Square, Inc.
Form 10-Q
May 02, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 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: 001-37622

Square, Inc.
(Exact name of registrant as specified in its charter)

Delaware	80-0429876
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1455 Market Street, Suite 600
San Francisco, CA 94103
(Address of principal executive offices, including zip code)
(415) 375-3176
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark 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 definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer ý Accelerated filer o Non-accelerated filer o (Do not check if smaller reporting company) 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 o No ý

As of April 30, 2018, the number of shares of the registrant's Class A common stock outstanding was 289,951,143 and the number of shares of the registrant's Class B common stock outstanding was 110,743,787.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that involve substantial risks and uncertainties. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “appears,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “c “believes,” “estimates,” “predicts,” “potential,” or “continue,” or the negative of these words or other similar terms or expressions that concern our expectations, strategy, plans, or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about our future financial performance, our anticipated growth and growth strategies and our ability to effectively manage that growth, our ability to invest in and develop our products and services to operate with changing technology, our anticipated expansion and growth in Gross Payment Volume (GPV) and revenue, our plans for international expansion, the expected closing and impact of our recent proposed acquisitions, our plans with respect to patents and other intellectual property, our expectations regarding litigation, our expectations regarding share-based compensation, our expectations regarding the impacts of accounting guidance, our expectations regarding restricted cash, and the sufficiency of our cash and cash equivalents and cash generated from operations to meet our working capital and capital expenditure requirements.

The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties, and other factors described in the section titled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q.

All forward-looking statements are based on information and estimates available to the Company at the time of this Quarterly Report on Form 10-Q and are not guarantees of future performance. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law.

Part I—Financial Information
Item 1. Financial Statements
SQUARE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except share and per share data)

	March 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$738,586	$696,474
Short-term investments	200,048	169,576
Restricted cash	27,688	28,805
Settlements receivable	700,646	620,523
Customer funds	152,661	103,042
Loans held for sale	78,821	73,420
Other current assets	91,933	86,454
Total current assets	1,990,383	1,778,294
Property and equipment, net	98,170	91,496
Goodwill	58,327	58,327
Acquired intangible assets, net	14,138	14,334
Long-term investments	176,672	203,667
Restricted cash	9,802	9,802
Other non-current assets	32,120	31,350
Total assets	$2,379,612	$2,187,270
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$19,556	$16,763
Customers payable	881,754	733,736
Settlements payable	116,902	114,788
Accrued transaction losses	28,309	26,893
Accrued expenses	57,997	52,280
Other current liabilities	27,214	28,367
Total current liabilities	1,131,732	972,827
Long-term debt (Note 11)	362,965	358,572
Other non-current liabilities	74,935	69,538
Total liabilities	1,569,632	1,400,937
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock, $0.0000001 par value: 100,000,000 shares authorized at March 31, 2018 and December 31, 2017. None issued and outstanding at March 31, 2018 and December 31, 2017.	—	—
Class A common stock, $0.0000001 par value: 1,000,000,000 shares authorized at March 31, 2018 and December 31, 2017; 287,921,742 and 280,400,813 issued and outstanding at March 31, 2018 and December 31, 2017, respectively.	—	—
Class B common stock, $0.0000001 par value: 500,000,000 shares authorized at March 31, 2018 and December 31, 2017; 112,462,337 and 114,793,262 issued and outstanding at March 31, 2018 and December 31, 2017, respectively.	—	—
Additional paid-in capital	1,682,581	1,630,386
Accumulated other comprehensive loss	(1,294)	(1,318)

Accumulated deficit	(871,307)	(842,735)
Total stockholders’ equity	809,980	786,333
Total liabilities and stockholders’ equity	$2,379,612	$2,187,270

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

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

	Three Months Ended March 31,	
	2018	2017
Revenue:		
Transaction-based revenue	$523,037	$403,478
Subscription and services-based revenue	97,054	49,060
Hardware revenue	14,417	9,016
Bitcoin revenue	34,095	—
Total net revenue	668,603	461,554
Cost of revenue:		
Transaction-based costs	327,911	257,778
Subscription and services-based costs	30,368	15,876
Hardware costs	19,702	12,662
Bitcoin costs	33,872	—
Amortization of acquired technology	1,580	1,807
Total cost of revenue	413,433	288,123
Gross profit	255,170	173,431
Operating expenses:		
Product development	105,095	68,582
Sales and marketing	77,266	49,900
General and administrative	75,501	56,935
Transaction, loan and advance losses	18,031	11,891
Amortization of acquired customer assets	269	205
Total operating expenses	276,162	187,513
Operating loss	(20,992)	(14,082)
Interest and other expense, net	2,819	499
Loss before income tax	(23,811)	(14,581)
Provision for income taxes	175	509
Net loss	$(23,986)	$(15,090)
Net loss per share:		
Basic	$(0.06)	$(0.04)
Diluted	$(0.06)	$(0.04)
Weighted-average shares used to compute net loss per share		
Basic	395,948	366,737
Diluted	395,948	366,737

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

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

	Three Months Ended March 31,	
	2018	2017
Net loss	$(23,986)	$(15,090)
Net foreign currency translation adjustments	549	757
Net unrealized gain (loss) on revaluation of intercompany loans	665	(29)
Net unrealized gain (loss) on marketable securities	(1,190)	19
Total comprehensive loss	$(23,962)	$(14,343)

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

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

	Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net loss	$(23,986)	$(15,090)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	10,160	9,437
Non-cash interest and other expense	4,847	1,534
Share-based compensation	46,824	31,670
Transaction, loan and advance losses	18,031	11,891
Deferred provision (benefit) for income taxes	(654)	99
Changes in operating assets and liabilities:		
Settlements receivable	(81,452)	54,586
Customer funds	(49,619)	(13,953)
Purchase of loans held for sale	(344,976)	(252,170)
Sales and principal payments of loans held for sale	337,092	242,431
Other current assets	(13,444)	6,105
Other non-current assets	(1,256)	141
Accounts payable	1,990	(1,459)
Customers payable	147,977	(11,132)
Settlements payable	2,114	(15,378)
Charge-offs to accrued transaction losses	(12,842)	(11,178)
Accrued expenses	2,703	3,930
Other current liabilities	3,165	(368)
Other non-current liabilities	5,379	2,902
Net cash provided by operating activities	52,053	43,998
Cash flows from investing activities:		
Purchase of marketable securities	(50,221)	(181,851)
Proceeds from maturities of marketable securities	45,450	15,569
Proceeds from sale of marketable securities	—	3,996
Purchase of property and equipment	(8,083)	(6,508)
Purchase of intangible assets	(1,584)	—
Business acquisitions	(1,055)	(1,600)
Net cash used in investing activities	(15,493)	(170,394)
Cash flows from financing activities:		
Proceeds from issuance of convertible senior notes, net	—	428,250
Purchase of convertible senior note hedges	—	(92,136)
Proceeds from issuance of warrants	—	57,244
Payment for termination of Starbucks warrant	—	(54,808)
Principal payments on capital lease obligation	(665)	(247)
Proceeds from the exercise of stock options, net	31,354	39,280
Payments for tax withholding related to vesting of restricted stock units	(27,651)	—
Net cash provided by financing activities	3,038	377,583
Effect of foreign exchange rate on cash and cash equivalents	1,397	1,058
Net increase in cash, cash equivalents and restricted cash	40,995	252,245
Cash, cash equivalents and restricted cash, beginning of period	735,081	488,745

Cash, cash equivalents and restricted cash, end of period	$776,076	$740,990

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

SQUARE, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

Business

Square, Inc. (together with its subsidiaries, Square or the Company) creates tools that help sellers start, run, and grow their businesses. Square enables sellers to accept card payments and also provides reporting and analytics, next-day settlement, and chargeback protection. Square's point-of-sale software and other business services help sellers manage inventory, locations, and employees; access financing; engage customers; and grow sales. Cash App is an easy way for businesses and individuals to send and receive money, store their funds as well as use their funds via a Visa debit card, and recently started offering customers the ability to purchase bitcoin (a 'cryptocurrency' or 'digital currency'). Caviar is a food ordering service for pickup and delivery that helps restaurants reach new customers. Square was founded in 2009 and is headquartered in San Francisco, with offices in the United States, Canada, Japan, Australia, Ireland, and the United Kingdom.

Basis of Presentation

The accompanying interim condensed consolidated financial statements of the Company are unaudited. These interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP) and the applicable rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The December 31, 2017 condensed consolidated balance sheet was derived from the audited financial statements as of that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

The accompanying unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all adjustments of a normal recurring nature considered necessary to state fairly the Company's consolidated financial position, results of operations, comprehensive loss, and cash flows for the interim periods. All intercompany transactions and balances have been eliminated in consolidation. The interim results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018, or for any other future annual or interim period.

The information included in this Quarterly Report on Form 10-Q should be read in conjunction with “Management's Discussion and Analysis of Financial Condition and Results of Operations,” “Quantitative and Qualitative Disclosures About Market Risk,” and the Consolidated Financial Statements and notes thereto included in Items 7, 7A, and 8, respectively, in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Use of Estimates

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

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

Concentration of Credit Risk

For the three months ended March 31, 2018 and 2017, the Company had no customer that accounted for greater than 10% of total net revenue.

The Company had three third-party payment processors that represented approximately 46%, 42%, and 7% of settlements receivable as of March 31, 2018. The same three parties represented approximately 46%, 42%, and 8% of settlements receivable as of December 31, 2017. All other third-party processors were insignificant.

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

Accounting Policies

Except for the adoption of ASC 606, Revenue from Contracts with Customers (ASC 606), described in Note 2, and the accounting policy on cryptocurrency transactions, described below, there have been no material changes to the Company’s accounting policies during the three months ended March 31, 2018, as compared to the accounting policies described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Cryptocurrency transactions

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

Recent Accounting Pronouncements

Recently issued accounting pronouncements not yet adopted

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, Leases, which will require, among other items, lessees to recognize a right of use asset and a related lease liability for most leases on the balance sheet. Qualitative and quantitative disclosures will be enhanced to better understand the amount, timing and uncertainty of cash flows arising from leases. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The new standard should be applied on a modified retrospective basis. The Company does not plan to early adopt this guidance. The Company’s operating leases primarily comprise of office spaces, with the most significant leases relating to corporate headquarters in San Francisco and an office in New York. While the Company continues to evaluate the impact of adopting this guidance on its consolidated financial statements, it does expect to record right to use assets and related lease liabilities on its consolidated balance sheets upon adoption, which will increase total assets and liabilities.

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

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

In March 2017, the FASB issued ASU No. 2017-08, Premium Amortization on Purchased Callable Debt Securities, which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. This standard is effective for annual periods beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The amendments in this guidance should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the impact this new guidance may have on the consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. When the Tax Cuts and Jobs Act of 2017 was enacted in December 2017, there was a valuation allowance on the deferred tax assets included within the Company's accumulated other comprehensive income; therefore no tax expense resulted from the change in the federal income tax rate. This guidance allows companies to reclassify such tax effects from accumulated other comprehensive income to retained earnings. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The Company does not expect the adoption of this guidance to have a material impact on the consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU 2018-03, Recognition and Measurement of Financial Assets and Financial Liabilities. This guidance clarifies that an entity that uses the measurement alternative for equity securities without readily determinable fair values can change its measurement approach to fair value. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. The Company does not expect the adoption of this guidance to have a material impact on the consolidated financial statements and related disclosures.
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NOTE 2 - REVENUE

Adoption of ASC 606, Revenue from Contracts with Customers

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic revenue recognition methodology under ASC 605, Revenue Recognition.

The Company recorded a net reduction to retained earnings of $4.6 million as of January 1, 2018, due to the cumulative impact of adopting ASC 606, primarily related to impact on revenue and associated cost of revenue from hardware sold through the retail distribution channels and hardware installment sales. The impact to revenue for the three months ended March 31, 2018, was an increase of $1.3 million as a result of applying ASC 606.

For the three months ended March 31, 2018, the revenue recognized from contracts with customers was $648.8 million, including $34.1 million from bitcoin sales. Revenue from other sources was $19.8 million. Impairment losses arising from contracts with customers were not significant in the current reporting period.

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

	Three Months Ended March 31, 2018		
	As reported	Balances without adoption of ASC 606	Effect of change
Impact on the Condensed Consolidated Statement of Operations:			
Subscription and services-based revenue	$97,054	$96,995	$59
Hardware revenue	14,417	13,154	1,263
Subscription and services-based costs	30,368	30,368	—
Hardware costs	19,702	18,757	945
Impact on the Condensed Consolidated Balance Sheets:			
Other current assets	91,933	100,573	(8,640)
Other current liabilities	27,214	31,976	(4,762)
Other non-current assets	32,120	33,355	(1,235)
Other non-current liabilities	$74,935	$75,993	$(1,058)

Revenue Recognition

Revenue is recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. The Company's contracts with customers generally do not include multiple performance obligations.

The following table presents the Company's revenue from contracts with customers disaggregated by revenue source (in thousands):

	Three Months Ended March 31,	
	2018	2017
Revenue from Contracts with Customers:		
Transaction-based revenue	$523,037	$403,478
Subscription and services-based revenue	77,215	31,321
Hardware revenue	$14,417	$9,016
Bitcoin revenue	$34,095	$—

Transaction-based revenue

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

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

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

The transaction fees collected from sellers are recognized as revenue on a gross basis as the Company is the principal in the delivery of the managed payments solutions to the sellers. The Company has concluded it is the principal because it controls the services before delivery to the seller, it is primarily responsible for the delivery of the services and it has discretion in setting prices charged to sellers. As the merchant of record, Square is liable for settlement of the transactions the Company processes for its sellers, which is recorded as cost of revenues.

Subscription and services-based revenue

Subscription and services-based revenue is primarily comprised of revenue the Company generates from Instant Deposit, Caviar and various software as a service (SaaS) products.

Instant Deposit is a functionality within the Cash App and the Company's managed payment solutions that enables customers, including individuals and sellers, to instantly deposit funds into their bank accounts. The Company charges a per transaction fee which is recognized as revenue when customers instantly deposit funds to their bank account.

Caviar is a food ordering platform that facilitates food delivery services for restaurants. The Company's performance obligation is the delivery of food orders from restaurants to customers. The Company charges fees to restaurants, as sellers, and also charges delivery and service fees to customers. All fees are billed upon delivery of food orders, when the Company considers that it has satisfied its performance obligations. Revenue is also recognized upon delivery of the food orders, net of refunds. Refunds are estimated based on historical experience.

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

Hardware revenue

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

The Company offers hardware installment sales to customers with terms ranging from three to twenty four months. The Company allocates a portion of the consideration received from these arrangements to a financing component when it determines that a significant financing component exists. The financing component is subsequently recognized as financing revenue over the terms of the arrangement with the customer.

Bitcoin revenue

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

Arrangements with Multiple Performance Obligations

Infrequently the Company has offered its hardware customers free managed payment solutions with the purchase of its hardware as part of a marketing promotion. For such arrangements, the Company allocates revenue to each performance obligation based on its relative standalone selling price. We generally determine standalone selling prices based on the prices charged to customers since the Company's products and services are normally sold on a stand alone basis.

Deferred revenues

Deferred revenue is comprised of unearned revenue related to managed payments services offered in conjunction with hardware sales for which the cash payments from customers are received and due upon the sale of the hardware.

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

	Three Months Ended March 31,	
	2018	2017
Deferred revenue, beginning of the period	$5,893	$5,407
Deferred revenue, end of the period	3,353	2,965
Revenue recognized in the period from amounts included in deferred revenue at the beginning of the period	298	4,062

Practical Expedients

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

NOTE 3 - RESTRICTED CASH

As of March 31, 2018 and December 31, 2017, restricted cash of $27.7 million and $28.8 million, respectively, is related to pledged cash deposited into savings accounts at the financial institutions that process the Company's sellers' payment transactions and as collateral pursuant to an agreement with the originating bank for the Company's loan product. The Company uses the restricted cash to secure letters of credit with the financial institution to provide collateral for cash flow timing differences in the processing of these payments. The Company has recorded this amount as a current asset on the consolidated balance sheets due to the short-term nature of these cash flow timing differences and that there is no minimum time frame during which the cash must remain restricted. Additionally, this balance includes certain amounts held as collateral pursuant to multi-year lease agreements, discussed in the paragraph below, which we expect to become unrestricted within the next year.

As of both March 31, 2018 and December 31, 2017, the remaining restricted cash of $9.8 million, is primarily related to cash deposited into money market funds that is used as collateral pursuant to multi-year lease agreements entered into in 2012 and 2014 (Note 16). The Company has recorded this amount as a non-current asset on the consolidated balance sheets as the terms of the related leases extend beyond one year.

NOTE 4 - FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

	March 31, 2018			December 31, 2017		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Cash and Cash Equivalents:						
Money market funds	$405,813	$—	$ —	$387,698	$—	$ —
Commercial paper	—	20,576	—	—	24,695	—
Short-term securities:						
U.S. agency securities	—	13,583	—	—	15,083	—
Corporate bonds	—	91,672	—	—	57,798	—
Commercial paper	—	14,286	—	—	17,428	—
Municipal securities	—	26,889	—	—	23,700	—
U.S. government securities	53,618		—	55,567	—	—
Long-term securities:						
U.S. agency securities	—	20,095	—	—	20,169	—
Corporate bonds	—	71,383	—	—	91,413	—
Municipal securities	—	14,519	—	—	26,224	—
U.S. government securities	70,675	—	—	65,861	—	—
Total	$530,106	$273,003	$ —	$509,126	$276,510	$ —

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

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

	March 31, 2018		December 31, 2017	
	Carrying Value	Fair Value (Level 2)	Carrying Value	Fair Value (Level 2)
Convertible senior notes	$362,965	$963,965	$358,572	$719,356
Total	$362,965	$963,965	$358,572	$719,356

Loans held for sale are recorded at the lower of amortized cost or fair value determined on an individual loan basis. To determine the fair value the Company utilizes industry-standard valuation modeling, such as discounted cash flow models, taking into account the estimated timing and amounts of periodic repayments.

A summary of loans disclosed at fair value on a recurring basis is as follows (in thousands):

	March 31, 2018		December 31, 2017	
	Carrying Value	Fair Value (Level 3)	Carrying Value	Fair Value (Level 3)
Loans held for sale	$78,821	$81,459	$73,420	$76,070
Total	$78,821	$81,459	$73,420	$76,070

The Company recognizes a charge within transaction, loan and advance losses on the consolidated statement of operations whenever the amortized cost of a loan exceeds its fair value, with such charges being reversed for subsequent increases in fair value, but only to the extent that such reversals do not result in the amortized cost of a loan exceeding its fair value. For the three months ended March 31, 2018, the Company recorded a charge for the excess of amortized cost over fair value of the loans of $2.5 million. No charges were recorded for the three months ended March 31, 2017.
If applicable, the Company will recognize transfers into and out of levels within the fair value hierarchy at the end of the reporting period in which the actual event or change in circumstance occurs. During the three months ended March 31, 2018 and 2017, the Company did not have any transfers in or out of Level 1, Level 2, or Level 3 assets or liabilities.

NOTE 5 - INVESTMENTS

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.

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term securities:				
U.S. agency securities	$13,581	$ 5	$ (3)	$13,583
Corporate bonds	92,023	11	(362)	91,672
Commercial paper	14,286	—	—	14,286
Municipal securities	26,950	20	(81)	26,889
U.S. government securities	53,615	11	(8)	53,618
Total	$200,455	$ 47	$ (454)	$200,048
Long-term securities:				
U.S. agency securities	$20,169	$ 8	$ (82)	$20,095
Corporate bonds	71,741	170	(528)	71,383
Municipal securities	14,467	70	(18)	14,519
U.S. government securities	71,078	—	(403)	70,675

Total	$ 177,455	$ 248	$ (1,031)	$ 176,672

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

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

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

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

	Amortized Cost	Fair Value
Due in one year or less	$ 200,455	$ 200,048
Due in one to five years	177,455	176,672
Total	$ 377,910	$ 376,720

NOTE 6 - PROPERTY AND EQUIPMENT, NET

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

	March 31, 2018	December 31, 2017
Leasehold improvements	$ 82,425	$ 77,073
Computer equipment	70,818	66,186
Capitalized software	39,268	35,063
Office furniture and equipment	15,152	14,490
	207,663	192,812
Less: Accumulated depreciation and amortization	(109,493)	(101,316)
Property and equipment, net	$ 98,170	$ 91,496

Depreciation and amortization expense on property and equipment was $8.3 million for the three months ended March 31, 2018. Depreciation and amortization expense on property and equipment was $7.3 million for the three months ended March 31, 2017.

NOTE 7 - GOODWILL

Goodwill is recorded when the consideration paid for an acquisition of a business exceeds the fair value of identifiable net tangible and intangible assets acquired. As of both March 31, 2018 and December 31, 2017, goodwill was $58.3 million.

The Company performs a goodwill impairment test annually on December 31 and more frequently if events and circumstances indicate that the asset might be impaired. For the periods presented, the Company had recorded no impairment charges.

NOTE 8 - ACQUIRED INTANGIBLE ASSETS

For the three months ended March 31, 2018, the Company did not make any material acquisitions.

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

	Balance at March 31, 2018		
	Cost	Accumulated Amortization	Net
Patents	$1,285	$ (585)	$700
Technology Assets	30,837	(22,909)	7,928
Customer Assets	10,319	(4,809)	5,510
Total	$42,441	$ (28,303)	$14,138

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

The weighted average amortization periods for acquired patents, acquired technology, and customer intangible assets are approximately 13 years, 4 years, and 9 years, respectively.

Amortization expense associated with other intangible assets was $1.9 million for the three months ended March 31, 2018. Amortization expense associated with other intangible assets was $2.1 million for the three months ended March 31, 2017.

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

2018 (remaining 9 months)	$4,864
2019	4,002
2020	2,039
2021	892
2022	611
Thereafter	1,730
Total	$14,138

NOTE 9 - OTHER CONSOLIDATED BALANCE SHEET COMPONENTS (CURRENT)

Other Current Assets

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

	March 31, 2018	December 31, 2017
Inventory, net	$ 20,899	$ 16,777
Processing costs receivable	27,099	21,083
Prepaid expenses	14,743	14,473
Accounts receivable, net	9,876	8,606
Deferred hardware costs (i)	—	7,931
Deferred magstripe reader costs (ii)	2,677	2,469
Other	16,639	15,115
Total	$ 91,933	$ 86,454

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

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

Accrued Expenses

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

	March 31, 2018	December 31, 2017
Accrued payroll	$ 13,833	$ 9,103
Accrued professional fees	5,888	5,638
Accrued advertising and other marketing	7,279	6,723
Processing costs payable	10,166	10,145
Accrued non income tax liabilities	4,677	6,155
Accrued hardware costs	1,305	2,496
Other accrued liabilities	14,849	12,020
Total	$ 57,997	$ 52,280

Other Current Liabilities

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

	March 31, 2018	December 31, 2017
Square Capital payable (iii)	$ 6,450	$ 7,671
Square Payroll payable (iv)	2,865	2,850
Deferred revenue	3,353	5,893
Current portion of deferred rent	3,252	3,311
Accrued redemptions	1,110	1,036
Other	10,184	7,606
Total	$ 27,214	$ 28,367

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

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

NOTE 10 - OTHER CONSOLIDATED BALANCE SHEET COMPONENTS (NON-CURRENT)

Other Non-Current Assets

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

	March 31, 2018	December 31, 2017
Investment in privately held entity	$ 25,000	$ 25,000
Deposits	2,379	2,738
Debt issuance costs	719	788
Deferred tax assets	666	519
Other	3,356	2,305
Total	$ 32,120	$ 31,350

Other Non-Current Liabilities

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

	March 31, 2018	December 31, 2017
Statutory liabilities (i)	$ 44,468	$ 40,768
Deferred rent	22,241	20,349
Deferred tax liabilities	139	644
Other	8,087	7,777
Total	$ 74,935	$ 69,538

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

NOTE 11 - INDEBTEDNESS

Revolving Credit Facility

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

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

Convertible Senior Notes

On March 6, 2017, the Company issued an aggregate principal amount of $400.0 million of convertible senior notes (Notes) and an additional 10% or $40.0 million pursuant to the exercise in full of the option to the initial purchasers to cover over-allotments. The Notes mature on March 1, 2022, unless earlier converted or repurchased, and bear interest at a rate of 0.375% payable semi-annually on March 1 and September 1 of each year. The Notes are convertible at an initial conversion rate of 43.5749 shares of the Company's Class A common stock per $1,000 principal amount of Notes, which is equivalent to an initial conversion price of approximately $22.95 per share of Class A common stock. Holders may convert their Notes at any time prior to the close of business on the business day immediately preceding December 1, 2021 only under the following circumstances: (1) during any calendar quarter (and only during such calendar quarter), if the last reported sale price of the Company’s Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period after any five consecutive trading day period (the measurement period) in which the trading price (as defined in the indenture governing the Notes) per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company’s Class A common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events, including certain distributions, the occurrence of a fundamental change (as defined in the indenture governing the Notes) or a transaction resulting in the Company’s Class A common stock converting into other securities or property or assets. On or after December 1, 2021, up until the close of business on the second scheduled trading day immediately preceding the maturity date, a holder may convert all or any portion of its Notes regardless of the foregoing circumstances. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of its Class A common stock, or a combination of cash and shares of its Class A common stock, at the Company’s election. It is the Company’s current intent and policy to settle conversions through combination settlement with a specified dollar amount of $1,000 per $1,000 principal amount of Notes. The circumstances required to allow the holders to convert their Notes were met for the quarters commencing January 1, 2018 and April 1, 2018, respectively. As of May 1, 2018, no holders have converted or indicated their intention to convert their Notes.

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

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

The Notes consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Principal	$440,000	$ 440,000
Less: unamortized debt discount	(69,425)	(73,384)
Less: unamortized debt issuance costs	(7,610)	(8,044)

Net carrying amount	$362,965	$ 358,572

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

	March 31, 2018	December 31, 2017
Debt discount related to value of conversion option	$86,203	$ 86,203
Less: allocated debt issuance costs	(2,302)	(2,302)
Equity component, net	$83,901	$ 83,901

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

	Three Months Ended March 31,	
	2018	2017
Contractual interest expense based on 0.375% per annum	$413	$113
Amortization of debt discount and issuance costs	4,393	1,390
Total	$4,806	$1,503
Effective interest rate of the liability component	5.34 %	5.34 %

Convertible Note Hedge and Warrant Transactions

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

NOTE 12 - ACCRUED TRANSACTION LOSSES

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

	Three Months Ended March 31,	
	2018	2017
Accrued transaction losses, beginning of the period	$26,893	$20,064
Provision for transaction losses	14,258	11,558
Charge-offs to accrued transaction losses	(12,842)	(11,178)
Accrued transaction losses, end of the period	$28,309	$20,444

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NOTE 13 - INCOME TAXES
The Company recorded an income tax expense of $0.2 million for the three months ended March 31, 2018, compared to income tax expense of $0.5 million for the three months ended March 31, 2017. The income tax expense recorded for the three months ended March 31, 2018 was primarily due to state and foreign income tax expense.

The Company's effective tax rate was (0.7)% for the three months ended March 31, 2018, compared to an effective tax rate of (3.5)% for the three months ended March 31, 2017. The difference between the effective tax rate and the federal statutory tax rate for the three months ended March 31, 2018 and March 31, 2017 primarily relates to the valuation allowance on the Company's deferred tax assets.

The Company's effective tax rate may be subject to fluctuation during the year as new information is obtained, which may affect the assumptions used to estimate the annual effective tax rate, including factors such as the mix of forecasted pre-tax earnings in the various jurisdictions in which the Company operates, valuation allowances against deferred tax assets, the recognition and de-recognition of tax benefits related to uncertain tax positions, and changes in or the interpretation of tax laws in jurisdictions where the Company conducts business.

As of March 31, 2018, the Company retains a full valuation allowance on its deferred tax assets in the U.S. and certain foreign jurisdictions. The realization of the Company's deferred tax assets depends primarily on its ability to generate taxable income in future periods. The amount of deferred tax assets considered realizable in future periods may change as management continues to reassess the underlying factors it uses in estimating future taxable income.
The tax provision for the three months ended March 31, 2018 and March 31, 2017, was calculated on a jurisdiction basis. The Company estimated the foreign income tax provision using the effective income tax rate expected to be applicable for the full year.

On December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act of 2017. The accounting for all items is expected to be complete when the 2017 U.S. corporate income tax return is filed in 2018. Any differences between what was previously recorded and the final tax return amounts or estimates done for subsequent quarters are not expected to be material.

NOTE 14 - STOCKHOLDERS' EQUITY
The changes in total stockholders' equity were as follows (in thousands):

	Total stockholders' equity
Balance at December 31, 2017	$ 786,333
Net loss	(23,986)
Exercise of stock options	31,354
Vesting of early exercised stock options and other	136
Share-based compensation	48,356
Tax withholding related to vesting of restricted stock units	(27,651)
Cumulative adjustment for adoption of ASC 606	(4,586)
Change in other comprehensive loss	24
Balance at March 31, 2018	$ 809,980

Common Stock

The Company has authorized the issuance of Class A common stock and Class B common stock. Class A common stock and Class B common stock are referred to as "common stock" throughout these Notes to the Condensed Consolidated Financial Statements, unless otherwise noted. As of March 31, 2018, the Company was authorized to issue 1,000,000,000 shares of Class A common stock and 500,000,000 shares of Class B common stock, each with a par value of $0.0000001 per share. As of March 31, 2018, there were 287,921,742 shares of Class A common stock and 112,462,337 shares of Class B common stock outstanding. Options and awards granted following the Company's Initial Public Offering are related to underlying Class A common stock. Additionally, holders of Class B common stock are able to convert such shares into Class A common stock.

Stock Plans

The Company maintains two share-based employee compensation plans: the 2009 Stock Plan (2009 Plan) and the 2015 Equity Incentive Plan (2015 Plan). The 2015 Plan serves as the successor to the 2009 Plan. The 2015 Plan became effective as of November 17, 2015. Outstanding awards under the 2009 Plan continue to be subject to the terms and conditions of the 2009 Plan. Since November 17, 2015, no additional awards have been nor will be in the future granted under the 2009 Plan.

Under the 2015 Plan, shares of the Company's Class A common stock are reserved for the issuance of incentive and nonstatutory stock options, restricted stock awards, restricted stock units (RSUs), performance shares, and stock bonuses to qualified employees, directors, and consultants. The awards must be granted at a price per share not less than the fair market value at the date of grant. Initially, 30,000,000 shares were reserved under the 2015 Plan, and any shares subject to options or other similar awards granted under the 2009 Plan that expire, are forfeited, are repurchased by the Company, or otherwise terminate unexercised, will become available under the 2015 Plan. The number of shares available for issuance under the 2015 Plan will be increased on the first day of each fiscal year, in an amount equal to the least of (i) 40,000,000 shares, (ii) 5% of the outstanding shares on the last day of the immediately preceding fiscal year, or (iii) such number of shares determined by the Company’s board of directors or a committee thereof. As of March 31, 2018, the total number of shares subject to stock options and RSUs outstanding under the 2015 Plan was 24,960,627, and 65,895,253 shares were available for future issuance. As of March 31, 2018, the total number of shares subject to stock options and RSUs outstanding under the 2009 Plan was 38,069,996.

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

	Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Balance at December 31, 2017	47,270,091	$ 8.67	6.52	$1,229,103
Exercised	(4,213,775)	7.44		
Forfeited	(328,651)	12.04		
Balance at March 31, 2018	42,727,665	$ 8.76	6.33	$1,727,761
Options exercisable as of March 31, 2018	40,039,760	$ 8.47	6.20	$1,630,725

Restricted Stock Activity

Activity related to RSUs during the three months ended March 31, 2018 is set forth below:

	Number of RSUs	Weighted Average Grant Date Fair Value
Unvested as of December 31, 2017	21,317,525	$ 17.84
Granted	1,226,422	44.78
Vested	(1,625,534)	14.54
Forfeited	(615,455)	15.67
Unvested as of March 31, 2018	20,302,958	$ 19.80

Share-Based Compensation

The fair value of stock options and employee stock purchase plan rights are estimated on the date of grant using the Black-Scholes-Merton option valuation model. The fair value of RSUs is determined by the closing price of the Company’s common stock on each grant date.

There were no stock options granted during the three months ended March 31, 2018 and 2017.

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

	Three Months Ended March 31,	
	2018	2017
Cost of revenue	$31	$—
Product development	30,482	19,356
Sales and marketing	4,961	3,935
General and administrative	11,350	8,379
Total	$46,824	$31,670

The Company recorded $2.3 million of share-based compensation expense related to the Company's 2015 Employee Stock Purchase Plan during the three months ended March 31, 2018, compared to $1.9 million for the three months ended March 31, 2017, which are included in the table above.

The Company capitalized $1.5 million of share-based compensation expense related to capitalized software costs during the three months ended March 31, 2018, compared to $0.5 million for the three months ended March 31, 2017. As of March 31, 2018, there was $418.7 million of total unrecognized compensation cost related to outstanding stock options that is expected to be recognized over a weighted-average period of 2.74 years.

NOTE 15 - LOSS PER SHARE

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period. Diluted loss per share is the same as basic loss per share for all periods presented because the effects of potentially dilutive items were anti-dilutive given the Company’s net loss.

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

	Three Months Ended March 31,	
	2018	2017
Net loss	$(23,986)	$(15,090)
Basic shares:		
Weighted-average common shares outstanding	397,246	368,571
Weighted-average unvested shares	(1,298)	(1,834)
Weighted-average shares used to compute basic net loss per share	395,948	366,737
Diluted shares:		
Weighted-average shares used to compute diluted loss per share	395,948	366,737
Net loss per share:		
Basic	$(0.06)	$(0.04)
Diluted	$(0.06)	$(0.04)

Additionally, since the Company expects to settle the principal amount of its 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 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 $22.95 per share for the Notes. Because the Company has reported a net loss for all periods presented, diluted loss per share is the same as basic loss per share for those periods.

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

	Three Months Ended March 31,	
	2018	2017
Stock options and restricted stock units	66,382	84,909
Common stock warrants	19,173	11,129
Unvested shares	1,298	1,834
Employee stock purchase plan	264	509
Total anti-dilutive securities	87,117	98,381

NOTE 16 - COMMITMENTS AND CONTINGENCIES

Operating and Capital Leases

The Company has entered into various non-cancelable operating leases for certain offices with contractual lease periods expiring between 2018 and 2025. The Company recognized total rental expenses under operating leases of $4.5 million for the three months ended March 31, 2018, compared to $2.8 million for the three months ended March 31, 2017.

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

	Capital	Operating
Year:		
2018 (remaining 9 months)	$1,996	$15,437
2019	2,549	19,600
2020	1,274	19,388
2021	44	19,009
2022	2	19,105
Thereafter	—	23,628
Total	$5,865	$116,167
Less amount representing interest	(15)	
Present value of capital lease obligations	5,850	
Less current portion of capital lease obligation	(2,654)	
Non-current portion of capital lease obligation	$3,196	

Litigation

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

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

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

NOTE 17 - SEGMENT AND GEOGRAPHICAL INFORMATION

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

Revenue

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

	Three Months Ended March 31,	
	2018	2017
Revenue		
United States	$640,173	$444,899
International	28,430	16,655
Total net revenue	$668,603	$461,554

No individual country from the international markets contributed in excess of 10% of total revenue for the three months ended March 31, 2018 and 2017.

Long-Lived Assets

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

	March 31, 2018	December 31, 2017
Long-lived assets		
United States	$165,530	$ 158,820
International	5,105	5,337
Total long-lived assets	$170,635	$ 164,157

NOTE 18 - SUPPLEMENTAL CASH FLOW INFORMATION

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

	Three Months Ended March 31,	
	2018	2017
Supplemental Cash Flow Data:		
Cash paid for interest	$966	$142
Cash paid for income taxes	658	334
Supplemental disclosures of non-cash investing and financing activities:		
Change in purchases of property and equipment in accounts payable and accrued expenses	(3,813)	(468)
Unpaid business acquisition purchase price	1,151	400

NOTE 19 - SUBSEQUENT EVENTS

Release of Caviar Shares Held Back

In 2014, in conjunction with the Company's acquisition of Caviar, Inc. (Caviar), 1,292,207 shares of the purchase consideration issuable were withheld for indemnification purposes. In April 2018, the Company reached an agreement with the former owners of Caviar whereby 822,085 of the shares held back would be released to the former owners and 469,894 shares would be forfeited back to the Company to cover any potential future liabilities.

Acquisition

In April 2018, the Company entered into an agreement to acquire Weebly Inc (Weebly), a technology company that provides customers with tools to build a professional website or online store, for a purchase price of approximately $265 million, comprising an aggregate of approximately $132.5 million in cash and approximately $132.5 million in the Company's Class A common stock, subject to adjustments based on (i) purchase price adjustment provisions and (ii) indemnification obligations of Weebly stockholders after the closing of the acquisition, as specified in the agreement. The acquisition of Weebly will enable the Company to combine Weebly's web presence tools with the Company's in-person and online offerings to create one cohesive solution for sellers to start or grow an omnichannel business. The acquisition will also expand the Company's customer base globally and add a new recurring revenue stream. The acquisition is expected to close in the second quarter of 2018, subject to customary closing conditions including regulatory approvals.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with the information set forth within the condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q. The statements in this discussion regarding our expectations of our future performance, liquidity and capital resources, our plans, estimates, beliefs and expectations that involve risks and uncertainties, and other non-historical statements in this discussion, are forward-looking statements. These forward-looking statements are subject to numerous risks and uncertainties, including, but not limited to, the risks and uncertainties described under "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q. Our actual results may differ materially from those contained in or implied by any forward-looking statements.

Overview

We started Square in February 2009 to enable businesses (sellers) to accept card payments, an important capability that was previously inaccessible to many businesses. However, sellers also need innovative solutions to thrive, and we have since expanded to provide additional products and services to give these businesses access to the same tools as large businesses. Square is a cohesive commerce ecosystem that helps our sellers start, run, and grow their businesses. We combine sophisticated software with affordable hardware to enable sellers to turn mobile and computing devices into powerful payment and point-of-sale solutions. We focus on technology and design to create products and services that are cohesive, fast, self-serve, and dependable.

The foundation of our ecosystem is a full service, managed payments offering. Once a seller downloads the Square Point of Sale mobile app, they can quickly and easily take their first payment, because we can typically bring them onto our system in minutes. With our offering, a seller can accept payments in person via magnetic stripe (a swipe), EMV (Europay, MasterCard, and Visa) (a dip), or NFC (Near Field Communication) (a tap); or online via Square Invoices, Square Virtual Terminal, or the seller's website or app. Once on our system, sellers gain access to technology and features such as reporting and analytics, next-day settlements, digital receipts, payment dispute and chargeback management, security, and Payment Card Industry (PCI) compliance.

Our commerce ecosystem also includes powerful point-of-sale software and services that help sellers make informed business decisions through the use of analytics and reporting. As a result, sellers can manage orders, inventory, locations, employees, and payroll; engage and grow their sales with customers; and gain access to business loans through our Square Capital service. Some of these advanced point-of-sale features are broadly applicable to our seller base and include Employee Management and Customer Engagement. We have also extended our ecosystem to serve sellers with more specific needs. Our Build with Square developer platform (application programming interface or APIs) allows businesses with individualized needs to customize their business solutions while processing payments on

Square and taking advantage of all the services in our ecosystem, including integration with third-party applications. In addition, certain verticals, such as service and retail sellers, benefit from specific features such as Invoices, Appointments, and Square for Retail. We monetize these features through either a per transaction fee, a subscription fee, or a service fee.

In the same way that we have empowered businesses with fast, simple, and cohesive tools, we see an opportunity with our Cash App to build a similar ecosystem of services for individuals. The Cash App offers individuals access to a fast, easy way to send and receive money electronically to and from individuals and businesses. We also offer our Cash App customers the ability to store their funds as well as use their funds via a Visa debit card. We have recently added functionality to the Cash App to enable customers to buy bitcoin from us. Additionally, we give customers the option to sell bitcoin to us.

We also serve sellers through Caviar, our food ordering platform that helps restaurants reach new customers and increase sales without additional overhead. Caviar revenue consists of seller fees charged to restaurants, and delivery and service fees from consumers. All fees are recognized upon delivery of the food, net of refunds.

With Square Capital, we facilitate the offering of loans to sellers based on their payment processing history, and the product is broadly available across our seller base. We currently fund a majority of these loans from arrangements with institutional third-party investors who purchase these loans. We recognize revenue upon the sale of the loans to third-party investors or over time as the sellers pay down the outstanding amounts for the loans that we hold as available for sale. We also earn a servicing fee from third-party investors that we record as revenue as we provide the services.

We also provide hardware to facilitate commerce for sellers. This hardware includes magstripe readers, contactless and chip readers, chip card readers, Square Stand, Square Register and third-party peripherals.

We have grown rapidly to serve millions of sellers that represent a diverse set of industries, including retail, services, and food-related businesses, and sizes, ranging from a single vendor at a farmers' market to multi-location businesses. These sellers also span geographies including the United States, Canada, Japan, Australia, and the United Kingdom.

Results of Operations

Revenue (in thousands, except for percentages)

	Three Months Ended March 31,				
	2018	2017	$ Change	% Change	
Transaction-based revenue	$523,037	$403,478	$119,559	30	%
Subscription and services-based revenue	97,054	49,060	47,994	98	%
Hardware revenue	14,417	9,016	5,401	60	%
Bitcoin revenue	$34,095	$—	$34,095	—	%
Total net revenue	$668,603	$461,554	$207,049	45	%

Total net revenue for the three months ended March 31, 2018 increased by $207.0 million or 45%, compared to the three months ended March 31, 2017.

Transaction-based revenue for the three months ended March 31, 2018 increased by $119.6 million or 30%, compared to the three months ended March 31, 2017. This increase was attributable to growth in Gross Payment Volume (GPV) processed for the three months ended March 31, 2018 of 31%, compared to the three months ended March 31, 2017. We continue to benefit from growth in processed volumes from our existing sellers, in addition to meaningful contributions from new sellers. Additionally, GPV from larger sellers, which we define as all sellers that generate more than $125,000 in annualized GPV, represented 47% of our GPV in the first quarter of 2018, an increase from 43% in the first quarter of 2017. We continue to see ongoing success with attracting and enabling large seller growth, which will help us to drive strong GPV growth as we scale.

Subscription and services-based revenue for the three months ended March 31, 2018 increased by $48.0 million or 98%, compared to the three months ended March 31, 2017. The increases were primarily driven by continued growth of Instant Deposit, Caviar, and Square Capital, which were also the largest contributors to subscription and services-based revenue. Subscription and services-based revenue contributed 15% of total net revenue in the three months ended March 31, 2018, compared to 11% in the three months ended March 31, 2017.

Hardware revenue for the three months ended March 31, 2018 increased by $5.4 million or 60%, compared to the three months ended March 31, 2017. The increase primarily reflects growth in shipments of Square Register following its launch in the fourth quarter of 2017. Square Register is our first all-in-one offering that combines our hardware, point-of-sale software, and payments technology. The increase was also driven by continued growth in sales of our Square Stand and third-party peripherals driven primarily by new features and product offerings. Additionally, the adoption of ASC 606 resulted in an increase of $1.3 million in hardware revenue primarily related to the earlier revenue recognition of hardware sold through the retail distribution channels and hardware installment sales, which were previously recorded upon sell through to the end user customer.

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

Total Cost of Revenue (in thousands, except for percentages)

	Three Months Ended March 31,			
	2018	2017	$ Change	% Change
Transaction-based costs	$327,911	$257,778	$70,133	27 %
Subscription and services-based costs	30,368	15,876	14,492	91 %
Hardware costs	19,702	12,662	7,040	56 %
Bitcoin costs	33,872	—	33,872	— %
Amortization of acquired technology	1,580	1,807	(227)	(13)%
Total cost of revenue	$413,433	$288,123	$125,310	43 %

Total cost of revenue for the three months ended March 31, 2018 increased by $125.3 million or 43%, compared to the three months ended March 31, 2017.

Transaction-based costs for the three months ended March 31, 2018 increased by $70.1 million or 27%, compared to the three months ended March 31, 2017. This increase was attributable to growth in GPV processed for the three months ended March 31, 2018 of 31%, compared to the three months ended March 31, 2017. Additionally, transaction-based margin as a percentage of GPV was 1.09% for the three months ended March 31, 2018, up from 1.07% for the three months ended March 31, 2017. Transaction-based profit continued to benefit from higher margin products and improvements in our transaction cost profile. GPV from higher margin products such as Invoices, Virtual Terminal, and eCommerce API payments more than doubled year over year.

Subscription and services-based costs for the three months ended March 31, 2018 increased by $14.5 million or 91%, compared to the three months ended March 31, 2017, primarily reflecting increased costs associated with the growth of Caviar and, to a lesser extent, increased costs associated with the growth of Instant Deposit.

Hardware costs for the three months ended March 31, 2018 increased by $7.0 million or 56%, compared to the three months ended March 31, 2017. The increase in hardware costs reflects growth in our sales of Square Register, Square Stand and third-party peripherals as described above. Additionally, the adoption of ASC 606 resulted in an increase of $0.9 million in hardware costs primarily related to earlier recognition of costs of hardware sold through the retail distribution channels and hardware installment sales in line with the revenue recognition for such sales under ASC 606.

Bitcoin costs comprises of the amounts we pay to purchase bitcoin in the public cryptocurrency exchanges or from customers. The amount of bitcoin costs will fluctuate in line with the associated revenue.

Amortization of acquired technology assets for the three months ended March 31, 2018 decreased by $0.2 million or 13%, compared to the three months ended March 31, 2017, as a result of certain technology assets reaching end of life.

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Operating Expenses (in thousands, except for percentages)

	Three Months Ended March 31,			
	2018	2017	$ Change	% Change
Product development	$105,095	$68,582	$36,513	53 %
% of total net revenue	16 %	15 %		
Sales and marketing	$77,266	$49,900	$27,366	55 %
% of total net revenue	12 %	11 %		
General and administrative	$75,501	$56,935	$18,566	33 %
% of total net revenue	11 %	12 %		
Transaction, loan and advance losses	$18,031	$11,891	$6,140	52 %
% of total net revenue	3 %	3 %		
Amortization of acquired customer assets	$269	$205	$64	31 %
% of total net revenue	— %	— %		
Total operating expenses	$276,162	$187,513	$88,649	47 %

Product development expenses for the three months ended March 31, 2018 increased by $36.5 million or 53%, compared to the three months ended March 31, 2017, primarily due to an increase of $30.2 million in personnel-related costs mainly in our engineering, product, data science and design teams. The increase in personnel-related costs includes an increase in share-based compensation expense of $11.1 million.
Sales and marketing expenses for the three months ended March 31, 2018 increased by $27.4 million or 55%, compared to the three months ended March 31, 2017, primarily due to the following:

- an increase of $12.3 million in costs associa>

Total Malaysia (Cost $3,139,243)		2,965,607
Philippines 3.8%		
Diversified 3.8%		
Filinvest Land, Inc.	36,202,000	1,690,731
Megaworld Corp.	17,963,000	1,553,557
		3,244,288
Total Philippines (Cost $3,204,054)		3,244,288
Singapore 13.2%		
Diversified 10.6%		
Allgreen Properties, Ltd.	1,965,000	2,682,901
CDL Hospitality Trusts *	1,343,000	2,158,275
City Developments, Ltd.	203,000	2,294,235
Keppel Land, Ltd,	170,000	971,746
Singapore Land, Ltd.	137,000	1,020,284
		9,127,441
Office 0.9%		
Ascott Residence Trust	593,000	782,531
Retail 1.7%		
Frasers Centrepoint Trust *	1,289,000	1,448,362
Total Singapore (Cost $11,004,678)		11,358,334
Total Common Stocks (Cost $85,930,252)		81,051,812
Warrants 1.3%		

Australia 1.3%			
Macquarie Bank, Ltd., Warrants, expriring 6/19/08 (a) (Cost $1,121,584)	90,000		1,115,100
Short-Term Investments 4.5%			
Other Investment Companies 4.5%			
SSgA Money Market Fund, 4.98% (b) (Cost $3,857,778)	3,857,778		3,857,778
Total Investments 100.2% (Cost $90,909,614)			86,024,690
Other assets less liabilities (0.2)%			(143,915)
Net Assets 100%		$	85,880,775

Notes to Portfolio of Investments

*
Company is organized as a real estate investment trust as defined by the laws of its country of domicile.

(a)
As of June 30, 2007, this security had not paid a distribution.

(b)
Rate reflects 7 day yield as of June 30, 2007.

See notes to financial statements.

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RMR Asia Real Estate Fund
Financial Statements

Statement of Assets and Liabilities

June 30, 2007 (unaudited)

Assets		
Investments in securities, at value (cost $90,909,614)	$	86,024,690
Cash		121
Dividends and interest receivable		140,252
Total assets		86,165,063
Liabilities		
Advisory fee payable		53,970
Accrued expenses and other liabilities		230,318
Total liabilities		284,288
Net assets	$	85,880,775
Composition of net assets		
$.001 par value per share; unlimited number of shares authorized, 4,755,000 shares issued and outstanding	$	4,755
Additional paid-in capital		90,630,245
Undistributed net investment income		109,632
Accumulated net realized gain on investment and foreign currency transactions		21,035
Net unrealized depreciation on investments and foreign currency transactions		(4,884,892)
Net assets	$	85,880,775
Net asset value per share (based on 4,755,000 shares outstanding)	$	18.06

See notes to financial statements.

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RMR Asia Real Estate Fund
Financial Statements continued

Statement of Operations

For the Period May 25, 2007(a) to June 30, 2007 (unaudited)

Investment Income		
Dividends (cash distributions received or due, net of foreign taxes withheld of $2,625)	$	109,718
Interest		102,134
Total investment income		211,852
Expenses		
Advisory		79,409
Audit and legal		11,050
Administrative		8,353
Compliance and internal audit		6,719
Custodian		5,810
Shareholder reporting		3,136
Trustees' fees and expenses		2,195
Other		5,400
Total expenses		122,072
Less: expense waived by the Advisor		(19,852)
Net expenses		102,220
Net investment income		109,632
Realized and unrealized gain (loss) on investment and foreign currency transactions		
Net realized gain on foreign currency transactions		21,035
Net change in unrealized appreciation/(depreciation) on investments		(4,884,892)
Net decrease in net assets attributable to common shares resulting from operations	$	(4,754,225)

(a) Commencement of operations.
See notes to financial statements.

RMR Asia Real Estate Fund
Financial Statements continued

Statements of Changes in Net Assets

For the Period May 25, 2007(a) to June 30, 2007 (unaudited)

Increase (decrease) in net assets resulting from operations	
Net investment income	$ 109,632
Net realized gain on foreign currency transactions	21,035
Net change in unrealized appreciation/(depreciation) on investments	(4,884,892)
Net decrease in net assets resulting from operations	(4,754,225)
Capital shares transactions	
Net proceeds from sale of common shares	90,535,000
Net increase from capital transactions	90,535,000
Total increase in net assets	85,780,775
Net assets	
Beginning of period	100,000
End of period (including undistributed net investment income of $109,632)	$ 85,880,775
Common shares	
Shares outstanding, beginning of period	5,000
Shares issued	4,750,000
Shares outstanding, end of period	4,755,000

(a) Commencement of operations.
See notes to financial statements.

RMR Asia Real Estate Fund
Financial Highlights

Selected Data For A Common Share Outstanding Throughout The Period

		For the Period May 25, 2007(a) to June 30, 2007 (unaudited)
Per Common Share Operating Performance (b)		
Net asset value, beginning of period	$	19.06 (c)
Income from Investment Operations		
Net investment income (d)		.02
Net realized and unrealized appreciation/(depreciation) on investments		(.98)
Net decrease in net asset value from operations		(.96)
Common share offering costs charged to capital		(.04)
Net asset value, end of period	$	18.06
Market price, beginning of period	$	20.00
Market price, end of period	$	19.16
Total Return (e)		
Total investment return based on:		
Market price (f)		(4.20)%
Net asset value (f)		(5.25)%
Ratios/Supplemental Data:		
Ratio to average net assets attributable to common shares of: (g)		
Net investment income (d)		1.38%
Expenses, net of fee waivers		1.29%
Expenses, before fee waivers		1.54%
Portfolio Turnover Rate		0.00%
Net assets attributable to common shares, end of period (000s)	$	85,881

(a) Commencement of operations.

(b) Based on average shares outstanding.

(c) Net asset value at May 25, 2007, reflects the deduction of the average sales load and offering costs of $0.94 per share paid by the holders of common shares from the $20.00 offering price. We paid a sales load of $0.90 per share on 4,750,000 common shares sold to the public.

(d) Amounts are net of expenses waived by RMR Advisors.

(e) Total returns for periods of less than one year are not annualized.

(f) Total return based on per share market price assumes the purchase of common shares at the market price on the first day and sales of common shares at the market price on the last day of the period indicated; dividends and distributions, if any, are assumed to be reinvested at market prices on the ex-dividend date. The total return based net asset value, or NAV, assumes the purchase of common shares at NAV on the first day and sales of common shares at NAV on the last day of the period indicated; distributions are assumed to be reinvested at NAV on the ex-dividend date. Results represent past performance and do not guarantee future results. Total return would have been lower if RMR Advisors had not contractually waived a portion of its investment advisory fee.

(g) Annualized.

See notes to financial statements.

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RMR Asia Real Estate Fund
Notes to Financial Statements

June 30, 2007 (unaudited)

Note A

(1) Organization

RMR Asia Real Estate Fund, or the Fund, was organized as a Massachusetts business trust on January 18, 2007, and is registered under the Investment Company Act of 1940, as amended, or the 1940 Act, as a non-diversified closed-end management investment company. The Fund had no operations prior to May 25, 2007, other than matters relating to the Fund's establishment, registration of the Fund's common shares under the Securities Act of 1933, and the sale of 5,000 common shares for $100,000 to RMR Advisors, Inc., or RMR Advisors. On May 25, 2007, the Fund sold 4,750,000 common shares in an initial public offering. Proceeds to the Fund were $90,535,000 after deducting underwriting commissions and $190,000 of offering expenses.

(2) Interim Financial Statements

The accompanying June 30, 2007, financial statements have been prepared without audit. The Fund believes that disclosures made are adequate to make the information presented not misleading. In the opinion of the Fund's management, all adjustments, which include normal recurring adjustments considered necessary for a fair presentation, have been included. The Fund's operating results for this interim period are not necessarily indicative of the results that may be expected on an annual basis or in the future.

(3) Use of Estimates

Preparation of these financial statements in conformity with accounting principles generally accepted in the United States requires the Fund's management to make estimates and assumptions that may affect the amounts reported in the financial statements and related notes. The actual results could differ from these estimates.

(4) Portfolio Valuation

Investment securities of the Fund are valued at the latest sales price reflected on the consolidated tape of the exchange that reflects the principal market for such securities whenever that price is readily available on that day; securities for which no sales were reported on that day, unless otherwise noted, are valued at the last available bid price on that day. Any of the Fund's securities which are not readily marketable, which are not traded or which have other characteristics of illiquidity are valued by the Fund at fair value as determined in good faith under the supervision of the Fund's board of trustees. Numerous factors may be considered when determining fair value of a security, including cost at date of purchase, type of security, the nature and duration of restrictions on disposition of the security and whether the issuer of the security being fair valued has other securities of the same type outstanding. Short-term debt securities with less than 60 days until maturity may be valued at cost, which when combined with interest accrued, approximates market value.

Some foreign markets close before the close of customary trading sessions on the American Stock Exchange or AMEX (normally 4:00 p.m. eastern time). Occasionally, events occur after the principal foreign exchange on which the foreign securities trade has closed but before the AMEX closes and the Fund determines net asset value, or NAV, that could affect the value of the securities the Fund owns or cause their prices to be unreliable. If these events are expected to materially affect the Fund's NAV, the prices of such securities will be adjusted to reflect their estimated fair value as of the close of the AMEX, as determined in good faith under procedures established by the Fund's board of trustees.

(5) Securities Transactions and Investment Income

Securities transactions are recorded on a trade date basis. Dividend income is recorded on the ex-dividend date. Non-cash dividends included in dividend income, if any, are recorded at the fair market value of the securities received. Interest income, including accretion of original issue discount, where applicable, and accretion of discount on short-term investments, is recorded on the accrual basis. Realized gains and losses from securities transactions are recorded on the basis of identified cost.

(6) Taxes

The Fund has qualified and intends to qualify in the future as a "regulated investment company" and to comply with the applicable provisions of subchapter M of the Internal Revenue Code of 1986, as amended, so that it will generally not be subject to United States federal income tax. However, the Fund may be subject to a 4% excise tax to the extent the Fund does not distribute substantially all taxable earnings each year.

Some Asian governments may subject the Fund's investment income and securities sales to withholding or other taxes. For the period ended June 30, 2007, $2,625 of foreign taxes has been withheld from distributions to the Fund and recorded as a reduction of dividend income. There were no sales of securities during the period.

(7) Distributable Earnings

The Fund earns income, net of expenses, daily on its investments. It is the policy of the Fund to make distributions of its income at least annually in amounts at least equal to the amount necessary to maintain its status as a registered investment company. As of June 30, 2007, the Fund had not declared or paid distributions to shareholders. Distributions to shareholders are recorded on the ex-dividend date. The Fund's distributions may consist of ordinary income (net investment income and short term capital gains), long term capital gains and return of capital. To the extent the Fund's net realized capital gains, if any, can be offset by capital loss carry-forwards, it is the policy of the Fund not to distribute such gains.

Although subject to adjustments, the cost, gross unrealized appreciation and unrealized depreciation of the Fund's investments for federal income tax purposes as of June 30, 2007, are as follows:

Cost	$	90,909,614
Gross unrealized appreciation	$	1,487,889
Gross unrealized depreciation		(6,372,813)
Net unrealized appreciation/(depreciation)	$	(4,884,924)

(8) Concentration of Risk

Under normal market conditions, the Fund's investments will be concentrated in common shares, preferred shares and debt securities, including convertible preferred and debt securities, issued by Asian real estate companies and REITs. The value of Fund shares may fluctuate more than the shares of a fund not concentrated in the real estate industry or in the Asian region due to economic, legal, regulatory, technological or other developments affecting the Asian real estate industry and securities market.

(9) Foreign Securities Risk

As compared to U.S. securities, foreign securities may be issued by companies which provide less financial and other information, and which are subject to less developed and difficult to access legal systems, less stringent accounting, auditing and financial reporting standards or different governmental regulations. As compared to U.S. securities markets, foreign securities markets may have different settlement procedures, may have higher transaction costs, may be conducted in a less regulated manner, are generally smaller and may be less liquid and more volatile than securities markets in the U.S. The value of foreign securities may also decline or be unstable because of political, social or economic events or instability outside of the U.S.

(10) Foreign Currency Translations

The accounting records of the Fund are maintained in U.S. dollars. Portfolio securities and other assets and liabilities denominated in a foreign currency are translated daily into U.S. dollars at the prevailing rates of exchange. Purchases and sales of securities, income receipts and expense payments are translated into U.S. dollars at the prevailing exchange rates on the respective transaction dates.

The Fund does not isolate the portion of operations resulting from changes in foreign exchange rates on investments from the fluctuations arising from changes in the market prices of investments. Such fluctuations are included in net realized and unrealized gain (loss) on investments. Net realized gain (loss) on foreign currency transactions represents net foreign currency gain (loss) from forward currency contracts, disposition of foreign currencies, currency gain (loss) realized between the trade and settlement dates on securities transactions, and the difference between the amount of dividends, interest and foreign withholding taxes recorded on the Fund's accounting records and the U.S. dollar equivalent amounts actually received or paid. Net unrealized foreign currency appreciation/(depreciation) arises from changes in the value of assets and liabilities, other than investments in securities, as a result of changes in exchange rates.

(11) Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48 "Accounting for Uncertainty in Income Taxes", or FIN 48. FIN 48 was effective for the fiscal years beginning after December 15, 2006. The Securities and Exchange Commission delayed the application of FIN 48 to open and closed end funds to not later than June 29, 2007. FIN 48 prescribes how the Fund should recognize, measure and present in the Fund's financial statements uncertain tax provisions that have been taken or expected to be taken in a tax return. Pursuant to FIN 48 the Fund can recognize a tax benefit only if it is "more likely than not" that a particular tax position will be sustained upon examination or audit. To the extent the "more likely than not" standard has been satisfied the benefits associated with a tax position is measured as the largest amount that is greater than 50% likely of being realized upon settlement. As required, the Fund adopted Fin 48 effective June 29, 2007, and concluded that the effect is not material to its financial statements.

In September 2006, FASB issued Statement of Accounting Standards No. 157, "Fair Value Measurement", or SFAS 157, which is effective for fiscal years beginning after November 15, 2007. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands required disclosures about fair value measurements. The Fund is currently evaluating the impact, if any, the adoption of SFAS 157 will have on its financial statements.

(12) Other Investment Companies

The Fund may invest in the securities of other investment companies to the extent that such investments are consistent with the Fund's investment objectives and principal investment strategies and permissible under the 1940 Act. Under one provision of the 1940 Act, the Fund may not acquire the securities of other investment companies if, as a result, (i) more than 3% of the total outstanding voting securities of any one investment company would be held by the Fund, (ii) more than 5% of the Fund's total assets would be invested in any one investment company or (iii) more than 10% of the Fund's total assets would be invested in securities of other investment companies. Other provisions of the 1940 Act are less restrictive provided that the Fund is able to meet certain conditions. These limitations do not apply to the acquisition of shares of any investment company in connection with a merger, consolidation, reorganization or acquisition of substantially all of the assets of another investment company and the acquisition of money market instruments. The Fund, as a holder of the securities of other investment companies, will bear its pro rata portion of the other investment companies' expenses, including advisory fees. These expenses will be in addition to the direct expenses incurred by the Fund.

Note B

Advisory, Subadvisory and Administration Agreements and Other Transactions with Affiliates

The Fund has an advisory agreement with RMR Advisors, to provide the Fund with a continuous investment program, oversee the subadvisor and generally manage the business affairs of the Fund in accordance with its investment objectives and policies. Pursuant to the agreement, RMR Advisors is compensated at an annual rate of 1% of the Fund's average daily net assets.

RMR Advisors has contractually agreed to waive a portion of its annual fee equal to 0.25% of the Fund's average daily managed assets until May 25, 2012. The Fund incurred net advisory fees of $59,557 during the period ended June 30, 2007.

RMR Advisors has entered into a subadvisory agreement with MacarthurCook Investment Managers Ltd., or MacarthurCook, to make day-to-day investment decisions and to generally manage the business affairs of the Fund in accordance with its investment objectives and policies. Pursuant to the agreement, RMR Advisors, and not the Fund, will pay the subadvisor a monthly fee equal to an annual rate of 0.375% of the Fund's average daily managed assets. MacarthurCook has agreed to waive a portion of the fee payable by RMR Advisors such that until May 25, 2012, the fee payable will be equal to 0.25% of the Fund's average daily managed assets.

RMR Advisors also performs administrative functions for the Fund pursuant to an administration agreement with the Fund. RMR Advisors has entered into a subadministration agreement with State Street Bank and Trust Company, or State Street, to perform substantially all Fund accounting and other administrative services. Under the administration agreement, RMR Advisors is entitled to reimbursement of the cost of providing administrative services. The Fund reimbursed RMR Advisors for $8,353 of subadministrative fees charged by State Street for the period ended June 30, 2007.

Each trustee who is not a director, officer or employee of RMR Advisors and who is not an "interested person" of the Fund as defined under the 1940 Act, is considered to be a "disinterested trustee". Disinterested trustees are each paid by the Fund an annual fee plus fees for board and committee meetings. The Fund incurred $2,195 of trustee fees and expenses during the period ended June 30, 2007.

The Fund's board of trustees and separately the disinterested trustees authorized the Fund to make reimbursement payments to RMR Advisors for costs related to the Fund's compliance and internal audit programs. The Fund incurred $6,719 of compliance and internal audit expense during the period ended June 30, 2007. The Fund also participates in pooled insurance programs with RMR Advisors and other funds managed by RMR Advisors and makes payments of allocated portions of related premiums. The Fund incurred $1,742 of insurance expense during the period ended June 30, 2007.

Note C

Securities Transactions

During the period ended June 30, 2007, there were purchases and sales transactions (excluding short term securities) of $87,051,836 and $0 respectively. Brokerage commissions on securities transactions amounted to $50,372 during the period ended June 30, 2007.

RMR Real Estate Fund
RMR Hospitality and Real Estate Fund
RMR F.I.R.E. Fund
RMR Preferred Dividend Fund
RMR Asia Pacific Real Estate Fund
RMR Asia Real Estate Fund
June 30, 2007

For the purposes of the following, RMR Real Estate Fund (RMR), RMR Hospitality and Real Estate Fund (RHR), RMR F.I.R.E. Fund (RFR), RMR Preferred Dividend Fund (RDR), RMR Asia Pacific Real Estate Fund (RAP) and RMR Asia Real Estate Fund (RAF) are each referred to as a "Trust" or collectively as the "Trusts".

Consideration of the Investment Advisory and Investment Sub-Advisory Agreements for RAF

RMR Advisors serves as the investment advisor to RAF, and MacarthurCook Investment Managers Limited ("MacarthurCook") serves as the sub-advisor to RAF. On February 12, 2007, the RAF board of trustees (the "board") entered into investment advisory and investment sub-advisory agreements for a period of two years to expire on February 11, 2009.

Investment Advisory Agreement. In making their determination to approve the RAF investment advisory agreement, the board, including the disinterested trustees, considered all of the factors described below.

The board considered the anticipated benefits to RAF shareholders from appointing RMR Advisors as investment advisor. The board's considerations included, among others: the nature, scope and quality of services that RMR Advisors was expected to provide to RAF; the advisory and other fees to be paid; the fact that RMR Advisors has agreed to waive a portion of its fee during the first five years of the RAF's existence in order to reduce RAF's operating expenses; the quality and depth of personnel of RMR Advisors's organization; the capacity and future commitment of RMR Advisors to perform its duties; the financial condition and anticipated profitability of RMR Advisors; the experience and expertise of RMR Advisors as an investment adviser; the level of fees to be paid to RMR Advisors as compared to similar funds; the potential for economies of scale; and any indirect benefits expected to be derived by RMR Advisors's relationship with RAF.

The board considered the level and depth of knowledge of RMR Advisors. In evaluating the quality of services to be provided by RMR Advisors, the board took into account its familiarity with RMR Advisors' management through board meetings, conversations and reports of other funds managed by RMR Advisors. The board also considered the historical performance of the other funds managed by RMR Advisors. The board also took into account RMR Advisors's compliance policies and procedures.

The board compared the proposed advisory fees and the estimated total expense ratio of RAF with various comparative fund data. The board considered RAF's investment objective. The board also considered the RAF's model portfolio composition and investment strategy.

The board considered the potential economies of scale that may be realized if the assets of the RAF grow. The board noted that shareholders might benefit from lower operating expenses as a result of an increasing amount of assets being spread over RAF's fixed expenses.

In considering the approval of the investment advisory agreement, the board, including the disinterested trustees, did not identify any single factor as controlling. Based on the board's evaluation of all the factors that it deemed to be relevant, the board, including the disinterested trustees of the board, concluded that: RMR

Advisors has demonstrated that it possesses the capability and resources to perform the duties required of it under the investment advisory agreement for the Fund; RMR Advisors maintains an appropriate compliance program; and the proposed advisory fee rate is fair and reasonable, given the scope and quality of the services to be rendered by RMR Advisors.

Investment Sub-Advisory Agreement. In making their determination to approve the RAF investment sub-advisory agreement, the board, including the disinterested trustees, considered all of the factors described below.

The board considered the anticipated benefits to RAF shareholders from appointing MacarthurCook as investment sub-advisor. The board's considerations included, among others: the nature, scope and quality of services that MacarthurCook was expected to provide; the sub-advisory fees to be paid by RMR Advisors to MacarthurCook; the fact that MacarthurCook has agreed to waive a portion of its fee during the first five years of RAF's existence; the quality and depth of personnel of MacarthurCook's organization; the capacity and future commitment of MacarthurCook to perform its duties; and the experience and expertise of MacarthurCook as an investment adviser.

The board considered the level and depth of knowledge of MacarthurCook, noting that MacarthurCook specialized in the area of real estate investment management. The board also took into account MacarthurCook's compliance policies and procedures.

The board compared the proposed sub-advisory fees and the estimated total expense ratio of RAF with various comparative fund data. The board considered RAF's investment objective. The board also took into consideration the performance of a model portfolio on which RAF's initial holdings would be based as well as the performance of other funds managed by MacarthurCook.

The board noted that sub-advisory fees under the investment sub-advisory agreement would be paid by RMR Advisers and not by RAF and therefore were the product of arm's-length negotiations between RMR Advisors and MacarthurCook. For these reasons, the anticipated profitability to MacarthurCook from its relationship with RAF was not a material factor in the board's deliberations. For similar reasons, the board did not consider the potential economies of scale in MacarthurCook's management of RAF to be a material factor in its consideration.

In considering the approval of the investment sub-advisory agreement, the board, including the disinterested trustees, did not identify any single factor as controlling. Based on the board's evaluation of all the factors that it deemed to be relevant, the board, including the disinterested trustees of the board, concluded that: MacarthurCook possesses the capability and resources to perform the duties required of it under the investment sub-advisory agreement; MacarthurCook maintains an appropriate compliance program; and the proposed sub-advisory fee rate is fair and reasonable, given the scope and quality of the services to be rendered by MacarthurCook.

Privacy Policy

Each of the Funds is committed to maintain shareholder privacy and to safeguard shareholder nonpublic personal information.

The Funds do not receive any nonpublic personal information relating to shareholders who purchase Fund shares through an intermediary that acts as the record owner of the shares. If a shareholder is the record owner of any Fund's shares, that Fund may receive nonpublic personal information on shareholder account documents or otherwise and also has access to specific information regarding shareholder Fund share transactions, either directly or through the Fund's transfer agent.

The Funds do not disclose any nonpublic personal information about shareholders or any former shareholders to anyone, except as permitted by law (e.g. in connection with litigation between the Fund and a shareholder) or as is necessary to service shareholder accounts. The Funds restrict access to nonpublic personal information about shareholders to employees of the Funds and RMR Advisors with a legitimate business need for the information.

Proxy Voting Policies and Procedures

A description of the policies and procedures that are used to vote proxies relating to each Fund's portfolio securities is available: (1) without charge, upon request, by calling us at 1-866-790-8165; and (2) as an exhibit to each Fund's annual report on Form N-CSR, which is available on the website of the U.S. Securities and Exchange Commission (the "Commission") at *http://www.sec.gov*. Information regarding how proxies received by each Fund during the most recent 12 month period ended June 30, 2007, have been voted is available (1) without charge, on request, by calling us at 1-866-790-3165, or (2) by visiting the Commission's website at *http://www.sec.gov* and accessing each Fund's Form N-PX.

Procedures for the Submission of Confidential and Anonymous Concerns or Complaints about Accounting, Internal Accounting Controls or Auditing Matters

The Funds are committed to compliance with all applicable securities laws and regulations, accounting standards, accounting controls and audit practices and have established procedures for handling concerns or complaints about accounting, internal accounting controls or auditing matters. Any shareholder or other interested party who desires to communicate with our independent trustees or any other trustees, individually or as a group, may do so by filling out a report at the "Contact Us" section of our website (*www.rmrfunds.com*), by calling our toll-free confidential message system at 866-511-5038, or by writing to the party for whom the communication is intended, care of our director of internal audit, RMR Funds, 400 Centre Street, Newton, MA 02458. Our director of internal audit will then deliver any communication to the appropriate party or parties.

Portfolio Holdings Reports

Each Fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year on Form N-Q, which are available on the Commission's website at *http://www.sec.gov*. The Funds' Forms N-Q may also be reviewed and copied at the Commission's Public Reference Room in Washington, D.C. Information on the operation of the Public Reference Room may be obtained by calling the Commission at 1-800-SEC-0330. Each Fund provides additional data at its website at *www.rmrfunds.com*.

Certifications

Each Fund's principal executive officer and principal financial officer certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 and filed with the Fund's N-CSR are available on the Securities and Exchange Commission's website at *http://www.sec.gov*.

WWW.RMRFUNDS.COM

Item 2. Code of Ethics.

The information is only required for the annual report on Form N-CSR.

Item 3. Audit Committee Financial Expert.

The information is only required for the annual report on Form N-CSR.

Item 4. Principal Accountant Fees and Services.

The information is only required for the annual report on Form N-CSR.

Item 5. Audit Committee of Listed Registrant.

The information is only required for the annual report on Form N-CSR.

Item 6. Schedule of Investments.

The information required under Item 6 is included as part of the report to shareholders filed under Item 1 of this Form N-CSR.

Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.

The information is only required for the annual report on Form N-CSR.

Item 8. Portfolio Managers of Closed-End Management Investment Companies.

The registrant's portfolio managers are:

Adam D. Portnoy. Mr. Portnoy is the President of the registrant and each of the other RMR Funds since May 2007. Mr. Portnoy is also a portfolio manager of the registrant, RMR Real Estate Fund or RMR, RMR Hospitality and Real Estate Fund or RHR or RFR and RMR Preferred Dividend Fund or RDR, since May 2007. Mr. Portnoy was the Vice President of RMR from 2004 to May 2007, RHR, RFR, RDR, RAP and RAF from inception to May 2007. Mr. Portnoy is also a President, Director and an owner of the Advisor. Mr. Portnoy was the Vice President of the Advisor from 2003 to May 2007. Mr. Portnoy is also a Managing Trustee of three public companies: HRPT Properties Trust (since 2006); Hospitality Properties Trust (January 2007 to present); and Senior Housing Properties Trust (May 2007 to present). Mr. Portnoy is the son of the registrant's trustee and portfolio manager Barry M. Portnoy.

Fernando Diaz. Mr. Diaz is Vice President of the registrant and each of the other RMR Funds since May 2007. Mr. Diaz is also a portfolio manager of the registrant, RMR, RHR and RDR, since May 2007. Mr. Diaz is also the Vice President of the Advisor from May 2007. Mr. Diaz was an assistant portfolio manager and senior reit analyst for GID Securities, LLC from 2006 to May, 2007 and SsGA/Tuckerman Group from 2001 to 2006.

Barry M. Portnoy. Mr. Portnoy is a Vice President of the registrant and each of the other RMR Funds since their respective inception dates. Mr. Portnoy is also a Vice President, Director and an owner of the Advisor, and has been since its inception date. Mr. Portnoy is also a portfolio manager of the registrant, RHR, RFR and RDR, positions he has held since their respective inception dates. Mr. Portnoy is also a Managing Trustee of three public companies and has been since their respective inception dates: HRPT Properties Trust (inception in 1986); Hospitality Properties Trust (inception in 1996); and Senior Housing Properties Trust (inception in 1999). Mr. Portnoy is also a Managing Director of two public companies and has been since their respective inception dates: Five Star Quality Care, Inc. (inception in 2001); and TravelCenters of America LLC.

The portfolio managers generally function as a team. Generally, Mr. Barry Portnoy provides strategic guidance to the team, while Messrs. Adam Portnoy and Fernando Diaz are in charge of substantially all of the day to day operations, research and trading functions.

The registrant's portfolio managers together manage RMR, RHR and RDR, registered investment companies that have an aggregate of $329 million of managed assets as of June 30, 2007. Each RMR Fund pays an advisory fee to the Advisor solely on the basis of assets under management. None of the portfolio managers currently manage other pooled investment vehicles or other accounts.

CONFLICTS OF INTEREST. Actual or potential conflicts of interest may arise when a portfolio manager has management responsibilities for more than one fund. For example, a portfolio manager may identify a limited investment opportunity that may be appropriate for us as well as for other funds he manages. A conflict of interest also might arise where a portfolio manager has a larger personal investment in one fund than in another. A portfolio manager may purchase a particular security for one or more funds while selling the security for one or more other funds; this could have a detrimental effect on the price or volume of the securities purchased or sold by a fund. A portfolio manager might devote unequal time and attention to the funds he manages. Our Advisor believes that the risk of a material conflict of interest developing is limited because: (i) the funds are generally managed in a similar fashion; (ii) the Advisor has adopted policies requiring the equitable allocation of trade orders for a particular security among participating funds; and (iii) the advisory fee and portfolio managers' compensation are not affected by the amount of time required to manage each fund. As a result, our Advisor does not believe that any of these potential sources of conflicts of interest will affect the portfolio managers' professional judgment in managing the funds.

COMPENSATION. Messrs. Barry M. Portnoy and Adam D. Portnoy are the owners of our Advisor and, to date, have not received a salary or other compensation from our Advisor except to the extent of their distributions from the Advisor and their interest in the Advisor's profits, if any.

Our other portfolio manager, Mr. Diaz, is paid based upon the discretion of the board of directors of our Advisor. Our Advisor's board of directors consists of Messrs. Barry M. Portnoy, Gerard M. Martin and Adam D. Portnoy. Compensation of Mr. Diaz includes base salary, annual cash bonus and he has the opportunity to participate in other employee benefit plans available to all of the employees of the Advisor. The level of compensation is not based upon a formula with reference to fund performance or the value of fund assets; however these factors, among others, may be considered by individual directors of our Advisor. Other factors which may be considered in setting the compensation of the portfolio manager are his historical levels of compensation and levels of compensation paid for similar services or to persons with similar responsibilities in the market generally and in the geographic area where the Advisor is located. Mr. Diaz devotes a substantial majority of his business time to providing services as a portfolio manager or officer of our Advisor and funds managed by our Advisor. Messrs. Barry D. Portnoy and Adam D. Portnoy also receive compensation for their services to affiliates of our Advisor.

OWNERSHIP OF SECURITIES OF THE FUND. The following table sets forth, for each portfolio manager, the aggregate dollar range of our equity securities beneficially owned as of June 30, 2007.

Name of Portfolio Manager	Dollar Range of Equity Securities in the Fund as of June 30, 2007
Fernando Diaz	None
Barry M. Portnoy	Over $100,000(1)
Adam D. Portnoy	$50,000 $100,000(2)

(1) 5,000 common shares of the Fund will be held indirectly by virtue of Mr. Barry M. Portnoy's ownership of our Advisor.

(2) 5,000 common shares of the Fund will be held indirectly by virtue of Mr. Adam D. Portnoy's ownership of our Advisor.

Item 9. Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers.

During the period ended June 30, 2007, there were no purchases made by or on behalf of the registrant or any "affiliated purchaser" as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")(17 CFR 240.10b-18(a)(3)), of shares of the registrant's equity securities that are registered by the registrant pursuant to Section 12 of the Exchange Act.

Item 10. Submission of Matters to a Vote of Security Holders.

There have been no material changes to the procedures by which shareholders may recommend nominees to the registrant's board of trustees.

Item 11. Controls and Procedures.

(a) The registrant's principal executive officer and principal financial officer have concluded that the registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended (the "1940 Act")) are effective, as of a date within 90 days of the filing date of this report, based on their evaluation of these controls and procedures.

(b) There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act) that occurred during the registrant's second fiscal quarter of the period covered by this report that have materially affected, or are reasonably likely to materially affect, the registrant's internal control over financial reporting.

Item 12. Exhibits.

(a) (2) Certifications of principal executive officer and principal financial officer of the registrant as required by Rule 30a-2(a) under the 1940 Act are attached hereto.

(b) Certifications of principal executive officer and principal financial officer of the registrant as required by Rule 30a-2(b) under the 1940 Act and Section 906 of the Sarbanes-Oxley Act of 2002 are attached hereto.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

RMR F.I.R.E. FUND

By: /s/ ADAM D. PORTNOY

Adam D. Portnoy
President
Date: August 17, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ ADAM D. PORTNOY

Adam D. Portnoy
President
Date: August 17, 2007

By: /s/ MARK L. KLEIFGES

Mark L. Kleifges
Treasurer
Date: August 17, 2007

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