PayPal Holdings, Inc.
Form 10-Q
October 23, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018.
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to .
Commission file number 001-36859

PayPal Holdings, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	47-2989869
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2211 North First Street San Jose, California	95131
(Address of Principal Executive Offices)	(Zip Code)

(408) 967-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [x] No [ ]
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes [x] No [ ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	ý	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o
		Emerging growth company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the

extended transition period for complying with any new
or revised financial accounting standards provided
pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).   Yes [ ]   No [x]
As of October 17, 2018, there were 1,178,359,088 shares of the registrant's common stock, $0.0001 par value, outstanding, which is the only class of common or voting stock of the registrant issued.

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements

PayPal Holdings, Inc.
CONDENSED CONSOLIDATED BALANCE SHEET

	September 30, 2018	December 31, 2017
	(In millions, except par value)	
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$8,147	$ 2,883
Short-term investments	1,440	2,812
Accounts receivable, net	412	283
Loans and interest receivable, net of allowances of $150 and $129 as of September 30, 2018 and December 31, 2017, respectively	2,112	1,314
Loans and interest receivable, held for sale	—	6,398
Funds receivable and customer accounts	20,951	18,242
Prepaid expenses and other current assets	928	713
Total current assets	33,990	32,645
Long-term investments	946	1,961
Property and equipment, net	1,646	1,528
Goodwill	6,054	4,339
Intangible assets, net	684	168
Other assets	404	133
Total assets	$43,724	$ 40,774
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$247	$ 257
Notes payable	2,000	1,000
Funds payable and amounts due to customers	22,451	19,742
Accrued expenses and other current liabilities	1,866	1,781
Income taxes payable	76	83
Total current liabilities	26,640	22,863
Deferred tax liability and other long-term liabilities	1,969	1,917
Total liabilities	28,609	24,780
Commitments and Contingencies (Note 13)		
Equity:		
Common stock, $0.0001 par value; 4,000 shares authorized; 1,178 and 1,200 shares outstanding as of September 30, 2018 and December 31, 2017, respectively	—	—
Treasury stock at cost, 84 and 47 shares as of September 30, 2018 and December 31, 2017, respectively	(4,911)	(2,001)
Additional paid-in-capital	14,664	14,314
Retained earnings	5,296	3,823
Accumulated other comprehensive income (loss)	66	(142)
Total equity	15,115	15,994
Total liabilities and equity	$43,724	$ 40,774

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

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PayPal Holdings, Inc.
CONDENSED CONSOLIDATED STATEMENT OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions, except per share data)			
	(Unaudited)			
Net revenues	$3,683	$3,239	$11,225	$9,350
Operating expenses:				
Transaction expense	1,366	1,102	4,003	3,153
Transaction and loan losses	295	363	934	971
Customer support and operations	367	346	1,075	998
Sales and marketing	326	278	924	800
Product development	269	240	782	686
General and administrative	354	293	1,061	840
Depreciation and amortization	188	194	553	578
Restructuring and other charges	28	—	297	40
Total operating expenses	3,193	2,816	9,629	8,066
Operating income	490	423	1,596	1,284
Other income (expense), net	43	28	94	52
Income before income taxes	533	451	1,690	1,336
Income tax expense	97	71	217	161
Net income	$436	$380	$1,473	$1,175
Net income per share:				
Basic	$0.37	$0.32	$1.24	$0.98
Diluted	$0.36	$0.31	$1.22	$0.96
Weighted average shares:				
Basic	1,181	1,202	1,187	1,203
Diluted	1,199	1,223	1,206	1,218

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

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PayPal Holdings, Inc.
CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions) (Unaudited)			
Net income	$436	$380	$1,473	$1,175
Other comprehensive income (loss), net of reclassification adjustments:				
Foreign currency translation	(6)	9	(33)	38
Unrealized gains (losses) on investments, net	4	4	(6)	5
Tax (expense) benefit on unrealized gains (losses) on investments, net	(1)	(1)	2	(2)
Unrealized gains (losses) on hedging activities, net	34	(57)	249	(246)
Tax (expense) benefit on unrealized gains (losses) on hedging activities, net	(1)	1	(4)	4
Other comprehensive income (loss), net of tax	30	(44)	208	(201)
Comprehensive income	$466	$336	$1,681	$974

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

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PayPal Holdings, Inc.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Nine Months Ended September 30,	
	2018	2017
	(In millions) (Unaudited)	
Cash flows from operating activities:		
Net income	$1,473	$1,175
Adjustments:		
Transaction and loan losses	934	971
Depreciation and amortization	553	578
Stock-based compensation	623	514
Deferred income taxes	(34)	13
Cost basis adjustments to loans and interest receivable held for sale	244	—
Other	(79)	(16)
Changes in assets and liabilities:		
Accounts receivable	(133)	(5)
Changes in loans and interest receivable held for sale, net	1,407	16
Accounts payable	5	4
Income taxes payable	(21)	24
Other assets and liabilities	(623)	(596)
Net cash provided by operating activities	4,349	2,678
Cash flows from investing activities:		
Purchases of property and equipment	(599)	(487)
Changes in principal loans receivable, net	3,573	(1,154)
Purchases of investments	(15,641)	(14,227)
Maturities and sales of investments	15,947	13,029
Acquisitions, net of cash acquired	(2,136)	(323)
Funds receivable	(427)	(461)
Net cash provided by (used in) investing activities	717	(3,623)
Cash flows from financing activities:		
Proceeds from issuance of common stock	83	100
Purchases of treasury stock	(2,925)	(706)
Tax withholdings related to net share settlements of equity awards	(392)	(140)
Borrowings under financing arrangements	2,075	800
Repayments under financing arrangements	(1,101)	(180)
Funds payable and amounts due to customers	2,767	2,553
Net cash provided by financing activities	507	2,427
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(89)	35
Net change in cash, cash equivalents and restricted cash	5,484	1,517
Cash, cash equivalents and restricted cash at beginning of period	8,285	6,119
Cash, cash equivalents and restricted cash at end of period	$13,769	$7,636
Supplemental cash flow disclosures:		
Cash paid for interest	$47	$3
Cash paid for income taxes, net	$228	$88

The below table reconciles cash, cash equivalents and restricted cash as reported in the condensed consolidated balance sheet to the total of the same amounts shown in the condensed consolidated statement of cash flows:		
Cash and cash equivalents	$8,147	$2,330
Short term investments	16	19
Funds receivable and customer accounts	5,606	5,287
Total cash, cash equivalents and restricted cash shown in the condensed consolidated statement of cash flows	$13,769	$7,636

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1—Overview and Summary of Significant Accounting Policies

Overview and Organization

PayPal Holdings, Inc. ("PayPal," the "Company," "we," "us," or "our") was incorporated in Delaware in January 2015 and is a leading technology platform and digital payments company that enables digital and mobile payments on behalf of consumers and merchants worldwide. Our vision is to democratize financial services, as we believe that managing and moving money is a right for all people, not just the affluent. Our goal is to increase our relevance for consumers and merchants to manage and move their money anywhere in the world, anytime, on any platform and using any device. We also facilitate person-to-person payments through our PayPal, Venmo and Xoom products. Our combined payment solutions, including our PayPal, PayPal Credit, Braintree, Venmo, and Xoom products, compose our proprietary Payments Platform.

We operate globally and in a rapidly evolving regulatory environment characterized by a heightened regulatory focus on all aspects of the payments industry. That focus continues to become even more heightened as regulators on a global basis focus on such important issues as countering terrorist financing, anti-money laundering, privacy and consumer protection. Some of the laws and regulations to which we are subject were enacted recently, and the laws and regulations applicable to us, including those enacted prior to the advent of digital and mobile payments, are continuing to evolve through legislative and regulatory action and judicial interpretation. Non-compliance with laws and regulations, increased penalties and enforcement actions related to non-compliance, changes in laws and regulations or their interpretation, and the enactment of new laws and regulations applicable to us could have a material adverse impact on our business, results of operations and financial condition.

Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the financial statements of PayPal and our wholly and majority-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. Investments in entities where we hold less than a 20% ownership interest are generally accounted for at cost minus impairment, if any, and are adjusted for changes resulting from observable price changes, which are included in other income (expense), net on our condensed consolidated statement of income. Our investment balance is included in long-term investments on our condensed consolidated balance sheet.

These condensed consolidated financial statements and accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K") filed with the Securities and Exchange Commission.

In the opinion of management, these condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for fair presentation of the condensed consolidated financial statements for interim periods. We have evaluated all subsequent events through the date the financial statements were issued. Certain amounts for prior years have been reclassified to conform to the financial presentation as of and for the three and nine months ended September 30, 2018.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses, during the reporting period. On an ongoing basis, we evaluate our estimates, including those related to provisions for transaction and loan losses, loss contingencies, income taxes, revenue recognition and the valuation of goodwill and intangible assets. We base our estimates on historical experience and various other assumptions which we believe to be reasonable under the circumstances. Actual results could differ from those estimates.

Recent Accounting Guidance

In 2016, the Financial Accounting Standards Board ("FASB") issued new accounting guidance related to accounting for leases, which will require lessees to recognize lease assets and lease liabilities on the balance sheet for the rights and obligations created by all leases with terms greater than 12 months. As we are not a lessor, other changes in the guidance applicable to lessors do not apply. Additionally, in 2018, the FASB issued codification and targeted improvements to this guidance effective for fiscal years and interim periods within those years beginning after December 15, 2018, with early adoption permitted. We will adopt the new guidance on January 1, 2019, using a modified retrospective basis and anticipate applying the optional practical expedients related to the transition. We estimate an increase of approximately $500 million for the right of use lease assets and lease liabilities associated with our operating leases upon adoption. We do not believe the adoption of this guidance will have a significant impact to our consolidated statements of earnings, stockholders' equity, and cash flows.

In 2016, the FASB issued new guidance on the measurement of credit losses on financial instruments. Credit losses on loans, trade and other receivables, held-to-maturity debt securities and other instruments will reflect our current estimate of the expected credit losses that generally will result in the earlier recognition of allowances for losses. Credit losses on available-for-sale debt securities with unrealized losses will be recognized as allowances for credit losses limited to the amount by which fair value is below amortized cost. Additional disclosures will be required, including information used to track credit quality by year of origination for most financing receivables. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. We will adopt the new guidance effective January 1, 2020. We are required to apply the provisions of this guidance as a cumulative effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted with impairment of available-for-sale debt securities applied prospectively after adoption. We are evaluating the impact of and approach to adopting this new accounting guidance on our financial statements.

In 2017, the FASB issued new guidance that requires certain premiums on callable debt securities to be amortized to the earliest call date. The amortization period for callable debt securities purchased at a discount will not be impacted. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. Transition is on a modified retrospective basis with a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We are evaluating the impact this new accounting guidance will have on our financial statements.

In 2018, the FASB issued new guidance in response to tax reform that allows the option to reclassify stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (the "Tax Act") from accumulated other comprehensive income to retained earnings. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. We will adopt the new guidance effective January 1, 2019. If such an option is elected, transition can be applied either retrospectively to each period in which the effect of tax reform is recognized or applied with a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The adoption of this guidance is not expected to have a material impact on our financial statements.

In 2018, the FASB issued amended guidance to remove, modify and add disclosure requirements for fair value measurements. This amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted for any removed or modified disclosure requirements. Transition is on a prospective basis for the new and modified disclosures, and on a retrospective basis for disclosures that have been eliminated. The adoption of this guidance is not expected to have a material impact on our financial statements.

In 2018, the FASB issued amended guidance on the disclosure requirements for defined benefit pension or other post-retirement plans. The amended guidance removes certain disclosure requirements and adds others including requiring disclosure related to interest credit ratings and changes in benefit obligations. This amendment is effective for fiscal years beginning after December 15, 2020, with early adoption permitted, and requires retrospective adoption for all periods presented. We are evaluating the impact this amended disclosure guidance may have on the footnotes to our financial statements.

In 2018, the FASB issued new accounting guidance intended to align the requirements for capitalization of implementation costs incurred in a cloud computing arrangement that is a service contract with the existing guidance for internal-use software. Capitalized implementation costs should be amortized over the term of the hosting arrangement and recorded in the same financial statement line items as amounts for the hosting arrangement. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The guidance provides flexibility in adoption, allowing for either retrospective adjustment or prospective adjustment for all implementation costs incurred after the date of adoption. We are evaluating the impact this new accounting guidance will have on our financial statements.

Recently Adopted Accounting Guidance

In 2014, the FASB issued new accounting guidance related to revenue recognition, which was further updated in 2016 for reporting revenue on a gross versus net basis. This new guidance replaced all existing GAAP guidance on this topic and eliminated all industry-specific guidance. The new revenue recognition guidance provides a unified model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. We adopted the guidance effective January 1, 2018 on a full retrospective basis. We performed an impact analysis for the opening balance sheet as of January 1, 2016 as well as for the years ended December 31, 2016 and 2017. The impacts were deemed de minimis. No practical expedients or exemptions were elected in conjunction with the adoption of this new guidance. For additional information, see "Note 2—Revenue."

In 2016, the FASB issued new accounting guidance related to the classification and measurement of financial instruments. This new guidance amends GAAP by requiring equity investments to be measured at fair value with changes in fair value recognized in net income. This new guidance also amends the presentation of certain fair value changes for financial liabilities measured at fair value and it amends certain disclosure requirements associated with the fair value of financial instruments. Additionally, in 2018, the FASB issued technical corrections and improvements to this guidance effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years beginning after June 15, 2018. We are required to apply the new guidance on a modified retrospective basis to all outstanding instruments, with a cumulative effect adjustment as of the date of adoption and on a prospective basis to all outstanding equity investments without a readily determinable fair value. We adopted the guidance, including early adoption of the technical corrections and improvements, effective January 1, 2018. Beginning in the first quarter of 2018, we applied the measurement alternative to all our equity investments, which required us to measure these equity investments at cost minus impairment, if any, and adjust for changes resulting from observable price changes in orderly transactions for an identical or similar investment in the same issuer. For additional information on the impact the adoption of this guidance had on our financial statements during the three and nine months ended September 30, 2018, please refer to "Note 8—Investments."

In 2016, the FASB issued new guidance on classifying certain cash receipts and cash payments on the statement of cash flows. The new guidance addresses the classification of cash flows related to: debt prepayment or extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance, including bank-owned life insurance, distributions received from equity method investees and beneficial interests in securitization transactions. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows.

The guidance should be applied retrospectively after adoption. We adopted the guidance effective January 1, 2018. The adoption of this guidance did not have a material impact on our financial statements.

In 2016, the FASB issued new guidance on restricted cash on the statement of cash flows. The new guidance requires the classification and presentation of changes in restricted cash and cash equivalents in the statement of cash flows. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning and ending balances shown on the statement of cash flows. The guidance should be applied retrospectively after adoption. We adopted the guidance effective January 1, 2018 on a retrospective basis. The beginning and ending balances of cash and cash equivalents on the statement of cash flows now include restricted cash and restricted cash equivalents, such as cash and cash equivalents underlying customer accounts and restricted cash and restricted cash equivalents within short-term investments.

In 2017, the FASB issued new guidance clarifying the scope and application of the de-recognition of non-financial assets and the sale or transfer of non-financial assets, including partial sales. We adopted the guidance effective January 1, 2018 on a full retrospective basis. The adoption of this guidance did not have a material impact on our financial statements.

In 2017, the FASB issued new guidance clarifying which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. Specifically, an entity would apply modification accounting only if the fair value, vesting conditions, or classification of the awards changes as a result of changes in the terms or conditions. We adopted the guidance effective January 1, 2018 and applied it prospectively upon adoption. The adoption of this guidance did not have a material impact on our financial statements.

In 2017, the FASB issued new guidance intended to better align the results of hedge accounting with an entity's risk management activities. This guidance updates the designation and measurement guidance for qualifying hedging relationships by expanding hedge accounting for both nonfinancial and financial risk components and by refining the measurement of hedge results to better reflect an entity's hedging strategies. The amendments also align the recognition and presentation of the effects of the hedge results in the financial statements to increase the understandability of the results of an entity's intended hedging strategies. Additionally, the guidance includes certain targeted improvements to ease the operational burden of applying hedge accounting. We are required to apply the guidance with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the guidance is adopted and prospectively apply the presentation and disclosure guidance. We early adopted the guidance in the first quarter of 2018 using a modified retrospective approach to reflect application of the new guidance effective January 1, 2018. The adoption of this guidance did not have a material impact on our financial statements.

In 2018, the FASB issued new guidance to provide clarity around application of income tax accounting in situations where the assessment of tax implications of the Tax Act might not be complete as of period end in which the Tax Act was enacted. This guidance prescribes that an entity must reflect the income tax impact of the Tax Act in the period in which the tax accounting is complete and allows an entity to report provisional amounts for those specific effects of the Tax Act for which the accounting is incomplete but a reasonable estimate can be determined. No provisional amounts should be reported for specific effects of the Tax Act for which a reasonable estimate cannot be determined, and the entity should continue to apply the provisions of the tax laws that were in effect prior to the enactment of the Tax Act. It further allows a measurement period of one year from the date of enactment within which to complete the accounting for all impacts of the Tax Act. Our financial statements reflect tax accounting in compliance with this guidance.

In 2018, the FASB amended existing guidance to include share-based payment transactions for acquiring goods and services from nonemployees. This amendment prescribes that entities should apply the requirements for employee share-based payment compensation to nonemployee awards used to acquire goods and services, except for specific guidance on inputs to an option pricing model and the attribution of cost (period of time that the awards vest and pattern of recognition). The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. We adopted the guidance effective April 1, 2018. The adoption of this guidance did not have a material impact on our financial statements.

Note 2—Revenue

PayPal enables its customers to send and receive payments. We earn revenue primarily by completing payment transactions for our customers on our Payments Platforms and from other value added services. Our revenues are classified into two categories, transaction revenues and revenues from other value added services.

Transaction Revenues

We earn transaction revenues primarily from fees charged to merchants and consumers on a transaction basis. These fees may have a fixed and variable component. The variable component is generally a percentage of the value of the payment amount and is known at the time the transaction is processed. If the underlying transaction is approved for refund, we reimburse the variable component of the fee. We estimate the amount of fee refunds that will be processed during the quarter and record a provision against our net revenues. The volume of activity processed on our Payments Platform, which results in transaction revenue, is referred to as Total Payments Volume ("TPV"). We define TPV as the value of payments, net of reversals, successfully completed on our Payments Platform or enabled by PayPal via a partner payment solution, not including gateway-exclusive transactions. We earn additional fees on transactions where we perform a currency conversion and when we enable cross-border transactions (i.e., transactions where the merchant and consumer are in different countries).

Our contracts with our customers are usually open-ended and can be terminated by either party without a termination penalty after the notice period has lapsed. Therefore, our contracts are defined at the transaction level and do not extend beyond the service already provided. Our contracts generally renew automatically without significant material rights. Some of our contracts include tiered pricing, based primarily on volume. The fee charged per transaction is adjusted up or down if the volume processed for a specified period is different from prior period defined volumes. We have concluded that this volume-based pricing approach does not constitute a future material right since the discount is within a range typically offered to class of customers with similar volume. We do not have any capitalized contract costs, and do not carry any contract balances.

Our service comprises a single performance obligation to complete payments on our Payments Platform for our customers. Using our risk assessment tools, we perform a transaction risk assessment on individual transactions to determine whether a transaction should be authorized for completion on our Payment Platform. Once our authorization is provided to the customer, PayPal becomes obligated to our customer to complete the payment transaction.

We recognize fees charged to our customers primarily on a gross basis as transaction revenue when we are the principal in respect of completing a payment transaction. As a principal to the transaction, we control the service of completing payments on our Payments Platform. We bear primary responsibility for the fulfillment of the payment service, contract directly with our customers, control the product specifications and define the value proposal from our services. Further, we have full discretion in determining the fee charged to our customers, which is independent of the costs we incur in instances where we may utilize payment processors or other financial institutions to perform services on our behalf. We therefore bear full margin risk when completing a payment transaction. These fees paid to payment processors and other financial institutions are recognized as transaction expense. We are also responsible for providing customer support.

We provide merchants and consumers with protection programs on most transactions completed on our Payments Platforms, except for transactions using our gateway products or where our customer agreements specifically do not provide for protections. These programs protect both merchants and consumers from loss primarily due to fraud and counterparty performance. Our buyer protection program provides protection to consumers for qualifying purchases by reimbursing the consumer for the full amount of the purchase if a purchased item does not arrive or does not match the seller's description. Our seller protection programs provide protection to merchants against claims that a transaction was not authorized by the buyer or claims that an item was not received by covering the seller for the full amount of the payment on eligible sales. These protection programs do not provide a separate service to our customers and we estimate and record associated costs in transaction and loan losses during the period the payment transaction is completed.

Revenues from Other Value Added Services

We earn revenues from other value added services which comprise of revenue earned through partnerships, subscription fees, gateway fees, and other services that we provide to our merchants and consumers. The contracts for these services cannot usually be terminated by either party without penalty. These contracts typically have one performance obligation which is provided and recognized over the term of the contract. The transaction price is generally fixed and known at the end of each reporting period; however, for some agreements, it may be necessary to estimate the transaction price using the expected value method.

We recognize revenue received from our financial institution partners on a net basis when we are considered the agent with respect to processing transactions. As we are an agent to the transaction, our financial institution partners directly contract with the end customers and are ultimately responsible for the fulfillment of the services. In an agent relationship, we may have some discretion in determining the fee charged to end customers, but always in conjunction

with a financial institution partner. As a result, related costs incurred by our financial institution partners when we are an agent are included as a reduction to the revenue share received.
We also earn revenues from interest and fees earned on our loans receivable portfolio, gain on sale of participation interest in certain loans and advances and interest earned on certain PayPal customer account balances. Interest and fees earned on the PayPal credit portfolio of loans receivable are computed and recognized based on contractual interest and fee rates and are net of any required reserves and amortization of deferred origination costs.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Disaggregation of Revenue

We determine operating segments based on how our chief operating decision maker (“CODM”) manages the business, makes operating decisions around the allocation of resources and evaluates operating performance. Our CODM is our Chief Executive Officer, who reviews our operating results on a consolidated basis. We operate in one segment and have one reportable segment. Based on the information provided to and reviewed by our CODM, we believe that the nature, amount, timing and uncertainty of our revenue and cash flows and how they are affected by economic factors is most appropriately depicted through our primary geographical markets and type of revenue (transaction and other value added services) categories. Revenues recorded within these categories are earned from similar services for which the nature of associated fees and the related revenue recognition models are substantially the same.

The following table presents our revenues disaggregated by primary geographical markets and type of revenue:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions)			
Primary geographical markets				
United States ("U.S.")	$1,962	$1,743	$6,135	$5,039
United Kingdom ("U.K.")	397	351	1,191	998
Other countries[1]	1,324	1,145	3,899	3,313
Total revenues[2]	$3,683	$3,239	$11,225	$9,350
Types of revenues				
Transaction revenues	$3,343	$2,858	$9,858	$8,257
Other value added services	340	381	1,367	1,093
Total revenues[2]	$3,683	$3,239	$11,225	$9,350

[1] No single country included in the other countries category generated more than 10% of total revenue.
[2] Total revenues include interest, fees and gains earned on loan and interest receivables, net and held for sale portfolio, as well as hedging gains or losses and interest earned on certain PayPal customer balances of $173 million and $287 million for the three months ended September 30, 2018 and 2017, respectively, and $973 million and $894 million for the nine months ended September 30, 2018 and 2017, respectively, which do not represent revenues recognized in the scope of ASC Topic 606, Revenue from contracts with customers.

Net revenues are attributed to the U.S., the U.K. and other countries primarily based upon the country in which the merchant is located, or in the case of a cross-border transaction, may be earned from the country in which the consumer and the merchant respectively reside. Net revenues earned from other value added services are typically attributed to the country in which either the customer or partner reside.

Note 3—Net Income Per Share

Basic net income per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income for the period by the weighted average number of shares of common stock and potentially dilutive common stock outstanding for the period. The dilutive effect of outstanding equity incentive awards is reflected in diluted net income per share by application of the treasury stock method. The calculation of diluted net income per share excludes all anti-dilutive common shares.

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The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
	(In millions, except per share amounts)			
Numerator:				
Net income	$436	$380	$1,473	$1,175
Denominator:				
Weighted average shares of common stock - basic	1,181	1,202	1,187	1,203
Dilutive effect of equity incentive awards	18	21	19	15
Weighted average shares of common stock - diluted	1,199	1,223	1,206	1,218
Net income per share:				
Basic	$0.37	$0.32	$1.24	$0.98
Diluted	$0.36	$0.31	$1.22	$0.96
Common stock equivalents excluded from income per diluted share because their effect would have been anti-dilutive	—	—	—	2

Note 4—Business Combinations

Acquisitions Completed in 2018

During the three and nine months ended September 30, 2018, we completed two and three acquisitions, respectively, reflecting 100% of the equity interests of the acquired companies, for an aggregate purchase price of $2.3 billion.

iZettle

We completed the acquisition of iZettle AB (publ) (“iZettle”) in September 2018 by acquiring all the outstanding shares for a total purchase price of $2.2 billion, consisting of cash consideration paid of approximately $2.1 billion (net of cash acquired of $107 million) and restricted shares of PayPal with a fair value of approximately $22 million. We acquired iZettle to expand our in-store presence and strengthen our Payments Platform to help small businesses around the world grow and thrive in an omnichannel retail environment.

The following table summarizes the preliminary allocation of the purchase consideration to the fair value of the assets acquired and liabilities assumed:

	(In millions)
Goodwill	$ 1,649
Customer lists and user base	349
Marketing related	102
Developed technologies	121
All other	1

Total intangibles	$ 573
Cash	107
Funds receivable and customer accounts	49
Funds payable and amounts due to customers	(49)
Deferred tax liabilities, net	(91)
Other net liabilities	(56)
Total purchase consideration	$ 2,182

The intangible assets acquired consists primarily of merchant relationships, trade name/trademarks, developed technologies, and existing acquirer relationships with estimated useful lives ranging from 3 to 7 years. The excess of the purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill, which is attributable to the workforce of iZettle and the synergies expected to arise from the acquisition. We do not expect goodwill to be deductible for income tax purposes. The allocation of the purchase price for this acquisition has been prepared on a preliminary basis and changes to the allocation to certain assets, liabilities and tax estimates may occur as additional information becomes available.

Simility

We completed the acquisition of Simility, Inc. ("Simility") in July 2018 by acquiring all the outstanding shares for a total purchase price of $107 million, consisting of cash consideration. We acquired Simility to enhance our ability to deliver fraud prevention and risk management solutions to merchants globally. The allocation of purchase consideration resulted in approximately $18 million of developed technologies intangible assets with an estimated useful life of 3 years, net assets of approximately $9 million, and initial goodwill of approximately $80 million, which is attributable to the workforce of Simility and the synergies expected to arise from the acquisition. We do not expect goodwill to be deductible for income tax purposes. The allocation of the purchase price for this acquisition has been prepared on a preliminary basis and changes to the allocation to certain assets, liabilities and tax estimates may occur as additional information becomes available.

Other Acquisitions

In May 2018, we completed an acquisition which was accounted for as a business combination. The total purchase price for this acquisition was $16 million, consisting of cash consideration. The allocation of purchase consideration resulted in approximately $13 million of developed technologies intangible assets with an estimated useful life of 2 years and initial goodwill of approximately $3 million, which is attributable to the workforce of the acquired company and the synergies expected to arise from the acquisition. We do not expect goodwill to be deductible for income tax purposes. The allocation of the purchase price for this acquisition has been prepared on a preliminary basis and changes to the allocation to certain assets, liabilities and tax estimates may occur as additional information becomes available.

We have included the financial results of the acquired businesses in our condensed consolidated financial statements from the date of acquisition. Revenues and expenses related to these acquisitions for the three and nine months ended September 30, 2018 were not material. Pro forma results of operations have not been presented because the effects of these acquisitions were not material to our financial results.

Acquisitions Completed in 2017

During the three and nine months ended September 30, 2017, we completed two acquisitions, reflecting 100% of the equity interests of the acquired companies, for an aggregate purchase price of $420 million.

TIO Networks Corp.

We completed the acquisition of TIO Networks Corp. (“TIO”) in July 2017 by acquiring all the outstanding shares of TIO for $2.64 per share in cash. We acquired TIO to expand our scale of operations, complement our product portfolio, and to help accelerate our entry into bill payments. The total purchase price of $238 million consisted of cash consideration. The allocation of purchase consideration resulted in approximately $66 million of technology and customer-related intangible assets with an estimated useful life of 1 to 5 years, net assets of approximately $6 million and goodwill of approximately $166 million, which is attributable to the workforce of TIO and the synergies expected to arise from the acquisition. We expect that not all of the goodwill will be deductible for income tax purposes.

In November 2017, we suspended the operations of TIO to protect customer data as part of an ongoing investigation of security vulnerabilities of the TIO platform. Refer to Note 13—"Commitments and Contingencies—Litigation and Regulatory Matters" for further details.

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Swift Financial Corporation

We completed the acquisition of Swift Financial Corporation ("Swift") in September 2017 by acquiring all the outstanding shares of Swift for a total purchase price of approximately $182 million. We acquired Swift to enable us to enhance our underwriting capabilities and strengthen our business financing offerings, helping us to deepen relationships with our existing merchants and expand services to new merchants. The allocation of purchase consideration resulted in approximately $44 million of technology and customer-related intangible assets with an estimated useful life of 1 to 3 years, $169 million of merchant receivables, net liabilities of approximately $129 million and goodwill of approximately $98 million, which is attributable to the workforce of Swift and the synergies expected to arise from the acquisition. We do not expect goodwill to be deductible for income tax purposes. The gross contractual merchant receivables acquired were approximately $213 million. Management estimates that the cash collected will approximate the contractual amounts of merchant receivables.

Note 5—Goodwill and Intangible Assets

Goodwill

The following table presents goodwill balances and adjustments to those balances during the nine months ended September 30, 2018:

	December 31, 2017	Goodwill Acquired	Adjustments	September 30, 2018
	(In millions)			
Total goodwill	$4,339	$ 1,732	$ (17)	$ 6,054

The adjustments to goodwill during the nine months ended September 30, 2018 pertain to measurement period adjustments related to our acquisitions of Swift and TIO completed in the third quarter of 2017 and foreign currency translation adjustments.

Intangible Assets

The components of identifiable intangible assets are as follows:

	September 30, 2018				December 31, 2017			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Useful Life (Years)
	(In millions, except years)							
Intangible assets:								
Customer lists and user base	$964	$ (598)	$ 366	7	$613	$ (563)	$ 50	3
Marketing related	300	(199)	101	3	198	(196)	2	1
Developed technologies	425	(249)	176	3	274	(215)	59	3
All other	245	(204)	41	5	245	(188)	57	5
Intangible assets, net	$1,934	$ (1,250)	$ 684		$1,330	$ (1,162)	$ 168	

Amortization expense for intangible assets was $34 million and $28 million for the three months ended September 30, 2018 and 2017, respectively. Amortization expense for intangible assets was $90 million and $96 million for the nine months ended September 30, 2018 and 2017, respectively.

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Expected future intangible asset amortization as of September 30, 2018 was as follows (in millions):

Fiscal years:	
Remaining 2018	$53
2019	179
2020	160
2021	106
2022	50
Thereafter	136
	$684

Note 6—Other Financial Statement Details

Property and Equipment, Net

Geographical Information

The following table summarizes long-lived assets based on geography:

	September 30, 2018	December 31, 2017
	(In millions)	
Long-lived assets:		
U.S.	$1,514	$ 1,432
Other countries	132	96
Total long-lived assets	$1,646	$ 1,528

Tangible long-lived assets as of September 30, 2018 and December 31, 2017 consisted of property and equipment. Long-lived assets attributed to the U.S. and other countries are based upon the country in which the asset is located or owned.

Accumulated Other Comprehensive Income (Loss)

The following table summarizes the changes in accumulated balances of other comprehensive income (loss) for the three months ended September 30, 2018:

	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Investments	Foreign Currency Translation	Estimated Tax Benefit (Expense)	Total
	(In millions)				
Beginning balance	$104	$ (22)	$ (52)	$ 6	$ 36
Other comprehensive income (loss) before reclassifications	41	5	(6)	(2)	38
Less: Amount of gains (losses) reclassified from accumulated other comprehensive income	7	1	—	—	8

Net current period other comprehensive income (loss)	34	4	(6)	(2)	30
Ending balance	$138	$ (18)	$ (58)	$ 4	$ 66

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The following table summarizes the changes in accumulated balances of other comprehensive income (loss) for the three months ended September 30, 2017:

	Unrealized Gains (Losses) on Cash Flow Hedges	Unrealized Gains (Losses) on Investments	Foreign Currency Translation	Estimated Tax Benefit	Total
	(In millions)				
Beginning balance	$(58)	$ (4)	$ (39)	$ 3	$(98)
Other comprehensive income (loss) before reclassifications	(70)	4	9	—	(57)
Less: Amount of gains (losses) reclassified from accumulated other comprehensive income	(13)	—	—	—	(13)
Net current period other comprehensive income (loss)	(57)	4	9	—	(44)
Ending balance	$(115)				