra L. Lee	Director	February 27, 2017
/s/ David Rosenblatt David Rosenblatt	Director	February 27, 2017
/s/ Marjorie Scardino Marjorie Scardino	Director	February 27, 2017
/s/ Bret Taylor Bret Taylor	Director	February 27, 2017
/s/ Evan Williams Evan Williams	Director	February 27, 2017

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
2.1	Agreement and Plan of Reorganization among Twitter, Inc., Raptor Merger Inc., MoPub Inc. and Fortis Advisors LLC, as Stockholders' Agent, dated as of September 9, 2013.	S-1	333-191552	2.1	October 3, 2013
3.1	Restated Certificate of Incorporation of Twitter, Inc.	S-1/A	333-191552	3.2	October 22, 2013
3.2	Amended and Restated Bylaws of Twitter, Inc.	S-1/A	333-191552	3.4	October 22, 2013
4.1	Form of common stock certificate of Twitter, Inc.	S-1/A	333-191552	4.1	October 22, 2013
4.2	Amended and Restated Investors' Rights Agreement among Twitter, Inc. and certain holders of its capital stock, amended as of October 4, 2013.	S-1/A	333-191552	4.2	October 15, 2013
4.3	Indenture, dated September 17, 2014, between Twitter, Inc. and U.S. Bank National Association.	8-K	001-36164	4.1	September 17, 2014
4.4	Form of Global 0.25% Convertible Senior Note due 2019 (included in Exhibit 4.1)	8-K	001-36164	4.2	September 17, 2014
4.5	Indenture, dated September 17, 2014, between Twitter, Inc. and U.S. Bank National Association.	8-K	001-36164	4.3	September 17, 2014
4.6	Form of Global 0.25% Convertible Senior Note due 2019 (included in Exhibit 4.3)	8-K	001-36164	4.4	September 17, 2014
4.7	Form of Selling Stockholder Agreement	S-3ASR	333-204775	4.4	June 5, 2015
10.1*	Form of Indemnification Agreement between Twitter, Inc. and each of its directors and executive officers.	S-1	333-191552	10.1	October 3, 2013
10.2*	Twitter, Inc. 2013 Equity Incentive Plan and related form agreements.	S-1/A	333-191552	10.2	October 22, 2013
10.3*	Twitter, Inc. 2013 Employee Stock Purchase Plan and related form agreements.	S-8	333-192150	4.3	November 7, 2013
10.4*	Twitter, Inc. 2007 Equity Incentive Plan and related form agreements.	S-1	333-191552	10.4	October 3, 2013

10.5*	Form of Performance-Based Restricted Stock Unit Award Agreement for Executives, including Notice of Grant, under the Twitter, Inc. 2013 Equity Incentive Plan.	S-8	333-209840	4.4	March 1, 2016
10.6*	Twitter, Inc. 2016 Equity Incentive Plan and related form agreements.	S-8	333-212740	4.2	July 29, 2016
10.7*	Twitter, Inc. 2011 Acquisition Option Plan.	S-1	333-191552	10.5	October 3, 2013
10.8*	Afterlive.tv Inc. 2010 Stock Plan.	S-8	333-198055	4.4	August 11, 2014
10.9*	Apps & Zerts, Inc. 2013 Stock Plan.	S-8	333-195743	4.2	May 6, 2014
10.10*	Bluefin Labs, Inc. 2008 Stock Plan.	S-1	333-191552	10.6	October 3, 2013
10.11*	CardSpring Inc. Amended and Restated 2011 Equity Incentive Plan.	S-8	333-198055	4.3	August 11, 2014
10.12*	Crashlytics, Inc. 2011 Stock Plan.	S-1	333-191552	10.7	October 3, 2013

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
10.13*	Gnip, Inc. 2008 Incentive Plan, as amended.	S-8	333-195743	4.3	May 6, 2014
10.14*	Magic Pony Technology Limited EMI Share Option Scheme	S-8	333-212740	4.3	July 29, 2016
10.15*	Mixer Labs, Inc. 2008 Stock Plan.	S-1	333-191552	10.8	October 3, 2013
10.16*	MoPub Inc. 2010 Equity Incentive Plan.	S-1/A	333-191552	10.9	November 4, 2013
10.17*	TapCommerce Inc. 2012 Stock Incentive Plan.	S-8	333-198055	4.5	August 11, 2014
10.18*	Twitter, Inc. Executive Incentive Compensation Plan.	S-1	333-191552	10.9	October 3, 2013
10.19*	Twitter, Inc. Change of Control and Involuntary Termination Protection Policy.	10-Q	001-36164	10.1	August 11, 2014
10.20*	Twitter, Inc. Outside Director Compensation Policy	10-K	001-36164	10.23	March 6, 2014
10.21*	Twitter, Inc. 2013 Target Commission Plan.	S-1/A	333-191552	10.20	October 22, 2013
10.22*	Offer Letter between Twitter, Inc. and Jack Dorsey, dated as of June 11, 2015.	8-K	001-36164	10.1	June 11, 2015
10.23*	Letter Agreement between Twitter, Inc. and Omid R. Kordestani, dated as of October 13, 2015.	8-K	001-36164	10.1	October 16, 2015
10.24*	Offer Letter between Twitter, Inc. and Anthony Noto, dated as of June 30, 2014.	8-K	333-191552	10.1	July 1, 2014
10.25*	Offer Letter between Twitter, Inc. and Adam Bain, dated as of October 1, 2013.	S-1/A	333-191552	10.14	October 22, 2013
10.26*	Offer Letter between Twitter, Inc. and Vijaya Gadde, dated as of October 1, 2013.	S-1/A	333-191552	10.16	October 22, 2013
10.27*	Offer Letter between Twitter, Inc. and Robert Kaiden, dated as of April 24, 2015.	8-K	001-36164	10.1	June 4, 2015
10.28*	Amended and Restated Change of Control Severance Policy Participation Agreement between Twitter, Inc. and Anthony				

	Noto, dated as of November 21, 2016				
10.29*	Contribution Agreement, dated October 22, 2015, by and between Twitter, Inc. and the Jack Dorsey Revocable Trust dated December 8, 2010	8-K	001-36164	10.1	October 22, 2015
10.30	Form of Innovator's Patent Agreement.	S-1	333-191552	10.19	October 3, 2013
10.31	Office Lease between Twitter, Inc. and SRI Nine Market Square LLC, dated as of April 20, 2011, as amended on May 16, 2011, September 30, 2011 and June 1, 2012.	S-1	333-191552	10.18	October 3, 2013
10.32	Revolving Credit Agreement among Twitter, Inc., the lenders party thereto and Morgan Stanley Senior Funding, Inc., as Administrative Agent, dated as of October 22, 2013.	S-1	333-191552	10.21	October 22, 2013

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Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
10.33	Amendment No. 1, dated September 10, 2014, to the Revolving Credit Agreement, dated October 22, 2013, among Twitter, Inc., Morgan Stanley Senior Funding, Inc., as administrative agent, and the lenders from time to time party thereto.	8-K	001-36164	10.1	September 10, 2014
10.34	Purchase Agreement, dated September 11, 2014, by and among Twitter, Inc. and Goldman, Sachs & Co. and Morgan Stanley & Co. LLC, as representatives of the initial purchasers named therein.	8-K	001-36164	10.1	September 17, 2014
10.35	Form of Convertible Note Hedge Confirmation.	8-K	001-36164	10.2	September 17, 2014
10.36	Form of Warrant Confirmation.	8-K	001-36164	10.3	September 17, 2014
21.1	List of subsidiaries of Twitter, Inc.	S-1	333-191552	21.1	October 15, 2013
23.1	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm.				
24.1	Power of Attorney (contained on signature page hereto)				
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 Schema Linkbase Document				
101.CAL	XBRL Taxonomy Definition Linkbase Document.				
101.DEF	XBRL Taxonomy Calculation Linkbase Document.				
101.LAB	XBRL Taxonomy Labels Linkbase Document.				

101.PRE XBRL Taxonomy Presentation Linkbase Document.

* Indicates a management contract or compensatory plan or arrangement.
† 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 Twitter, Inc. 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.