

# YAHOO INC

## FORM 10-Q (Quarterly Report)

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Address	YAHOO! INC. 701 FIRST AVENUE SUNNYVALE, CA 94089
Telephone	4083493300
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Symbol	YHOO
SIC Code	7373 - Computer Integrated Systems Design
Industry	Internet Services
Sector	Technology
Fiscal Year	12/31

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

**Form 10-Q**

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

For the quarterly period ended September 30, 2016

or

**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 000-28018

**Yahoo! Inc.**

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

77-0398689

(I.R.S. Employer Identification No.)

701 First Avenue

Sunnyvale, California 94089

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (408) 349-3300

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

Indicate by check mark whether the Registrant has submitted electronically 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  No

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 28, 2016
Common Stock, \$0.001 par value	954,124,482

**YAHOO! INC.**  
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## Forward-Looking Statements

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In addition to current and historical information, this Quarterly Report on Form 10-Q (“Report”) contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our future operations, prospects, potential products, services, developments, and business strategies. These statements can, in some cases, be identified by the use of terms such as “may,” “will,” “should,” “could,” “would,” “intend,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “project,” “potential,” or “continue,” the negative of such terms, or other comparable terminology. This Report includes, among others, forward-looking statements regarding our:

- expectations related to our strategic plan announced in February 2016;
- expectations regarding the pending transaction with Verizon Communications Inc.;
- security incident disclosed on September 22, 2016;
- expectations about revenue, including search, display, and other revenue, as well as revenue from our offerings in mobile, video, native, and social (“Mavens”);
- expectations about the financial and operational impacts of our Search and Advertising Services and Sales Agreement (“Microsoft Search Agreement”) with Microsoft Corporation (“Microsoft”) and our Google Services Agreement with Google Inc.;
- expectations about the opportunities for monetization of, and revenue growth from, our mobile offerings;
- expectations about growth in users;
- projections and estimates with respect to our restructuring activities;
- expectations about our operating expenses;
- anticipated capital expenditures;
- expectations about the amount of unrecognized tax benefits, the outcome of tax assessment appeals, the adequacy of our existing tax reserves, future tax expenditures, and tax rates;
- expectations about the sufficiency of our available sources of liquidity to meet normal operating requirements and capital expenditures; and
- expectations regarding the future outcome of legal proceedings in which we are involved.

These statements involve known and unknown risks and uncertainties that could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. You are urged to carefully review the disclosures made concerning risks and uncertainties that may affect our business or operating results, which include, among others, those listed in Part II, Item 1A. “Risk Factors” of this Report. We do not intend, and undertake no obligation, to update or revise any of our forward-looking statements after the date of this Report to reflect new information, actual results or future events or circumstances.

# PART I — FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements (unaudited)

Yahoo! Inc.

### Condensed Consolidated Balance Sheets

	December 31, 2015	September 30, 2016
(Unaudited, in thousands except par values)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,631,911	\$ 1,411,308
Short-term marketable securities	4,225,112	5,189,207
Accounts receivable, net	1,047,504	945,659
Prepaid expenses and other current assets	602,792	244,782
Total current assets	7,507,319	7,790,956
Long-term marketable securities	975,961	1,170,962
Property and equipment, net	1,547,323	1,273,327
Goodwill	808,114	437,609
Intangible assets, net	347,269	181,998
Other long-term assets and investments	342,390	218,585
Investment in Alibaba Group	31,172,361	40,577,385
Investments in equity interests	2,503,229	3,020,804
<b>Total assets</b>	<b>\$ 45,203,966</b>	<b>\$ 54,671,626</b>
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 208,691	\$ 168,148
Other accrued expenses and current liabilities	934,658	984,301
Deferred revenue	134,031	115,991
Total current liabilities	1,277,380	1,268,440
Convertible notes	1,233,485	1,283,002
Long-term deferred revenue	27,801	36,609
Other long-term liabilities	118,689	102,283
Deferred tax liabilities related to investment in Alibaba Group	12,611,867	16,444,038
Deferred and other long-term tax liabilities	855,324	668,098
<b>Total liabilities</b>	<b>16,124,546</b>	<b>19,802,470</b>
Commitments and contingencies (Note 12)	-	-
Yahoo! Inc. stockholders' equity:		
Common stock, \$0.001 par value; 5,000,000 shares authorized; 962,959 shares issued and 945,854 shares outstanding as of December 31, 2015 and 970,528 shares issued and 953,467 shares outstanding as of September 30, 2016	959	967
Additional paid-in capital	8,807,273	9,036,876
Treasury stock at cost, 17,105 shares as of December 31, 2015 and 17,061 shares as of September 30, 2016	(911,533)	(909,508)
Retained earnings	4,570,807	4,192,467
Accumulated other comprehensive income	16,576,031	22,515,470
Total Yahoo! Inc. stockholders' equity	29,043,537	34,836,272
Noncontrolling interests	35,883	32,884
<b>Total equity</b>	<b>29,079,420</b>	<b>34,869,156</b>
<b>Total liabilities and equity</b>	<b>\$ 45,203,966</b>	<b>\$ 54,671,626</b>

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

**Yahoo! Inc.**  
**Condensed Consolidated Statements of Operations**

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2015</u>	<u>2016</u>	<u>2015</u>	<u>2016</u>
	(Unaudited, in thousands except per share amounts)			
Revenue	\$ 1,225,673	\$ 1,305,206	\$ 3,694,908	\$ 3,699,995
Operating expenses:				
Cost of revenue — traffic acquisition costs	223,229	447,537	606,598	1,141,786
Cost of revenue — other	302,846	255,421	884,041	806,491
Sales and marketing	274,329	212,654	823,990	674,711
Product development	272,285	243,644	905,460	801,708
General and administrative	151,963	176,713	506,071	490,519
Amortization of intangibles	19,622	11,594	59,677	46,736
Gain on sale of patents and land	-	-	(11,100)	(121,559)
Asset impairment charge	41,699	-	41,699	-
Goodwill impairment charge	-	-	-	394,901
Intangible assets impairment charge	-	-	-	87,335
Restructuring charges, net	26,012	9,962	96,932	86,576
Total operating expenses	1,311,985	1,357,525	3,913,368	4,409,204
Loss from operations	(86,312)	(52,319)	(218,460)	(709,209)
Other expense, net	(23,955)	(6,122)	(66,759)	(38,476)
Loss before income taxes and earnings in equity interests	(110,267)	(58,441)	(285,219)	(747,685)
Benefit for income taxes	93,208	105,513	75,613	124,736
Earnings in equity interests, net of tax	95,195	116,228	290,726	249,579
Net income (loss)	78,136	163,300	81,120	(373,370)
Net income attributable to noncontrolling interests	(1,875)	(474)	(5,215)	(2,949)
Net income (loss) attributable to Yahoo! Inc.	\$ 76,261	\$ 162,826	\$ 75,905	\$ (376,319)
Net income (loss) attributable to Yahoo! Inc. common stockholders per share — basic	\$ 0.08	\$ 0.17	\$ 0.08	\$ (0.40)
Net income (loss) attributable to Yahoo! Inc. common stockholders per share — diluted	\$ 0.08	\$ 0.17	\$ 0.08	\$ (0.40)
Shares used in per share calculation — basic	940,822	951,421	937,713	948,524
Shares used in per share calculation — diluted	946,934	957,304	944,160	948,524
Stock-based compensation expense by function:				
Cost of revenue — other	\$ 9,748	\$ 9,440	\$ 22,957	\$ 25,876
Sales and marketing	33,317	36,428	111,416	108,259
Product development	46,461	54,720	145,444	161,182
General and administrative	20,900	28,304	71,435	73,946
Restructuring charges, net	-	-	2,705	7,374

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

**Yahoo! Inc.**  
**Condensed Consolidated Statements of Comprehensive (Loss) Income**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
	(Unaudited, in thousands)			
Net income (loss)	\$ 78,136	\$ 163,300	\$ 81,120	\$ (373,370)
Available-for-sale securities:				
Unrealized (losses) gains on available-for-sale securities, net of taxes of \$3,646,362 and \$(4,099,170) for the three months ended September 30, 2015 and 2016, respectively, and \$7,034,475 and \$(3,812,738) for the nine months ended September 30, 2015 and 2016, respectively	(5,299,758)	5,960,520	(10,225,842)	5,555,697
Reclassification adjustment for realized losses (gains) on available-for-sale securities included in net income, net of taxes of \$(44) and \$(6) for the three months ended September 30, 2015 and 2016, respectively, and \$(45) and \$(113) for the nine months ended September 30, 2015 and 2016, respectively	72	11	74	206
Net change in unrealized (losses) gains on available-for-sale securities, net of tax	(5,299,686)	5,960,531	(10,225,768)	5,555,903
Foreign currency translation adjustments ("CTA"):				
Foreign CTA (losses) gains, net of taxes of \$607 and \$106 for the three months ended September 30, 2015 and 2016, respectively, and \$1,061 and \$(273) for the nine months ended September 30, 2015 and 2016, respectively	(126,774)	291,871	(359,876)	459,805
Net investment hedge CTA (losses) gains, net of taxes of \$8,252 and \$(217) for the three months ended September 30, 2015 and 2016, respectively, and \$(2,492) and \$30,036 for the nine months ended September 30, 2015 and 2016, respectively	(13,855)	393	4,183	(54,482)
Reclassification adjustment for realized (gains) losses included in CTA, net of taxes of \$0 for both the three and nine months ended September 30, 2016, respectively	-	(2,863)	-	(19,363)
Net foreign CTA (losses) gains, net of tax	(140,629)	289,401	(355,693)	385,960
Cash flow hedges:				
Unrealized (losses) gains on cash flow hedges, net of taxes of \$362 and \$163 for the three months ended September 30, 2015 and 2016, respectively, and \$(327) and \$3,138 for the nine months ended September 30, 2015 and 2016, respectively	(1,440)	(296)	(6,721)	(5,694)
Reclassification adjustment for realized losses (gains) on cash flow hedges included in net income, net of taxes of \$274 and \$(1,013) for the three months ended September 30, 2015 and 2016, respectively, and \$992 and \$(1,802) for the nine months ended September 30, 2015 and 2016, respectively	869	1,838	3,007	3,270
Net change in unrealized (losses) gains on cash flow hedges, net of tax	(571)	1,542	(3,714)	(2,424)
Other comprehensive (loss) income	(5,440,886)	6,251,474	(10,585,175)	5,939,439
Comprehensive (loss) income	(5,362,750)	6,414,774	(10,504,055)	5,566,069
Less: comprehensive income attributable to noncontrolling interests	(1,875)	(474)	(5,215)	(2,949)
Comprehensive (loss) income attributable to Yahoo! Inc.	\$ (5,364,625)	\$ 6,414,300	\$ (10,509,270)	\$ 5,563,120

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

**Yahoo! Inc.**  
**Condensed Consolidated Statements of Cash Flows**

	Nine Months Ended September 30,	
	2015	2016
	(Unaudited, in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ 81,120	\$ (373,370)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation	355,540	308,324
Amortization of intangible assets	102,090	80,036
Accretion of convertible notes discount	46,984	49,517
Stock-based compensation expense	353,957	376,637
Non-cash asset impairment charge	41,699	-
Non-cash goodwill impairment charge	-	394,901
Non-cash intangible assets impairment charge	-	87,335
Non-cash restructuring (reversals) charges	(31)	1,227
Non-cash accretion on marketable debt securities	38,328	23,060
Foreign exchange loss (gain)	10,337	(46,046)
Gain on sale of assets and other	(3,058)	(2,719)
Gain on sale of patents and land	(11,100)	(121,559)
Loss on Hortonworks warrants	19,241	49,930
Earnings in equity interests	(290,726)	(249,579)
Tax benefits (detriments) from stock-based awards	22,990	(8,598)
Excess tax benefits from stock-based awards	(33,359)	(1,743)
Deferred income taxes	(52,605)	(175,984)
Dividends received from equity investee	142,045	156,968
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	34,303	106,261
Prepaid expenses and other	(64,112)	346,103
Accounts payable	(29,642)	(10,083)
Accrued expenses and other liabilities	194,569	12,974
Incomes taxes payable related to sale of Alibaba Group ADSs	(3,282,293)	-
Deferred revenue	(191,989)	(9,988)
Net cash (used in) provided by operating activities	<u>(2,515,712)</u>	<u>993,604</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment	(428,345)	(197,508)
Proceeds from sales of property and equipment	11,069	249,089
Purchases of marketable securities	(3,472,587)	(5,680,284)
Proceeds from sales of marketable securities	566,321	281,393
Proceeds from maturities of marketable securities	4,889,437	4,223,735
Acquisitions, net of cash acquired	(174,630)	-
Proceeds from sales of patents	29,100	1,500
Purchases of intangible assets	(4,733)	(2,001)
Proceeds from settlement of derivative hedge contracts	120,682	39,007
Payments for settlement of derivative hedge contracts	(6,594)	(7,012)
Payments for equity investments in privately held companies	-	(9)
Other investing activities, net	(203)	(127)
Net cash provided by (used in) investing activities	<u>1,529,517</u>	<u>(1,092,217)</u>

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

**Yahoo! Inc.**  
**Condensed Consolidated Statements of Cash Flows (continued)**

	<b>Nine Months Ended September 30,</b>	
	<b>2015</b>	<b>2016</b>
	<b>(Unaudited, in thousands)</b>	
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	52,297	15,512
Repurchases of common stock	(203,771)	-
Excess tax benefits from stock-based awards	33,359	1,743
Tax withholdings related to net share settlements of restricted stock units	(216,061)	(157,442)
Distributions to noncontrolling interests	(15,847)	(5,948)
Other financing activities, net	(13,554)	(10,414)
Net cash used in financing activities	(363,577)	(156,549)
Effect of exchange rate changes on cash and cash equivalents	(33,166)	34,559
Net change in cash and cash equivalents	(1,382,938)	(220,603)
Cash and cash equivalents at beginning of period	2,664,098	1,631,911
Cash and cash equivalents at end of period	<u>\$ 1,281,160</u>	<u>\$ 1,411,308</u>
<b>NON-CASH ACTIVITIES:</b>		
Change in non-cash acquisitions of property and equipment	\$ 38,761	\$ (3,570)

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

Yahoo! Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

## Note 1 The Company and Summary of Significant Accounting Policies

**The Company** . Yahoo! Inc., together with its consolidated subsidiaries (“Yahoo” or the “Company”), is a guide to digital information discovery, focused on informing, connecting, and entertaining users through its search, communications, and digital content products. By creating highly personalized experiences, the Company helps users discover the information that matters most to them around the world — on mobile or desktop. The Company creates value for advertisers with a streamlined, simple advertising technology stack that leverages Yahoo’s data, content, and technology to connect advertisers with their target audiences. Advertisers can build their businesses through advertising to targeted audiences on the Company’s online properties and services (“Yahoo Properties”) and a distribution network of third party entities (“Affiliates”) who integrate the Company’s advertising offerings into their websites or other offerings (“Affiliate sites”). The Company’s revenue is generated principally from search and display advertising. The Company manages and measures its business geographically, principally in the Americas, EMEA (Europe, Middle East, and Africa) and Asia Pacific.

**Basis of Presentation** . The condensed consolidated financial statements include the accounts of Yahoo! Inc. and its majority-owned or otherwise controlled subsidiaries. All intercompany accounts and transactions have been eliminated. Investments in entities in which the Company can exercise significant influence, but does not own a majority equity interest or otherwise control, are accounted for using the equity method and are included as investments in equity interests on the condensed consolidated balance sheets. The Company has included the results of operations of acquired companies from the date of the acquisition.

The Company revised the consolidated statement of cash flows for the nine months ended September 30, 2015 to correct for a non-cash acquisition of property and equipment resulting in an increase in cash used in operating activities of \$23 million and a corresponding increase in net cash provided by investing activities. Certain other prior period amounts have been reclassified to conform to the current period presentation.

The accompanying unaudited condensed consolidated interim financial statements reflect all adjustments, consisting of only normal recurring items, which, in the opinion of management, are necessary for a fair statement of the results of operations for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full year or for any future periods.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles (“GAAP”) in the United States (“U.S.”) requires management to make estimates, judgments, and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses and the related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to revenue, the useful lives of long-lived assets including property and equipment and intangible assets, investment fair values, originally developed content, acquired content, stock-based compensation, goodwill, income taxes, contingencies, and restructuring charges. The Company bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results may differ from these estimates.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. The condensed consolidated balance sheet as of December 31, 2015 was derived from the Company’s audited financial statements for the year ended December 31, 2015, but does not include all disclosures required by U.S. GAAP. However, the Company believes the disclosures are adequate to make the information presented not misleading.

**Revenue Recognition — Search Revenue and Cost of Revenue — TAC**. On April 15, 2015, the Company and Microsoft Corporation (“Microsoft”) entered into the Eleventh Amendment (the “Eleventh Amendment”) to the Search and Advertising Services and Sales Agreement (“Microsoft Search Agreement”). Pursuant to the Eleventh Amendment, the Company completed the transition of its exclusive sales responsibilities to Microsoft for Microsoft’s paid search services to premium advertisers in the United States, Canada, and Europe on April 1, 2016 and in its remaining markets (other than Taiwan and Hong Kong) on June 1, 2016. Following the transition in each respective market, Yahoo is considered the principal in the sale of traffic to Microsoft and other customers because Yahoo is the primary obligor in its arrangements with Microsoft and has discretion in how search queries from Affiliate sites will be fulfilled and monetized. As a result, amounts paid to Affiliates under the Microsoft Search Agreement in the transitioned markets are recorded as cost of revenue — TAC rather than as a reduction to revenue, resulting in revenue from the Microsoft Search Agreement being reported on a gross rather than net basis. Effective June 3, 2016, the Company and Microsoft further amended the Microsoft Search Agreement to provide that sales responsibilities for premium advertisers in Taiwan and Hong Kong will not be transitioned. TAC in those markets will continue to be reported as a reduction to revenue.

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The table below presents how the Company accounted for amounts paid to Affiliates related to the Microsoft Search Agreement in transitioned markets, and shows the impact of the implementation of the Eleventh Amendment in transitioned markets (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Cost of revenue — TAC in transitioned markets (*)	\$ -	\$ 257,601	\$ -	\$ 509,932
Reduction to revenue in transitioned markets	\$ 299,710	\$ -	\$ 987,601	\$ 273,705

(\*) For the three months ended September 30, 2016, cost of revenue—TAC included \$222 million in the Americas segment, \$34 million in the EMEA segment and \$2 million in the Asia Pacific segment. For the nine months ended September 30, 2016, cost of revenue—TAC included \$440 million in the Americas segment, \$67 million in the EMEA segment and \$3 million in the Asia Pacific segment.

See Note 17—“Microsoft Search Agreement” for a description of the Search Agreement with Microsoft.

Prior to the Eleventh Amendment, the Company was entitled to receive a percentage of the revenue (the “Revenue Share Rate”) generated from Microsoft’s services on Yahoo Properties and on Affiliate sites after deduction of the Affiliate sites’ share of revenue and certain Microsoft costs. The Revenue Share Rate was 88 percent for the first five years of the Microsoft Search Agreement and then increased to 90 percent on February 23, 2015. Pursuant to the Eleventh Amendment, the Revenue Share Rate increased to 93 percent, but Microsoft now receives its 7 percent revenue share before deduction of the Affiliate site’s share of revenue. The Company is responsible for paying the Affiliate for the Affiliate site’s share of revenue.

Search revenue is generated from mobile and desktop clicks on text-based links to advertisers’ websites that appear primarily on search results pages (“search advertising”). The Company recognizes revenue from search advertising on Yahoo Properties and Affiliate sites. Search revenue is recognized based on Paid Clicks. A Paid Click occurs when an end-user clicks on a sponsored listing on Yahoo Properties and Affiliate sites for which an advertiser pays on a per click basis. The Company also sells search traffic to certain customers where it does not have a direct relationship with the advertiser, in which case revenue is also recognized based on Paid Clicks. In the Microsoft Search Agreement, the Company agreed to request paid search results from Microsoft for 51 percent of search queries originating from desktop computers accessing Yahoo Properties and Affiliate sites (the “Volume Commitment”). There is no such Volume Commitment for traffic generated on mobile devices.

The Company recognizes search revenue generated from mobile and desktop ads served through Yahoo Gemini (Yahoo’s marketplace for search and native advertising) to Yahoo Properties and Affiliate sites. The Company is considered the primary obligor to the advertisers who are the customers of the search advertising service. Accordingly, the search revenue generated from mobile and desktop ads served through Yahoo Gemini that involve traffic supplied by Affiliates is reported gross of the traffic acquisition costs (“TAC”) paid to Affiliates (reported as cost of revenue—TAC) as the Company performs the search service for advertisers.

In October 2015, Yahoo reached an agreement with Google that provides Yahoo with additional flexibility to choose among suppliers of search results and ads. Google’s offerings complement the search services provided by Microsoft and Yahoo Gemini. The Company also generates search revenue from a revenue sharing arrangement with Yahoo Japan for search technology and services and records the related revenue as reported.

TAC consists of payments made to Affiliates and payments made to companies that direct consumer and business traffic to Yahoo Properties. TAC is either recorded as a reduction to revenue or as cost of revenue—TAC. TAC related to the Microsoft Search Agreement was recorded as a reduction to revenue for reporting periods through March 31, 2016. Beginning in the reporting period ended June 30, 2016, TAC related to the Microsoft Search Agreement is recorded as cost of revenue—TAC in markets that have completed the transition of exclusive sales responsibilities to Microsoft for paid search services to premium advertisers pursuant to the Eleventh Amendment as described above.

**Originally Developed Content and Acquired Content.** Originally developed content and acquired content are both carried at cost. Originally developed content is amortized based on the expected pattern of viewing, typically over 18 months. Acquired content is amortized on a straight-line basis over the shorter of each program’s contractual window of availability or estimated period of use, beginning with the month of first availability. Marketing and general and administrative costs are expensed as incurred.

For originally developed content, the Company performs regular recoverability assessments on a program-by-program basis. If there are any events or changes in circumstances indicating that the Company should assess whether the fair value of originally developed content is less than its unamortized costs, the Company performs a fair value analysis using an expected cash flow approach. The amount by which the unamortized costs of the originally developed content exceed estimated fair value is charged to expense as an asset impairment. During the three and nine months ended September 30, 2015, the Company recorded an asset impairment charge of \$14 million related to originally developed content.

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For acquired content, the Company compares the net realizable value on a program-by-program basis with the unamortized cost. The amount by which the unamortized costs of the acquired content exceed net realizable value is charged to expense as an asset impairment. During the three and nine months ended September 30, 2015, the Company recorded an asset impairment charge of \$28 million related to acquired content, primarily driven by a reduction of forecasted revenues to be generated from advertising on Yahoo Properties.

**Recent Accounting Pronouncements.** In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2014-09, “Revenue from Contracts with Customers,” which supersedes the revenue recognition requirements in Topic 605, “Revenue Recognition” and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, which defers by one year the effective date of ASU 2014-09. Accordingly, this guidance is effective for interim and annual periods beginning after December 15, 2016 with early adoption permitted for interim and annual periods beginning after December 15, 2016. In March 2016, the FASB issued ASU 2016-08 “Principal versus Agent Considerations (Reporting Revenue Gross versus Net),” which finalizes its amendments to the guidance in the new revenue standard on assessing whether an entity is a principal or an agent in a revenue transaction. This conclusion impacts whether an entity reports revenue on a gross or net basis. In April 2016, the FASB issued ASU 2016-10 “Identifying Performance Obligations and Licensing” which finalizes its amendments to the guidance in the new revenue standard regarding the identification of performance obligations and accounting for the license of intellectual property. In May 2016, the FASB issued ASU 2016-12 “Narrow-Scope Improvements and Practical Expedients” which finalizes its amendments to the guidance in the new revenue standard on collectability, noncash consideration, presentation of sales tax, and transition. The amendments are intended to make the guidance more operable and lead to more consistent application. The amendments have the same effective date and transition requirements as the new revenue recognition standard. The Company plans to adopt this guidance on January 1, 2018. The Company is currently evaluating the effects, if any, that the adoption of this guidance will have on the Company’s financial position, results of operations, and cash flows.

In August 2014, the FASB issued ASU No. 2014-15, “Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” that requires management to evaluate whether there are conditions and events that raise substantial doubt about the Company’s ability to continue as a going concern within one year after the financial statements are issued on both an interim and annual basis. Management is required to provide certain footnote disclosures if it concludes that substantial doubt exists or when its plans alleviate substantial doubt about the Company’s ability to continue as a going concern. ASU 2014-15 becomes effective for annual periods beginning after December 15, 2016 and for interim reporting periods thereafter. The Company does not expect the adoption of this ASU to have a material impact on the Company’s disclosures in the footnotes to its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities”. The new standard principally affects accounting standards for equity investments, financial liabilities where the fair value option has been elected, and the presentation and disclosure requirements for financial instruments. Upon the effective date of the new standards, all equity investments in unconsolidated entities, other than those accounted for using the equity method of accounting, will generally be measured at fair value through earnings. There will no longer be an available-for-sale classification and therefore, no changes in fair value will be reported in other comprehensive income (loss) for equity securities with readily determinable fair values. The new guidance on the classification and measurement will be effective for public business entities in fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. The Company is in the process of evaluating the impact of the adoption of ASU 2016-01 on the consolidated financial statements and currently anticipates the new guidance would significantly impact its consolidated statements of operations and consolidated statements of comprehensive income (loss) as the Company’s marketable equity securities, primarily the Company’s investments in Alibaba Group Holding Limited (“Alibaba Group”) and Hortonworks Inc. (“Hortonworks”), are currently classified as available-for-sale and are reported at fair value, with unrealized gains and losses, net of tax, recorded in accumulated other comprehensive income.

In February 2016, the FASB issued ASU 2016-02, “Leases” which, for operating leases, requires a lessee to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. The ASU is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the effects that the adoption of ASU 2016-02 will have on the Company’s consolidated financial position, results of operations and cash flows and anticipates the new guidance will significantly impact its consolidated financial statements given the Company has a significant number of leases.

In March 2016, the FASB issued ASU 2016-06, “Contingent put and call options in debt instruments, a consensus of the FASB’s Emerging Issues Task Force,” which simplifies the embedded derivative analysis for debt instruments containing contingent call or put options. The new guidance clarifies that an exercise contingency does not need to be evaluated to determine whether it relates to interest rates and credit risk in an embedded derivative analysis. A contingent put or call option embedded in a debt instrument would be evaluated for possible separate accounting as a derivative instrument without regard to the nature of the exercise contingency. The ASU is effective for public companies for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not yet been issued. The new guidance is required to be applied on a modified retrospective basis to all existing and future debt instruments. An entity will be able to elect the fair value option at transition for the entire debt instrument, including its embedded features, but will not be able to unwind a previously-elected fair value option. The Company is currently evaluating the effects, if any, that the adoption of this guidance will have on the Company’s consolidated financial position, results of operations and cash flows.

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In March 2016, the FASB issued ASU 2016-07, "Simplifying the Transition to the Equity Method of Accounting," which eliminates the requirement to apply the equity method of accounting retrospectively when a reporting entity obtains significant influence over a previously held investment in order to reduce recognition and presentation complexity in financial reporting. Instead, the new guidance requires equity method of accounting to be applied prospectively from the date significant influence is obtained. The ASU is effective for public companies for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not yet been issued. The new guidance is required to be applied prospectively for investments that qualify for the equity method of accounting after the effective date. The Company is currently evaluating the effects, if any, that the adoption of this guidance will have on the Company's consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting" as part of its simplification initiative, which involves several aspects of accounting for share-based payment transactions, including the income tax effects, statutory withholding requirements, forfeitures, and classification on the statement of cash flows. The ASU is effective for public companies for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted for any interim and annual financial statements that have not been issued. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company is currently evaluating the effects, if any, that the adoption of this guidance will have on the Company's consolidated financial position, results of operations and cash flows.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses", which introduces new guidance for credit losses on instruments within its scope. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments, including, but not limited to, trade and other receivables, held-to-maturity debt securities, loans and net investments in leases. The new guidance also modifies the impairment model for available-for-sale debt securities and requires the entities to determine whether all or a portion of the unrealized loss on an available-for-sale debt security is a credit loss. The standard also indicates that entities may not use the length of time a security has been in an unrealized loss position as a factor in concluding whether a credit loss exists. The ASU is effective for public companies for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted for all entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the effects, if any, that the adoption of this guidance will have on the Company's consolidated financial position, results of operations and cash flows.

In June 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230), a consensus of the FASB's Emerging Issues Task Force." The new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The ASU is effective for public companies for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including interim periods within those fiscal years. An entity that elects early adoption must adopt all of the amendments in the same period. The guidance requires application using a retrospective transition method. The Company is currently evaluating the effects, if any, that the adoption of this guidance will have on the Company's consolidated cash flows.

In October 2016, FASB issued ASU 2016-16, "Income Taxes: Intra-Entity Transfers of Assets Other than Inventory" which amends the accounting for income taxes. The new guidance requires the recognition of the income tax consequences of an intra-entity asset transfer, other than transfers of inventory, when the transfer occurs. For intra-entity transfers of inventory, the income tax effects will continue to be deferred until the inventory has been sold to a third party. The ASU is effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The new guidance is required to 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 effects, if any, that the adoption of this guidance will have on the Company's consolidated financial position, results of operations and cash flows.

## Note 2 Marketable Securities, Investments and Fair Value Disclosures

The following tables summarize the available-for-sale securities (in thousands):

	December 31, 2015			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government and agency securities	\$ 616,501	\$ 24	\$ (635)	\$ 615,890
Corporate debt securities, commercial paper, time deposits, and bank certificates of deposit	4,589,799	292	(4,908)	4,585,183
Alibaba Group equity securities	2,713,483	28,458,878	-	31,172,361
Hortonworks equity securities	26,246	57,977	-	84,223
Other corporate equity securities	298	-	(101)	197
Total available-for-sale marketable securities	<u>\$ 7,946,327</u>	<u>\$ 28,517,171</u>	<u>\$ (5,644)</u>	<u>\$ 36,457,854</u>

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	September 30, 2016			
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Government and agency securities	\$ 685,888	\$ 310	\$ (191)	\$ 686,007
Corporate debt securities, commercial paper, time deposits, and bank certificates of deposit	5,673,306	2,472	(1,616)	5,674,162
Alibaba Group equity securities	2,713,484	37,863,901	-	40,577,385
Hortonworks equity securities	26,246	5,867	-	32,113
Other corporate equity securities	8,267	74	(1,380)	6,961
Total available-for-sale marketable securities	<u>\$ 9,107,191</u>	<u>\$ 37,872,624</u>	<u>\$ (3,187)</u>	<u>\$ 46,976,628</u>

	December 31, 2015	September 30, 2016
Reported as:		
Short-term marketable securities	\$ 4,225,112	\$ 5,189,207
Long-term marketable securities	975,961	1,170,962
Investment in Alibaba Group	31,172,361	40,577,385
Other long-term assets and investments	84,420	39,074
Total	<u>\$ 36,457,854</u>	<u>\$ 46,976,628</u>

Short-term, highly liquid investments of \$667 million and \$644 million as of December 31, 2015 and September 30, 2016, respectively, included in cash and cash equivalents on the condensed consolidated balance sheets are not included in the table above as the gross unrealized gains and losses were immaterial as the carrying value approximates fair value because of the short maturity of those instruments. Realized gains and losses from sales of available-for-sale marketable debt securities were not material for both the three and nine months ended September 30, 2015 and 2016.

The remaining contractual maturities of available-for-sale marketable debt securities were as follows (in thousands):

	December 31, 2015	September 30, 2016
Due within one year	\$ 4,225,112	\$ 5,189,207
Due after one year through five years	975,961	1,170,962
Total available-for-sale marketable debt securities	<u>\$ 5,201,073</u>	<u>\$ 6,360,169</u>

The following tables show all available-for-sale marketable debt securities in an unrealized loss position for which an other-than-temporary impairment has not been recognized and the related gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	December 31, 2015					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Government and agency securities	\$ 552,041	\$ (635)	\$ -	\$ -	\$ 552,041	\$ (635)
Corporate debt securities, commercial paper, and bank certificates of deposit	2,415,347	(4,763)	99,214	(145)	2,514,561	(4,908)
Total available-for-sale marketable debt securities	<u>\$ 2,967,388</u>	<u>\$ (5,398)</u>	<u>\$99,214</u>	<u>\$ (145)</u>	<u>\$3,066,602</u>	<u>\$ (5,543)</u>

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	September 30, 2016					
	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Government and agency securities	\$ 197,080	\$ (191)	\$ -	\$ -	\$ 197,080	\$ (191)
Corporate debt securities, commercial paper, and bank certificates of deposit	1,570,989	(1,586)	56,522	(30)	1,627,511	(1,616)
Total available-for-sale marketable debt securities	<u>\$ 1,768,069</u>	<u>\$ (1,777)</u>	<u>\$56,522</u>	<u>\$ (30)</u>	<u>\$ 1,824,591</u>	<u>\$ (1,807)</u>

The Company's investment portfolio includes equity securities of Alibaba Group and Hortonworks, as well as liquid high-quality fixed income debt securities including government, agency and corporate debt, money market funds, commercial paper, certificates of deposit and time deposits held with financial institutions. The fair value of any debt or equity security will vary over time and is subject to a variety of market risks including: macro-economic, regulatory, industry, company performance, and systemic risks of the equity markets overall. Consequently, the carrying value of the Company's investment portfolio will vary over time as the value of the various marketable securities changes.

Investments in instruments that earn a fixed rate or a floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Fixed income securities may have their fair value adversely impacted due to a deterioration of the credit quality of the issuer. The longer the term of the securities, the more susceptible they are to changes in market rates.

Available-for-sale marketable debt securities are reviewed periodically to identify possible other-than-temporary impairment. The Company has no current requirement or intent to sell the securities in an unrealized loss position. The Company expects to recover up to (or beyond) the initial cost of investment for securities held.

The following table sets forth the financial assets and liabilities, measured at fair value, by level within the fair value hierarchy as of December 31, 2015 (in thousands):

Assets	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Money market funds (1)	\$ 386,792	\$ -	\$ -	\$ 386,792
Available-for-sale marketable debt securities:				
Government and agency securities (1)	-	635,917	-	635,917
Commercial paper and bank certificates of deposit (1)	-	1,844,494	-	1,844,494
Corporate debt securities (1)	-	2,918,496	-	2,918,496
Time deposits (1)	-	82,703	-	82,703
Available-for-sale equity securities:				
Other corporate equity securities (2)	197	-	-	197
Alibaba Group equity securities	31,172,361	-	-	31,172,361
Hortonworks equity securities (2)	84,223	-	-	84,223
Hortonworks warrants	-	-	78,861	78,861
Foreign currency derivative contracts (3)	-	84,319	-	84,319
Financial assets at fair value	<u>\$ 31,643,573</u>	<u>\$ 5,565,929</u>	<u>\$ 78,861</u>	<u>\$ 37,288,363</u>
<b>Liabilities</b>				
Foreign currency derivative contracts (3)	-	(5,661)	-	(5,661)
Total financial assets and liabilities at fair value	<u>\$ 31,643,573</u>	<u>\$ 5,560,268</u>	<u>\$ 78,861</u>	<u>\$ 37,282,702</u>

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The following table sets forth the financial assets and liabilities, measured at fair value, by level within the fair value hierarchy as of September 30, 2016 (in thousands):

Assets	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Money market funds (1)	\$ 574,351	\$ -	\$ -	\$ 574,351
Available-for-sale marketable debt securities:				
Government and agency securities (1)	-	686,007	-	686,007
Commercial paper and bank certificates of deposit (1)	-	2,658,311	-	2,658,311
Corporate debt securities (1)	-	3,045,334	-	3,045,334
Time deposits (1)	-	40,297	-	40,297
Available-for-sale equity securities:				
Other corporate equity securities (2)	6,961	-	-	6,961
Alibaba Group equity securities	40,577,385	-	-	40,577,385
Hortonworks equity securities (2)	32,113	-	-	32,113
Hortonworks warrants	-	-	28,931	28,931
Foreign currency derivative contracts (3)	-	47	-	47
Financial assets at fair value	\$ 41,190,810	\$ 6,429,996	\$ 28,931	\$ 47,649,737
<b>Liabilities</b>				
Foreign currency derivative contracts (3)	-	(45,657)	-	(45,657)
Total financial assets and liabilities at fair value	\$ 41,190,810	\$ 6,384,339	\$ 28,931	\$ 47,604,080

- (1) The money market funds, government and agency securities, commercial paper and bank certificates of deposit, corporate debt securities, and time deposits are classified as part of either cash and cash equivalents or short or long-term marketable securities on the condensed consolidated balance sheets.
- (2) The Hortonworks equity securities and other corporate equity securities are classified as part of other long-term assets and investments on the condensed consolidated balance sheets.
- (3) Foreign currency derivative contracts are classified as part of either current or noncurrent assets or liabilities on the condensed consolidated balance sheets. The notional amounts of the foreign currency derivative contracts were: \$1.5 billion, including contracts designated as net investment hedges of \$1.2 billion, as of December 31, 2015; and \$0.3 billion, including contracts designated as net investment hedges of \$0.2 billion, as of September 30, 2016.

The amount of cash included in cash and cash equivalents as of December 31, 2015 and September 30, 2016 was \$965 million and \$767 million, respectively.

The fair values of the Company's Level 1 financial assets and liabilities are based on quoted prices in active markets for identical assets or liabilities. The fair values of the Company's Level 2 financial assets and liabilities are obtained using quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets in markets that are not active; and inputs other than quoted prices (e.g., interest rates and yield curves). The Company utilizes a pricing service to assist in obtaining fair value pricing for the marketable debt securities. The fair value for the Company's Level 3 financial asset was obtained using a Black-Scholes model.

## Activity between Levels of the Fair Value Hierarchy

During the year ended December 31, 2015 and the nine months ended September 30, 2016, the Company did not make any transfers between Level 1, Level 2, and Level 3 assets or liabilities.

## Hortonworks Warrants

The estimated fair value of the Hortonworks warrants was \$79 million and \$29 million as of December 31, 2015 and September 30, 2016, respectively, which is included in other long-term assets and investments on the condensed consolidated balance sheets. During the three and nine months ended September 30, 2015, the Company recorded a loss of \$13 million and \$19 million, respectively, and during the three and nine months ended September 30, 2016, the Company recorded losses of \$8 million and \$50 million, respectively, due to the change in estimated fair value of the Hortonworks warrants during the respective periods, which was included within other expense, net in the Company's condensed consolidated statements of operations. The estimated fair value of the Hortonworks warrants was determined using a Black-Scholes model.

## Assets and Liabilities at Fair Value on a Nonrecurring Basis

**Convertible Senior Notes.** In 2013, the Company issued \$1.4 billion aggregate principal amount of 0.00% Convertible Senior Notes due in 2018 (the “Notes”). The Notes are carried at their original issuance value, net of unamortized debt discount, and are not marked to market each period. The approximate estimated fair value of the Notes as of both December 31, 2015 and September 30, 2016 was \$1.3 billion. The estimated fair value of the Notes was determined on the basis of quoted market prices observable in the market and is considered Level 2 in the fair value hierarchy. See Note 11—“Convertible Notes” for additional information related to the Notes.

**Goodwill and Definite-Lived Intangible Assets.** The inputs used to measure the estimated fair value of goodwill and definite-lived intangible assets are classified as a Level 3 fair value measurement due to the significance of unobservable inputs using company-specific information. The valuation methodology used to estimate the fair value of goodwill and definite-lived intangible assets is discussed in Note 5—“Goodwill” and Note 6—“Intangible Assets, Net.”

**Other Investments .** As of both December 31, 2015 and September 30, 2016, the Company held approximately \$83 million of investments in equity securities of privately-held companies that are accounted for using the cost method. These investments are included within other long-term assets and investments on the condensed consolidated balance sheets. Such investments are reviewed periodically for impairment.

## Note 3 Consolidated Financial Statement Details

### Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income were as follows (in thousands):

	December 31, 2015	September 30, 2016
Unrealized gains on available-for-sale securities, net of tax	\$ 16,918,539	\$ 22,474,442
Unrealized gains (losses) on cash flow hedges, net of tax	482	(1,942)
Foreign currency translation, net of tax	(342,990)	42,970
Accumulated other comprehensive income	<u>\$ 16,576,031</u>	<u>\$ 22,515,470</u>

### Noncontrolling Interests

Noncontrolling interests were as follows (in thousands):

	September 30, 2015	September 30, 2016
Beginning noncontrolling interests	\$ 43,755	\$ 35,883
Distributions to noncontrolling interests	(15,847)	(5,948)
Net income attributable to noncontrolling interests	5,215	2,949
Ending noncontrolling interests	<u>\$ 33,123</u>	<u>\$ 32,884</u>

## Other Expense, Net

Other expense, net was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Interest and investment income	\$ 8,010	\$ 17,013	\$ 24,888	\$ 42,534
Interest expense	(18,411)	(18,513)	(53,540)	(55,238)
Loss on Hortonworks warrants	(12,782)	(8,493)	(19,241)	(49,930)
Foreign exchange (loss) gain	(1,490)	3,180	(21,017)	22,006
Other	718	691	2,151	2,152
Total other expense, net	<u>\$ (23,955)</u>	<u>\$ (6,122)</u>	<u>\$ (66,759)</u>	<u>\$ (38,476)</u>

Interest and investment income consists of income earned from cash and cash equivalents in bank accounts and investments made in marketable debt securities.

Interest expense is related to the Notes and notes payable related to building and capital lease obligations for data centers.

During the three and nine months ended September 30, 2015, the Company recorded losses of \$13 million and \$19 million, respectively, and during the three and nine months ended September 30, 2016, the Company recorded losses of \$8 million and \$50 million, respectively, due to the change in estimated fair value of the Hortonworks warrants during the respective periods. See Note 2—"Marketable Securities, Investments and Fair Value Disclosures" for additional information.

Foreign exchange (loss) gain consists of foreign exchange gains and losses due to re-measurement of monetary assets and liabilities denominated in non-functional currencies, and unrealized and realized foreign currency transaction gains and losses, including gains and losses related to balance sheet hedges. Additionally, during the three and nine months ended September 30, 2016, the Company reclassified certain unrealized currency translation adjustments from accumulated other comprehensive income and realized a gain of \$3 million and \$20 million, respectively, due to the liquidation of foreign subsidiaries.

Other consists of gains from other non-operational items.

## Reclassifications Out of Accumulated Other Comprehensive Income

Reclassifications out of accumulated other comprehensive income for the three months ended September 30, 2015 and 2016 were as follows (in thousands):

	Three Months Ended		Affected Line Item in the Statement of Income
	September 30, 2015	September 30, 2016	
	Reclassified from Accumulated Other Comprehensive Income	Reclassified from Accumulated Other Comprehensive Income	
Realized losses on cash flow hedges, net of tax	\$ 869	\$ 1,838	Revenue
Realized losses on available-for-sale securities, net of tax	72	11	Other expense, net
Realized (gains) on foreign currency translation adjustments ("CTA"):			
Liquidation of foreign subsidiary CTA reclassification	-	(2,863)	Other expense, net
Total reclassifications for the period	<u>\$ 941</u>	<u>\$ (1,014)</u>	

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Reclassifications out of accumulated other comprehensive income for the nine months ended September 30, 2015 and 2016 were as follows (in thousands):

	Nine Months Ended		Affected Line Item in the Statement of Income
	September 30, 2015	September 30, 2016	
	Reclassified from Accumulated Other Comprehensive Income	Reclassified from Accumulated Other Comprehensive Income	
Realized losses on cash flow hedges, net of tax	\$ 3,007	\$ 3,270	Revenue
Realized losses on available-for-sale securities, net of tax	74	206	Other expense, net
Realized (gains) losses on foreign currency translation adjustments ("CTA"):			
Liquidation of foreign subsidiary CTA reclassification	-	1,110	Restructuring charges, net
Liquidation of foreign subsidiary CTA reclassification	-	(20,473)	Other expense, net
Total reclassifications for the period	<u>\$ 3,081</u>	<u>\$ (15,887)</u>	

## Note 4 Acquisitions and Dispositions

### Transactions completed in 2015

*Polyvore*. On September 2, 2015, the Company acquired Polyvore, Inc. ("Polyvore"), a social commerce website that lets users across the globe discover and shop for their favorite products in fashion, beauty and home décor.

The total purchase price of approximately \$161 million consisted of cash consideration. Under the terms of the agreement, the Company acquired all of the equity interests (including all outstanding vested options) of Polyvore. Outstanding Polyvore unvested options were assumed and converted into equivalent awards for Yahoo common stock valued at \$7 million, which is being recognized as stock-based compensation expense as the options vest over periods of up to four years from the date of the acquisition.

Separately, in connection with the acquisition, the Company is also recognizing stock-based compensation expense of \$15 million over a period of four years from the date of the acquisition. This amount is comprised of Yahoo common stock issued to the founders (which had a fair value of \$15 million at the acquisition date). The Yahoo common stock held in escrow was issued to the founders, but is subject to forfeiture and will be released over four years from the date of the acquisition provided they remain employees of the Company (or a successor company).

The allocation of the purchase price of the assets acquired and liabilities assumed based on their fair values was as follows (in thousands):

Cash acquired	\$ 6,019
Other tangible assets acquired	12,057
Amortizable intangible assets:	
Developed technology	17,550
Tradename	1,150
Customer contracts and related relationships	225
Goodwill	<u>131,084</u>
Total assets acquired	168,085
Liabilities assumed	<u>(7,503)</u>
Total	<u>\$ 160,582</u>

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The amortizable intangible assets have useful lives not exceeding five years and a weighted average useful life of three years. The purchase price of \$161 million exceeded the estimated fair value of the tangible and identifiable intangible assets and liabilities acquired and, as a result of the allocation, the Company recorded goodwill of \$131 million in connection with this transaction. Goodwill represented the excess of the purchase price over the estimated fair value of the net tangible and identifiable intangible assets acquired and is not deductible for tax purposes. The entire goodwill amount was recorded in the Americas segment and was subsequently impaired during the fourth quarter of 2015 as a result of the impairment testing performed by the Company on its reporting units as of October 31, 2015.

*Other Acquisitions.* During the nine months ended September 30, 2015, the Company acquired one other company which was accounted for as a business combination. The total purchase price for this acquisition was \$23 million. The purchase price allocation of the assets acquired and liabilities assumed based on their estimated fair values was as follows: \$5 million to amortizable intangibles; \$4 million to net liabilities assumed; and the remainder of \$22 million to goodwill. Goodwill represents the excess of the purchase price over the estimated fair value of the net tangible and identifiable intangible assets acquired and is not deductible for tax purposes. The entire goodwill amount which was recorded in the EMEA segment was subsequently impaired during the fourth quarter of 2015 as a result of the impairment testing performed by the Company on its reporting units as of October 31, 2015.

The Company's business combination completed during the nine months ended September 30, 2015 did not have a material impact on the Company's condensed consolidated financial statements and therefore actual and pro forma disclosures have not been presented.

The Company did not make any acquisitions during the nine months ended September 30, 2016.

## ***Patent Sale and License Agreement***

During 2014, the Company entered into a patent sale and license agreement for total cash consideration of \$460 million. The total consideration was allocated based on the estimated relative fair value of each of the elements of the agreement: \$61 million was allocated to the sale of patents ("Sold Patents"), \$135 million to the license to existing patents ("Existing Patents") and \$264 million to the license of patents developed or acquired in the five years following the date the Company entered into the agreement ("Capture Period Patents"). The Company recorded \$61 million as a gain on the Sold Patents during 2014.

The amounts allocated to the license of the Existing Patents are being recorded as revenue over the four-year payment period under the license when payments are due. The amounts allocated to the Capture Period Patents are being recorded as revenue over the five-year capture period. During both the three and nine months ended September 30, 2015 and 2016, the Company recognized \$22 million and \$65 million in revenue related to the Existing Patents and the Capture Period Patents.

During both the three months ended September 30, 2015 and 2016, the Company did not have any patent sales. During the nine months ended September 30, 2015 and 2016, the Company sold certain patents and recorded a gain on sale of patents of approximately \$11 million and \$2 million, respectively.

## ***Sale of Santa Clara Property***

On April 21, 2016, the Company entered into a purchase agreement to sell certain property located in Santa Clara, California. The total carrying value of the property assets was \$126 million, which mostly pertained to the land, and was reported within the Americas segment. The decision to sell this property was largely based upon a general lack of operational need for the land and recent improvements in market conditions for commercial real estate in the area. The sale under the purchase agreement was finalized on June 16, 2016 for total proceeds of \$246 million, net of closing costs of \$4 million. During the nine months ended September 30, 2016, the Company recorded a gain of \$120 million, net of closing costs, on the sale of the property assets which is included in gain on sale of patents and land in our condensed consolidated statements of operations.

## ***Pending Sale of the Operating Business to Verizon Communications Inc.***

On July 23, 2016, the Company entered into a Stock Purchase Agreement (the "Stock Purchase Agreement") with Verizon Communications Inc. ("Verizon"), pursuant to which the Company has agreed to sell, and Verizon has agreed to purchase (the "Sale"), all of the outstanding shares of Yahoo Holdings, Inc., a newly formed wholly-owned subsidiary of the Company ("Yahoo Holdings") (and, if elected by Verizon, prior to the sale of Yahoo Holdings to cause Yahoo Holdings to sell to a foreign subsidiary of Verizon all of the equity interests in a foreign subsidiary of Yahoo Holdings that will hold certain foreign subsidiaries relating to the operating business), which, immediately prior to the consummation of the Sale, will own the Company's operating business. The aggregate consideration to be paid to the Company by Verizon in connection with the Sale is \$4,825,800,000 in cash, subject to certain adjustments as provided in the Stock Purchase Agreement.

Concurrently with the execution of the Stock Purchase Agreement, the Company entered into a Reorganization Agreement (the "Reorganization Agreement") with Yahoo Holdings, pursuant to which the Company will transfer to Yahoo Holdings prior to the consummation of the Sale all of its assets and liabilities relating to its operating business, other than specified excluded assets and retained liabilities (the "Reorganization"). Upon completion of the Sale, Verizon will also receive for its benefit and that of its current and

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certain of its future affiliates, a non-exclusive, worldwide, perpetual, royalty-free license to certain intellectual property not core to the operating business held by Excalibur IP, LLC, a wholly-owned subsidiary of the Company ("Excalibur"), that is not being transferred to Yahoo Holdings with the operating business.

The excluded assets include the Company's cash and marketable securities as of the closing of the Sale, the Company's shares in Alibaba Group and Yahoo Japan, certain other minority equity investments, and all of the equity in Excalibur. The retained liabilities will include the Notes, securityholder litigation, and certain director and officer indemnification obligations. Following the closing of the Sale, the excluded assets and retained liabilities will remain in Yahoo which will be renamed and will become an independent, publicly traded, management investment company registered under the Investment Company Act of 1940.

The closing of the Sale is subject to certain conditions, including, among others, the approval of the Sale by the Company's stockholders, antitrust approvals, the closing of the Reorganization, and certain other customary closing conditions.

## Note 5 Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2016 were as follows (in thousands):

	Americas (1)	EMEA (2)	Asia Pacific (3)	Total
Net balance as of January 1, 2016	\$ 518,886	\$ -	\$ 289,228	\$ 808,114
Goodwill impairment charge	(394,901)	-	-	(394,901)
Foreign currency translation adjustments	-	-	24,396	24,396
Net balance as of September 30, 2016	<u>\$ 123,985</u>	<u>\$ -</u>	<u>\$ 313,624</u>	<u>\$ 437,609</u>

- (1) Gross goodwill balance for the Americas segment was \$4.4 billion as of September 30, 2016. The Americas segment includes accumulated impairment losses of \$4.3 billion as of September 30, 2016.
- (2) The EMEA segment includes accumulated impairment losses of \$1.2 billion as of September 30, 2016.
- (3) Gross goodwill balance for the Asia Pacific segment was \$466 million as of September 30, 2016. The Asia Pacific segment includes accumulated impairment losses of \$159 million as of September 30, 2016.

### Goodwill Impairment Testing

Goodwill is not amortized but is tested for impairment annually (as of October 31) at the reporting unit level or whenever the Company identifies certain triggering events or circumstances that would more likely than not reduce the estimated fair value of a reporting unit below its carrying amount. Events or circumstances that might indicate an interim evaluation is warranted include, among other things, unexpected adverse business conditions, regulatory changes, loss of key personnel and reporting unit and macro-economic factors such as deterioration in general economic conditions, limitations on accessing capital, fluctuations in foreign exchange rates, or other developments in equity and credit markets.

Goodwill is tested for impairment at the reporting unit level, which is one level below the Company's operating segments. The Company identified U.S. & Canada, Latin America, and Tumblr as the reporting units below the Americas operating segment; Europe and Middle East as the reporting units below the EMEA operating segment; and Taiwan, Hong Kong, Australia & New Zealand, India & Southeast Asia as the reporting units below the Asia Pacific operating segment. These operating segments are the same as the Company's reportable segments.

Determining the fair value of each reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and operating margins, discount rates and future market conditions, among others. It is reasonably possible that a future decline in market conditions, and/or changes in the Company's market share could negatively impact the market comparables, estimated future cash flows and discount rates used in the market and income approaches to determine the fair value of each reporting unit and could result in some portion or all of the remaining goodwill to become impaired in the future.

After recording the goodwill impairment charge as of October 31, 2015 for Tumblr during the fourth quarter of 2015, the fair value of the Tumblr reporting unit approximated its carrying value. As such, any significant unfavorable changes in the forecast would result in the fair value being less than the carrying value.

## Goodwill Impairment Testing Performed During the Second Quarter of 2016

Subsequent to the most recent annual goodwill impairment assessment performed as of October 31, 2015, the Company has continued to monitor the actual performance of its reporting units. During the second quarter of 2016, the Company determined that there were indicators present to suggest that it was more likely than not that the fair value of the Tumblr reporting unit was less than its carrying amount. The significant changes for the Tumblr reporting unit subsequent to the annual goodwill impairment test performed as of October 31, 2015 included a decline in the 2016 and beyond forecasted revenue, operating income and cash flows.

### Step One

To test the Tumblr reporting unit for impairment, the Company used the two-step quantitative test. Consistent with methodology used for the prior year's annual goodwill impairment testing, the Company estimated the fair value of the Tumblr reporting unit using an income approach which was deemed to be the most indicative of fair value in an orderly transaction between market participants. Under the income approach, the Company determined fair value based on estimated future cash flows of the Tumblr reporting unit discounted by an estimated weighted-average cost of capital, reflecting the overall level of inherent risk of the Tumblr reporting unit and the rate of return an outside investor would expect to earn. The Company based its cash flow projections for the Tumblr reporting unit using a forecast of cash flows and a terminal value based on the Perpetuity Growth Model. The forecast and related assumptions were derived from an updated financial forecast prepared during the second quarter of 2016. As a result of the analysis, the Company concluded that the carrying value of the Tumblr reporting unit exceeded its estimated fair value.

### Step Two

As identified above, in step one, the Tumblr reporting unit's carrying value exceeded its estimated fair value. The second step of the quantitative test was performed by comparing the carrying value of the goodwill in the Tumblr reporting unit to its implied fair value. The implied fair value is calculated by allocating all of the assets and liabilities of the Tumblr reporting unit, including any unrecognized intangible assets, in a hypothetical analysis that calculates the implied fair value of goodwill in the same manner as if the reporting unit was being acquired in a business combination. An impairment charge is recognized for the excess of the carrying value of goodwill over its implied fair value.

The step two quantitative test for the Tumblr reporting unit resulted in an impairment for the Tumblr reporting unit, and the Company recorded a goodwill impairment charge of \$395 million during the second quarter of 2016.

The remaining goodwill related to the Tumblr reporting unit as of September 30, 2016 was \$124 million, which is included in the Americas operating segment. As of September 30, 2016, there was also goodwill remaining for Taiwan, Hong Kong, and Australia & New Zealand reporting units, which are included in the Asia Pacific operating segment.

As noted above, the Company recorded goodwill impairment charges in the Tumblr reporting unit during the second quarter of 2016. It is reasonably possible that future changes in judgments, assumptions and estimates we made in assessing the fair value of goodwill could cause us to consider some portion or all of the remaining goodwill of the Tumblr reporting unit to become impaired. For example, a future decline in market conditions, changes in our market share, and/or other factors could negatively impact the estimated future cash flows and discount rates used in the income approach to determine the fair value of the Tumblr reporting unit and could result in one or more additional impairment charges in the future .

## Note 6 Intangible Assets, Net

The following table summarizes the Company's intangible assets, net (in thousands):

	December 31, 2015	September 30, 2016			Net
	Net	Gross Carrying Amount	Accumulated Amortization (*)	Impairment Charge	
Customer, affiliate, and advertiser related relationships	\$ 220,055	\$ 350,911	\$ (170,517)	\$ (66,680)	\$ 113,714
Developed technology and patents	86,909	128,732	(73,358)	-	55,374
Tradenames, trademarks, and domain names	40,305	66,631	(33,066)	(20,655)	12,910
Total intangible assets, net	<u>\$ 347,269</u>	<u>\$ 546,274</u>	<u>\$ (276,941)</u>	<u>\$ (87,335)</u>	<u>\$ 181,998</u>

(\*) Cumulative foreign currency translation adjustments, reflecting movement in the currencies of the underlying entities, totaled approximately \$18 million as of September 30, 2016.

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As a result of the impairment testing performed in the fourth quarter of 2015, the entire carrying value of the indefinite-lived intangible assets were fully impaired as of December 31, 2015 and the Company did not purchase any indefinite-lived intangibles during the nine months ended September 30, 2016. As of September 30, 2016, the Company only had definite-lived intangible assets.

For the three months ended September 30, 2015 and 2016, the Company recognized amortization expense for intangible assets of \$34 million and \$20 million, respectively, including \$14 million and \$9 million in cost of revenue — other for the three months ended September 30, 2015 and 2016, respectively. For the nine months ended September 30, 2015 and 2016, the Company recognized amortization expense for intangible assets of \$102 million and \$80 million, respectively, including \$42 million and \$33 million in cost of revenue — other for the nine months ended September 30, 2015 and 2016, respectively. Based on the current amount of intangibles subject to amortization, the estimated amortization expense for the remainder of 2016 and each of the succeeding years is as follows: three months ending December 31, 2016: \$20 million; 2017: \$76 million; 2018: \$55 million; 2019: \$30 million; 2020 and cumulatively thereafter: \$1 million.

### ***Intangibles Impairment Testing***

Definite-lived intangible assets are carried at cost and are amortized over their estimated useful lives, generally on a straight-line basis over one to seven years as the pattern of use is ratable. The Company reviews identifiable amortizable intangible assets to be held and used for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Determination of recoverability is based on the lowest level of identifiable estimated undiscounted cash flows resulting from use of the asset and its eventual disposition. Measurement of impairment losses on definite-lived intangible assets are based on the excess of the carrying value of the asset over its fair value.

### ***Intangibles Impairment Testing Performed During the Second Quarter of 2016***

During the second quarter of 2016, the Company reviewed its Tumblr asset group for impairment as there were events and changes in circumstances that indicated that the carrying value of the long-lived assets may not be recoverable. As a result, the Company performed a quantitative test comparing the fair value of the Tumblr long-lived assets with the carrying amounts and recorded an impairment charge of \$87 million associated with its definite-lived intangible assets, which were included within customer, affiliate, and advertiser related relationships and tradenames, trademarks, and domain names.

## **Note 7 Basic and Diluted Net Income (Loss) Attributable to Yahoo! Inc. Common Stockholders Per Share**

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Basic and diluted net income (loss) attributable to Yahoo! Inc. common stockholders per share is computed using the weighted average number of common shares outstanding during the period, excluding net income attributable to participating securities (restricted stock units granted under the Directors' Stock Plan (the "Directors' Plan")). Diluted net income (loss) per share is computed using the weighted average number of common shares and, if dilutive, potential common shares outstanding during the period. Potential common shares are calculated using the treasury stock method and consist of unvested restricted stock and the incremental common shares issuable upon the exercise of stock options. The Company calculates potential tax windfalls and shortfalls by including the impact of deferred tax assets.

The Company takes into account the effect on consolidated net income (loss) per share of dilutive securities of entities in which the Company holds equity interests that are accounted for using the equity method.

Potentially dilutive securities representing approximately 14 million and 6 million shares of common stock for the three and nine months ended September 30, 2015, respectively, and 2 million shares of common stock for the three months ended September 30, 2016 were excluded from the computation of diluted earnings per share for these periods because their effect would have been anti-dilutive.

The Company has the option to pay cash, issue shares of common stock or any combination thereof for the aggregate amount due upon conversion of the Notes. The Company's intent is to settle the principal amount of the Notes in cash upon conversion. As a result, upon conversion of the Notes, only the amounts payable in excess of the principal amounts of the Notes are considered in diluted earnings per share under the treasury stock method.

The denominator for diluted net income (loss) per share also does not include any effect from the note hedges. In future periods, the denominator for diluted net income (loss) per share will exclude any effect of the note hedges, if their effect would be anti-dilutive. In the event an actual conversion of any or all of the Notes occurs, the shares that would be delivered to the Company under the note hedges are designed to reduce the dilutive effect of the shares that the Company would issue under the Notes. See Note 11—"Convertible Notes" for additional information.

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The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except per share amounts):

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u> <u>2015</u>	<u>September 30,</u> <u>2016</u>	<u>September 30,</u> <u>2015</u>	<u>September 30,</u> <u>2016</u>
<b>Basic:</b>				
Numerator:				
Net income (loss) attributable to Yahoo! Inc.	\$ 76,261	\$ 162,826	\$ 75,905	\$ (376,319)
Less: Net income allocated to participating securities	-	(2)	-	-
Net income (loss) attributable to Yahoo! Inc. common stockholders — basic	<u>\$ 76,261</u>	<u>\$ 162,824</u>	<u>\$ 75,905</u>	<u>\$ (376,319)</u>
Denominator:				
Weighted average common shares	940,822	951,421	937,713	948,524
Net income (loss) attributable to Yahoo! Inc. common stockholders per share—basic	<u>\$ 0.08</u>	<u>\$ 0.17</u>	<u>\$ 0.08</u>	<u>\$ (0.40)</u>
<b>Diluted:</b>				
Numerator:				
Net income (loss) attributable to Yahoo! Inc.	\$ 76,261	\$ 162,826	\$ 75,905	\$ (376,319)
Less: Net income allocated to participating securities	-	(2)	-	-
Less: Effect of dilutive securities issued by equity investees	(1,112)	(1,282)	(3,431)	-
Net income (loss) attributable to Yahoo! Inc. common stockholders—diluted	<u>\$ 75,149</u>	<u>\$ 161,542</u>	<u>\$ 72,474</u>	<u>\$ (376,319)</u>
Denominator:				
Denominator for basic calculation	940,822	951,421	937,713	948,524
Weighted average effect of Yahoo! Inc. dilutive securities:				
Restricted stock units	4,551	4,373	5,155	-
Stock options and employee stock purchase plan	1,561	1,510	1,292	-
Denominator for diluted calculation	<u>946,934</u>	<u>957,304</u>	<u>944,160</u>	<u>948,524</u>
Net income (loss) attributable to Yahoo! Inc. common stockholders per share—diluted	<u>\$ 0.08</u>	<u>\$ 0.17</u>	<u>\$ 0.08</u>	<u>\$ (0.40)</u>

## Note 8 Investments in Equity Interests Accounted for Using the Equity Method of Accounting

The following table summarizes the Company's investments in equity interests accounted for using the equity method of accounting (dollars in thousands):

	<u>December 31,</u> <u>2015</u>	<u>Percent</u> <u>Ownership</u>	<u>September 30,</u> <u>2016</u>	<u>Percent</u> <u>Ownership</u>
Yahoo Japan	\$ 2,496,657	35.5%	\$ 3,020,804	35.5%
Other	6,572	20%	-	-
Total	<u>\$ 2,503,229</u>		<u>\$ 3,020,804</u>	

## Equity Investment in Yahoo Japan

The investment in Yahoo Japan is accounted for using the equity method and the total investment, including net tangible assets, identifiable intangible assets, and goodwill, is classified as part of the investments in equity interests balance on the Company's condensed consolidated balance sheets. The Company records its share of the results of Yahoo Japan, and any related amortization expense, one quarter in arrears within earnings in equity interests in the condensed consolidated statements of operations.

The Company makes adjustments to the earnings in equity interests line in the condensed consolidated statements of operations for any material differences between U.S. GAAP and International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board, the standards by which Yahoo Japan's financial statements are prepared.

The fair value of the Company's ownership interest in the common stock of Yahoo Japan, based on the quoted stock price, was \$8.1 billion as of September 30, 2016.

During the nine months ended September 30, 2015 and 2016, the Company received cash dividends from Yahoo Japan in the amount of \$142 million and \$157 million, net of withholding taxes, respectively, which were recorded as reductions to the Company's investment in Yahoo Japan.

The following tables present summarized financial information derived from Yahoo Japan's consolidated financial statements, which are prepared on the basis of IFRS. The Company has made adjustments to the Yahoo Japan summarized financial information to address differences between IFRS and U.S. GAAP that materially impact the summarized financial information below. Any other differences between U.S. GAAP and IFRS did not have any material impact on the Yahoo Japan's summarized financial information presented below:

	Three Months Ended		Nine Months Ended	
	June 30, 2015	June 30, 2016	June 30, 2015	June 30, 2016
	(In thousands)			
<b>Operating data:</b>				
Revenue	\$ 911,735	\$ 1,126,615	\$ 2,840,393	\$ 3,147,894
Gross profit	\$ 712,561	\$ 875,570	\$ 2,254,511	\$ 2,461,125
Income from operations	\$ 402,865	\$ 466,435	\$ 1,266,084	\$ 1,040,561
Net income	\$ 274,567	\$ 324,820	\$ 836,081	\$ 700,785
Net income attributable to Yahoo Japan	\$ 273,636	\$ 325,553	\$ 832,611	\$ 705,449

	September 30, 2015	June 30, 2016
		(In thousands)
<b>Balance sheet data:</b>		
Current assets	\$ 6,150,688	\$ 6,377,258
Long-term assets	\$ 2,430,699	\$ 4,094,564
Current liabilities	\$ 2,003,960	\$ 2,456,712
Long-term liabilities	\$ 245,834	\$ 314,035
Noncontrolling interests	\$ 165,601	\$ 191,735

Under technology and trademark license and other commercial arrangements with Yahoo Japan, the Company records revenue from Yahoo Japan based on a percentage of advertising revenue earned by Yahoo Japan. The Company recorded revenue from Yahoo Japan of approximately \$57 million and \$68 million for the three months ended September 30, 2015 and 2016, respectively, and approximately \$172 million and \$190 million for the nine months ended September 30, 2015 and 2016, respectively. As of December 31, 2015 and September 30, 2016, the Company had net receivable balances from Yahoo Japan of approximately \$37 million and \$48 million, respectively.

## Alibaba Group

**Equity Investment in Alibaba Group**. The Company reflects the investment in Alibaba Group as an available-for-sale equity security on the consolidated balance sheet and adjusts the investment to fair value each quarterly reporting period with changes in fair value recorded within other comprehensive loss, net of tax. See Note 2 — "Marketable Securities, Investments and Fair Value Disclosures" and the condensed consolidated statements of comprehensive loss for additional information. The Company does not currently intend to sell its shares of Alibaba Group in response to changes in the market price of the shares.

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**Technology and Intellectual Property License Agreement (the "TIPLA").** As a result of the initial public offering of Alibaba Group in September 2014 (the "Alibaba Group IPO"), Alibaba Group's obligation to make royalty payments under the TIPLA ceased on September 24, 2014 and the Company's recognition of the remaining TIPLA deferred revenue was completed on September 18, 2015. For the three and nine months ended September 30, 2015, the Company recognized approximately \$60 million and \$199 million, respectively, related to the TIPLA.

## Note 9 Foreign Currency Derivative Financial Instruments

The Company uses derivative financial instruments, primarily forward contracts (and previously including option contracts), to mitigate risk associated with adverse movements in foreign currency exchange rates.

The Company records all derivatives in the condensed consolidated balance sheets at fair value, with assets included in prepaid expenses and other current assets or other long-term assets, and liabilities included in accrued expenses and other current liabilities or other long-term liabilities. The Company's accounting treatment for these instruments is based on whether or not the instruments are designated as a hedging instrument. The effective portions of net investment hedges are recorded in other comprehensive loss as a part of the cumulative translation adjustment. The effective portions of cash flow hedges are recorded in accumulated other comprehensive income until the hedged item is recognized in revenue on the condensed consolidated statements of operations when the underlying hedged revenue is recognized. Any ineffective portions of net investment hedges and cash flow hedges are recorded in other expense, net on the Company's condensed consolidated statements of operations. For balance sheet hedges, changes in the fair value are recorded in other expense, net on the Company's condensed consolidated statements of operations.

The Company has master netting arrangements, which are designed to reduce credit risk by permitting net settlement of foreign exchange contracts with the same counterparty, subject to applicable requirements. The Company presents its derivative assets and liabilities at their gross fair values on the condensed consolidated balance sheets. The Company is not required to pledge, and is not entitled to receive, cash collateral related to these derivative transactions.

### Designated as Hedging Instruments

**Net Investment Hedges.** The Company currently hedges, on an after-tax basis, a portion of its net investment in Yahoo Japan with forward contracts to reduce the risk that its investment in Yahoo Japan will be adversely affected by foreign currency exchange rate fluctuations. The total of the after-tax net investment hedge was less than the Yahoo Japan investment balance as of both December 31, 2015 and September 30, 2016. As such, the net investment hedge was considered to be effective.

**Cash Flow Hedges.** The Company entered into foreign currency forward contracts designated as cash flow hedges of varying maturities through January 31, 2017. The cash flow hedges were considered to be effective as of December 31, 2015 and September 30, 2016. All of the forward contracts designated as cash flow hedges that were settled were reclassified to revenue during the three and nine months ended September 30, 2015 and 2016. All current outstanding cash flow hedges are expected to be reclassified into revenue during 2016. For the three and nine months ended September 30, 2015 and 2016, the amounts recorded in other expense, net as a result of hedge ineffectiveness were not material.

### Not Designated as Hedging Instruments

**Balance Sheet Hedges.** The Company hedges certain of its net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that its earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These derivative instruments hedge monetary assets and liabilities, including intercompany transactions, which are denominated in foreign currencies.

Notional amounts of the Company's outstanding derivative contracts as of December 31, 2015 and September 30, 2016 were as follows (in millions):

	December 31, 2015	September 30, 2016
Derivatives designated as hedging instruments:		
Net investment hedge forward and option contracts	\$ 1,150	\$ 200
Cash flow hedge forwards	\$ 75	\$ 37
Derivatives not designated as hedging instruments:		
Balance sheet hedges	\$ 225	\$ 80

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Foreign currency derivative activity for the nine months ended September 30, 2015 was as follows (in millions):

	Beginning Fair Value	Settlement Payment (Receipt), Net	Gain (Loss) Recorded in Other Expense, Net	Gain (Loss) Recorded in Other Comprehensive (Loss) Income	Gain (Loss) Recorded in Revenue	Ending Fair Value
<b>Derivatives designated as hedging instruments:</b>						
Net investment hedges	\$ 185	\$ (92)	\$ 1	\$ 7 (*)	\$ -	\$ 101
Cash flow hedges	\$ 8	\$ (1)	\$ (1)	\$ (3)	\$ (2)	\$ 1
<b>Derivatives not designated as hedging instruments:</b>						
Balance sheet hedges	\$ 4	\$ (22)	\$ 17	\$ -	\$ -	\$ (1)

(\*) This amount does not reflect the tax impact of \$3 million recorded during the nine months ended September 30, 2015. The \$4 million after tax impact of the gain recorded within other comprehensive (loss) income was included in accumulated other comprehensive income on the Company's condensed consolidated balance sheets.

Foreign currency derivative activity for the nine months ended September 30, 2016 was as follows (in millions):

	Beginning Fair Value	Settlement Payment (Receipt), Net	Gain (Loss) Recorded in Other Expense, Net	Gain (Loss) Recorded in Other Comprehensive (Loss) Income	Gain (Loss) Recorded in Revenue	Ending Fair Value
<b>Derivatives designated as hedging instruments:</b>						
Net investment hedges	\$ 74	\$ (30)	\$ -	\$ (84) (*)	\$ -	\$ (40)
Cash flow hedges	\$ 2	\$ 2	\$ (1)	\$ (4)	\$ (5)	\$ (6)
<b>Derivatives not designated as hedging instruments:</b>						
Balance sheet hedges	\$ 2	\$ (4)	\$ 2	\$ -	\$ -	\$ -

(\*) This amount does not reflect the tax impact of \$30 million recorded during the nine months ended September 30, 2016. The \$54 million after tax impact of the loss recorded within other comprehensive (loss) income was included in accumulated other comprehensive income on the Company's condensed consolidated balance sheets.

Foreign currency derivative contracts balance sheet location and ending fair value was as follows (in millions):

	Balance Sheet Location	December 31, 2015	September 30, 2016
<b>Derivatives designated as hedging instruments:</b>			
Net investment hedges	Asset (1)	\$ 79	\$ -
	Liability (2)	\$ (5)	\$ (40)
Cash flow hedges	Asset (1)	\$ 2	\$ -
	Liability (2)	\$ -	\$ (6)
<b>Derivatives not designated as hedging instruments:</b>			
Balance sheet hedges	Asset (1)	\$ 3	\$ -
	Liability (2)	\$ (1)	\$ -

(1) Included in prepaid expenses and other current assets or other long-term assets and investments on the condensed consolidated balance sheets.

(2) Included in other accrued expenses and current liabilities or other long-term liabilities on the condensed consolidated balance sheets.

## Note 10 Credit Agreement

On May 18, 2016, the Company delivered notice to Citibank to terminate its credit agreement with Citibank, N.A., as Administrative Agent, entered into on October 19, 2012 (as amended on October 10, 2013, October 9, 2014, and July 24, 2015, the "Credit Agreement") which provided for a \$750 million unsecured revolving credit facility. The termination of the Credit Agreement and \$750 million unsecured revolving credit facility provided thereunder took effect on May 23, 2016.

## Note 11 Convertible Notes

### 0.00% Convertible Senior Notes

As of September 30, 2016, the Company had \$1.4 billion in principal amount of Notes outstanding. The Notes are senior unsecured obligations of Yahoo, the Notes do not bear regular interest, and the principal amount of the Notes was issued at par value. The Notes mature on December 1, 2018, unless previously purchased or converted in accordance with their terms prior to such date. The Company may not redeem the Notes prior to maturity. However, holders of the Notes may convert them at certain times and upon the occurrence of certain events in the future, as outlined in the indenture governing the Notes (the "Indenture"). Holders of the Notes who convert in connection with a "make-whole fundamental change," as defined in the Indenture, may require Yahoo to purchase for cash all or any portion of their Notes at a purchase price equal to 100 percent of the principal amount, plus accrued and unpaid special interest as defined in the Indenture, if any. The Notes are convertible, subject to certain conditions, into shares of Yahoo common stock at an initial conversion rate of 18.7161 shares per \$1,000 principal amount of Notes (which is equivalent to an initial conversion price of approximately \$53.43 per share), subject to adjustment upon the occurrence of certain events. Upon conversion of the Notes, holders will receive cash, shares of Yahoo's common stock or a combination thereof, at Yahoo's election. The Company's intent is to settle the principal amount of the Notes in cash upon conversion. If the conversion value exceeds the principal amount, the Company would deliver shares of its common stock with respect to the remainder of its conversion obligation in excess of the aggregate principal amount (conversion spread). As of September 30, 2016, none of the conditions allowing holders of the Notes to convert had been met.

The Notes consist of the following (in thousands):

	December 31, 2015	September 30, 2016
Liability component:		
Principal	\$ 1,437,500	\$ 1,437,500
Less: note discount	(204,015)	(154,498)
Net carrying amount	<u>\$ 1,233,485</u>	<u>\$ 1,283,002</u>
Equity component (*)	<u>\$ 305,569</u>	<u>\$ 305,569</u>

(\*) Recorded on the condensed consolidated balance sheets within additional paid-in capital.

The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2016	September 30, 2015	September 30, 2016
Accretion of convertible note discount	\$ 15,867	\$ 16,723	\$ 46,984	\$ 49,517

The fair value of the Notes, which was determined based on inputs that are observable in the market (Level 2), and the carrying value of debt instruments (carrying value excludes the equity component of the Notes classified in equity) were as follows (in thousands):

	December 31, 2015		September 30, 2016	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Convertible senior notes	\$ 1,250,124	\$ 1,233,485	\$ 1,310,293	\$ 1,283,002

## Note Hedge Transactions and Warrant Transactions

The Company entered into note hedge transactions with certain option counterparties (the "Counterparties") to reduce the potential dilution with respect to Yahoo's common stock upon conversion of the Notes or offset any cash payment the Company is required to make in excess of the principal amount of converted Notes. Separately, the Company also entered into privately negotiated warrant transactions with the Counterparties giving them the right to purchase common stock from the Company. The warrant transactions could separately have a dilutive effect with respect to Yahoo's common stock to the extent that the market price per share of its common stock exceeds the strike price of the warrants. The initial strike price of the warrants was \$71.24. Counterparties to the warrants may make adjustments to certain terms of the warrants upon the occurrence of specified events, including the announcement of the Stock Purchase Agreement, if the event results in a material change to the trading price of Yahoo's common stock or the value of the warrants. To date, two Counterparties have given the Company notices of adjustment to their warrant exercise prices.

## Note 12 Commitments and Contingencies

**Lease Commitments.** The Company leases office space and data centers under operating and capital lease agreements with original lease periods of up to 15 years which expire between 2016 and 2025. A summary of gross and net lease commitments as of September 30, 2016 was as follows (in millions):

	Gross Operating Lease Commitments	Sublease Income	Net Operating Lease Commitments
Three months ending December 31, 2016	\$ 31	\$ (4)	\$ 27
Years ending December 31,			
2017	98	(15)	83
2018	76	(12)	64
2019	61	(9)	52
2020	47	(7)	40
2021	38	(6)	32
Due after 5 years	86	(2)	84
Total gross and net lease commitments	<u>\$ 437</u>	<u>\$ (55)</u>	<u>\$ 382</u>

	Capital Lease Commitments
Three months ending December 31, 2016	\$ 4
Years ending December 31,	
2017	11
2018	9
2019	5
2020	-
2021	-
Due after 5 years	3
Gross capital lease commitments	<u>\$ 32</u>
Less: interest	6
Net capital lease commitments included in other accrued expenses and current liabilities and other long-term liabilities	<u>\$ 26</u>

**Affiliate Commitments** . The Company is obligated to make payments, which represent TAC, to its Affiliates. As of September 30, 2016, these commitments totaled \$985 million, of which \$60 million will be payable in the remainder of 2016, \$300 million will be payable in each year from 2017 through 2019, and \$25 million will be payable in 2020.

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**Non-cancelable Obligations** . The Company is obligated to make payments under various non-cancelable arrangements with vendors and other business partners, principally for content, bandwidth, and marketing arrangements. As of September 30, 2016, these commitments totaled \$124 million, of which \$23 million will be payable in the remainder of 2016, \$47 million will be payable in 2017, \$32 million will be payable in 2018, \$9 million will be payable in 2019, \$3 million will be payable in 2020, \$3 million will be payable in 2021 and \$7 million will be payable thereafter.

**Intellectual Property Rights** . The Company is committed to make certain payments under various intellectual property arrangements of up to \$13 million through 2023.

**Note Payable Obligations**. The Company is obligated to make payments for notes payable related to two buildings in Sunnyvale, California. The estimated timing and amounts of payments totaled \$53 million, of which \$1 million will be payable in the remainder of 2016, \$5 million will be payable in each year from 2017 through 2021, and \$27 million will be payable thereafter.

**Standby Letters of Credit**. As of September 30, 2016, the Company had outstanding potential obligations relating to standby letters of credit of \$38 million. Standby letters of credit are financial guarantees provided by third parties for ongoing operating liabilities such as leases, utility bills, taxes, and insurance. If any letter of credit is drawn upon by a beneficiary, the Company is obligated to reimburse the provider of the guarantee. The standby letters of credit generally renew annually.

**Other Commitments** . In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to customers, vendors, lessors, joint ventures and business partners, purchasers of assets or subsidiaries and other parties with respect to certain matters, including, but not limited to, losses arising out of the Company's breach of agreements or representations and warranties made by the Company, services to be provided by the Company, intellectual property infringement claims made by third parties or, with respect to the sale, lease, or assignment of assets, or the sale of a subsidiary, matters related to the Company's conduct of the business and tax matters prior to the sale, lease or assignment. In addition, the Company has entered into indemnification agreements with its directors and certain of its officers that will require the Company, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. The Company has also agreed to indemnify certain former officers, directors, and employees of acquired companies in connection with the acquisition of such companies. The Company maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its current and former directors and officers, and former directors and officers of acquired companies, in certain circumstances. It is not possible to determine the aggregate maximum potential loss under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements might not be subject to maximum loss clauses. Historically, the Company has not incurred material costs as a result of obligations under these agreements and it has not accrued any material liabilities related to such indemnification obligations in the Company's condensed consolidated financial statements.

As of September 30, 2016, the Company did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, the Company is not exposed to any financing, liquidity, market, or credit risk that could arise if the Company had such relationships. In addition, the Company identified no variable interests currently held in entities for which it is the primary beneficiary.

## **Legal Contingencies**

**Patent Matters**. From time to time, third parties assert patent infringement claims against the Company. Currently, the Company is engaged in lawsuits regarding patent issues and has been notified of other potential patent disputes.

**Stockholder and Securities Matters**. On April 22, 2015, a stockholder action captioned *Cathy Buch v. David Filo, et al.* , was filed in the Delaware Court of Chancery against the Company and certain of its current and former directors. The complaint asserts both derivative claims, purportedly on behalf of Yahoo, and class action claims, purportedly on behalf of the plaintiff and all similarly situated stockholders, relating to the termination of, and severance payments made to, our former chief operating officer, Henrique de Castro. The plaintiff claims that certain current and former board members allegedly violated or acquiesced in the violation of the Company's Bylaws when Mr. de Castro was terminated without cause, and breached fiduciary duties by allowing Yahoo to make allegedly false and misleading statements regarding the value of his severance. The plaintiff has also asserted claims against Mr. de Castro. The plaintiff seeks to have the full Board reassess the propriety of terminating Mr. de Castro without cause, potentially leading to disgorgement in favor of the Company of the severance paid to Mr. de Castro, an equitable accounting, monetary damages, declaratory relief, injunctive relief, and an award of attorneys' fees and costs. The Company and the individual defendants filed a motion to dismiss the action, which the Court denied in part and granted in part on July 27, 2016.

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On January 27, 2016, a stockholder action captioned *UCFW Local 1500 Pension Fund v. Marissa Mayer, et al.*, was filed in the U.S. District Court for the Northern District of California against the Company, and certain current and former officers and directors of the Company. On April 29, 2016, the plaintiff filed an amended complaint. The amended complaint asserts derivative claims, purportedly on behalf of Yahoo, for violations of the Investment Company Act of 1940, breach of fiduciary duty, unjust enrichment, violations of Delaware General Corporation Law Section 124, and violations of California Business & Professions Code Section 17200. The amended complaint seeks to rescind Yahoo's employment contracts with the individual defendants because those defendants allegedly caused Yahoo to illegally operate as an unregistered investment company. The plaintiff seeks disgorgement in favor of Yahoo, rescission, and an award of attorneys' fees and costs. In addition, the amended complaint asserts a direct claim against Yahoo for alleged violation of Delaware General Corporation Law Section 124(1), based on the allegation that Yahoo has illegally operated as an unregistered investment company. Pursuant to this claim, the plaintiff seeks injunctive relief preventing Yahoo from entering into any future contracts, including any contracts to sell its assets. On October 19, 2016, the District Court dismissed the amended complaint, with leave to amend.

**TCPA Litigation Concerning Yahoo Messenger.** On March 21, 2014 and April 16, 2014, civil complaints were filed in the U.S. District Court for the Northern District of Illinois by plaintiffs Rachel Johnson and Zenaida Calderin, respectively, against the Company, alleging that the process by which Yahoo Messenger sends a notification SMS message in addition to delivering a user's instant message to a recipient's cellular telephone constitutes a violation of the Telephone Consumer Protection Act ("TCPA"), 47 U.S.C. § 227. The penalty per violation ranges from \$500 to \$1,500. The complaints, which were consolidated, seek statutory damages for a purported class of plaintiffs. In January 2016, the District Court denied class certification treatment proposed by plaintiff Calderin, who accepted a \$1,500 offer of judgment to resolve her case in its entirety. The District Court certified a class proposed by plaintiff Johnson comprising more than 300,000 potential members. The Company sought permission from the United States Court of Appeals for the Seventh Circuit to appeal the District Court's certification order, which the Court of Appeals denied. No decision has been made on the merits of plaintiffs' claims, which the Company is defending vigorously. The Company also previously defended related litigation in the United States District Court for the Southern District of California, which denied class certification in September 2015; that case was dismissed with prejudice in March 2016.

**General.** The Company is regularly involved in claims, suits, government investigations, and proceedings arising from the ordinary course of the Company's business, including actions with respect to intellectual property claims, privacy, consumer protection, information security, data protection or law enforcement matters, tax matters, labor and employment claims, commercial claims, as well as actions involving content generated by users, stockholder derivative actions, purported class action lawsuits, and other matters.

The Company has determined, based on current knowledge, that the amount or range of reasonably possible losses, including reasonably possible losses in excess of amounts already accrued, is not reasonably estimable with respect to certain matters described above. The Company has also determined, based on current knowledge, that the aggregate amount or range of losses that are estimable with respect to the Company's legal proceedings, including the matters described above, would not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows. Amounts accrued as of September 30, 2016 were not material. The ultimate outcome of legal proceedings involves judgments, estimates and inherent uncertainties, and cannot be predicted with certainty. In the event of a determination adverse to Yahoo, its subsidiaries, directors, or officers in these matters, the Company may incur substantial monetary liability, and be required to change its business practices. Either of these events could have a material adverse effect on the Company's financial position, results of operations, or cash flows. The Company may also incur substantial legal fees, which are expensed as incurred, in defending against these claims.

## **Security Incident Contingencies**

On September 22, 2016, the Company disclosed that, based on an ongoing investigation, a copy of certain user account information for at least 500 million user accounts was stolen from Yahoo's network in late 2014 (the "Security Incident"). To date, 23 putative consumer class action lawsuits have been filed against the Company in U.S. federal and state courts, and in foreign courts relating to the Security Incident. The plaintiffs, who purport to represent various classes of users, generally claim to have been harmed by the Company's alleged actions and/or omissions in connection with the Security Incident and assert a variety of common law and statutory claims seeking monetary damages or other related relief. Additional lawsuits and claims related to the Security Incident may be asserted by or on behalf of users, partners, shareholders, or others seeking damages or other related relief.

While a loss from these matters is reasonably possible, the Company cannot reasonably estimate a range of possible losses related to these legal proceedings at this time because the investigation into the Security Incident is ongoing, the legal proceedings remain in the early stages, alleged damages have not been specified, there is uncertainty as to the likelihood of a class or classes being certified or the ultimate size of any class if certified, and there are significant factual and legal issues to be resolved. Based on current information, the Company does not believe that a loss from these matters is probable and therefore has not recorded an accrual for litigation or other contingencies relating to the Security Incident. The Company will continue to evaluate information as it becomes known and will record an accrual for estimated losses at the time or times it is determined that a loss is both probable and reasonably estimable.

## Note 13 Stockholders' Equity and Employee Benefits

**Stock Options** . The Company's Stock Plan, the Directors' Plan, and stock-based awards assumed through acquisitions (including stock-based commitments related to continued service of acquired employees, such as holdbacks by Yahoo of shares of Yahoo common stock issued to founders of acquired companies in connection with certain of the Company's acquisitions) are collectively referred to as the "Plans". Stock option activity under the Company's Plans for the nine months ended September 30, 2016 is summarized as follows (in thousands, except per share amounts):

	Shares	Weighted Average Exercise Price Per Share
Outstanding at December 31, 2015 (1)	6,522	\$ 18.82
Options granted	-	\$ -
Options exercised (2)	(1,080)	\$ 14.36
Options expired	(433)	\$ 18.55
Options cancelled/forfeited	(369)	\$ 18.23
Outstanding at September 30, 2016 (1)	<u>4,640</u>	\$ 19.93

(1) Includes shares subject to performance-based stock options for which performance goals had not been set as of the date shown.

(2) The Company generally issues new shares to satisfy stock option exercises.

As of September 30, 2016, there was \$12 million of unamortized stock-based compensation expense related to unvested stock options, which is expected to be recognized over a weighted average period of 0.9 years.

**Restricted Stock and Restricted Stock Units**. Restricted stock and restricted stock unit activity under the Plans for the nine months ended September 30, 2016 is summarized as follows (in thousands, except per share amounts):

	Shares	Weighted Average Grant Date Fair Value Per Share
Awarded and unvested at December 31, 2015 (1)	28,739	\$ 39.15
Granted (2)	14,497	\$ 34.39
Vested	(11,386)	\$ 31.95
Forfeited	(6,144)	\$ 35.80
Awarded and unvested at September 30, 2016 (1)	<u>25,706</u>	\$ 40.46

(1) Includes the maximum number of shares issuable under the Company's performance-based restricted stock unit awards (including future-year tranches for which performance goals had not been set) as of the date shown.

(2) Includes the maximum number of shares issuable under the performance-based restricted stock unit awards granted during the nine months ended September 30, 2016 (including future-year tranches for which performance goals had not been set during the period); excludes tranches of previously granted performance-based restricted stock units for which performance goals were set during the nine months ended September 30, 2016.

As of September 30, 2016, there was \$602 million of unamortized stock-based compensation expense related to unvested restricted stock and restricted stock units, which is expected to be recognized over a weighted average period of 2.4 years.

During the nine months ended September 30, 2015 and 2016, 13.8 million shares and 11.4 million shares, respectively, that were subject to previously granted restricted stock units, vested. These vested restricted stock units were net share settled. During the nine months ended September 30, 2015 and 2016, the Company withheld 5.3 million shares and 4.2 million shares, respectively, based upon the Company's closing stock price on the vesting date, to satisfy the Company's tax withholding obligation relating to the employees' minimum statutory obligation for the applicable income and other employment taxes. The Company then remitted cash to the appropriate taxing authorities.

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Total payments for the employees' tax obligations to the relevant taxing authorities were \$216 million and \$157 million, respectively, for the nine months ended September 30, 2015 and 2016 and are reflected as a financing activity within the condensed consolidated statements of cash flows. The payments were used for tax withholdings related to the net share settlements of restricted stock units. The payments had the effect of share repurchases by the Company as they reduced the number of shares that would have otherwise been issued on the vesting date and were recorded as a reduction of additional paid-in capital.

**Performance Options** . The financial performance stock options awarded by the Company in November 2012 to Ms. Mayer include multiple performance periods. The number of stock options that ultimately vest for each performance period will range from 0 percent to 100 percent of the target amount for such period stated in each executive's award agreement based on the Company's performance relative to goals. The financial performance goals are established at the beginning of each performance period and the portion (or "tranche") of the award related to each performance period is treated as a separate grant for accounting purposes. In March 2016, the Compensation Committee established performance goals under these stock options for the 2016 performance year. The 2016 financial performance metrics (and their weightings) under the performance stock options are GAAP revenue (one-third), revenue ex-TAC (one-third), and adjusted EBITDA (one-third). The grant date fair value of the 2016 tranche of the November 2012 financial performance stock options was \$13 million, and is being recognized over the twelve-month service period. The Company began recording stock-based compensation expense for this tranche in March 2016, when the financial performance goals were established.

**Performance RSUs** . In March 2016, the Compensation Committee approved additional annual financial performance-based RSU awards to Ms. Mayer and other senior officers, and established the 2016 annual performance goals for these awards as well as for the similar performance-based RSUs granted in February 2013, February 2014, and March 2015. The 2013, 2014, 2015, and 2016 performance-based RSU awards are generally eligible to vest in equal annual target amounts over four years (three years for Ms. Mayer) based on the Company's attainment of annual financial performance goals as well as the executive's continued employment through each vesting date. The number of shares that ultimately vest each year will range from 0 percent to 200 percent of the annual target amount, based on the Company's performance. Annual financial performance metrics and goals are established for these RSU awards at the beginning of each year and the tranche of each RSU award related to that year's performance goal is treated as a separate annual grant for accounting purposes. The 2016 financial performance metrics (and their weightings) established for the performance RSUs are: GAAP revenue (one-third), revenue ex-TAC (one-third), and adjusted EBITDA (one-third). The grant date fair value of the first tranche of the March 2016 performance RSUs was \$10 million, the grant date fair value of the second tranche of the March 2015 performance RSUs was \$8 million, the grant date fair value of the third tranche of the February 2014 performance RSUs was \$4 million, and the grant date fair value of the fourth tranche of the February 2013 performance RSUs was \$8 million. These values are being recognized over the tranches' twelve-month service periods. The Company began recording stock-based compensation expense for these tranches in March 2016, when the financial performance goals were established.

**Stock Repurchases** . In November 2013, the Board authorized a stock repurchase program with an authorized level of \$5 billion. The November 2013 program, according to its terms, will expire in December 2016. The aggregate amount remaining under the November 2013 repurchase program was approximately \$726 million at September 30, 2016. In March 2015, the Board authorized an additional stock repurchase program with an authorized level of \$2 billion. The March 2015 program, according to its terms, will expire in March 2018. The aggregate amount available under the March 2015 repurchase program was \$2 billion at September 30, 2016. Repurchases under the repurchase programs may take place in the open market or in privately negotiated transactions, including structured and derivative transactions such as accelerated share repurchase transactions, and may be made under a Rule 10b5-1 plan. During the nine months ended September 30, 2016, the Company did not repurchase any of its outstanding common stock.

## Note 14 Restructuring Charges, Net

Restructuring charges, net consists of employee severance pay and related costs, accelerations of stock-based compensation expense, facility restructuring costs, contract termination and other non-cash charges associated with the exit of facilities, as well as reversals of restructuring charges arising from changes in estimates.

Restructuring charges, net was comprised of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2016	September 30, 2015	September 30, 2016
Employee severance pay and related costs	\$ 16,597	\$ 6,772	\$ 67,746	\$ 56,620
Non-cancelable lease, contract termination, and other charges	11,103	4,368	33,123	24,302
Reversals of previous charges	(2,590)	(1,029)	(6,611)	(2,947)
Non-cash accelerations of stock-based compensation expense	-	-	2,705	7,374
Other non-cash (credits) charges, net	902	(149)	(31)	1,227
Restructuring charges, net	<u>\$ 26,012</u>	<u>\$ 9,962</u>	<u>\$ 96,932</u>	<u>\$ 86,576</u>

The Company has implemented multiple restructuring plans to reduce its cost structure, align resources with its product strategy and improve efficiency, which have resulted in workforce reductions and the consolidation of certain real estate facilities and data centers. For the three months ended September 30, 2015, the Company recorded expense of \$9 million and \$17 million related to the Americas and EMEA, respectively. For the nine months ended September 30, 2015, the Company recorded expense of \$62 million, \$31 million, and \$4 million related to the Americas, EMEA, and Asia Pacific segments, respectively. For the three months ended September 30, 2016, the Company recorded expense of \$5 million and \$5 million related to the Americas and EMEA segments, respectively. For the nine months ended September 30, 2016, the Company recorded expense of \$65 million, \$18 million, and \$4 million related to the Americas, EMEA, and Asia Pacific segments, respectively.

The amounts recorded during the nine months ended September 30, 2016 were primarily related to the Company's announced plans in February 2016 to reduce the Company's workforce by approximately 15 percent by the end of 2016 and exit six offices in Dubai, Mexico City, Buenos Aires, Madrid, Milan and Burbank, California, subject to applicable laws and consultation processes, as a part of the strategic plan to simplify Yahoo's product portfolio. During the three months ended September 30, 2016, in connection with this action, the Company incurred pre-tax cash charges of \$1 million for severance pay expenses and related cash expenditures and pre-tax cash charges of \$1 million related to the consolidation and exit of facilities related to non-cancelable lease costs and other related costs. During the nine months ended September 30, 2016, in connection with this action, the Company incurred pre-tax cash charges of \$47 million for severance pay expenses and related cash expenditures, pre-tax cash charges of \$17 million related to the consolidation and exit of facilities related to non-cancelable lease costs and other related costs, pre-tax non-cash charges of \$7 million related to stock-based compensation expense and less than \$1 million related to impairment costs.

The Company's restructuring accrual activity for the nine months ended September 30, 2016 is summarized as follows (in thousands):

Accrual balance as of December 31, 2015	\$ 65,891
Restructuring charges	86,576
Cash paid	(90,078)
Non-cash accelerations of stock-based compensation expense	(7,374)
Foreign currency translation and other adjustments	(1,012)
Accrual balance as of September 30, 2016	<u>\$ 54,003</u>

The \$54 million restructuring liability as of September 30, 2016 consisted of \$8 million for employee severance expenses, which the Company expects to pay out by the end of the second quarter of 2017, and \$46 million related to non-cancelable lease costs, which the Company expects to pay over the terms of the related obligations through the fourth quarter of 2025, less estimated sublease income.

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The restructuring accruals by segment consisted of the following (in thousands):

	December 31, 2015	September 30, 2016
Americas	\$ 47,054	\$ 44,499
EMEA	18,389	9,264
Asia Pacific	448	240
Total restructuring accruals	<u>\$ 65,891</u>	<u>\$ 54,003</u>

## Note 15 Income Taxes

The Company's effective tax rate is the result of the mix of income earned and losses incurred in various tax jurisdictions that apply a broad range of income tax rates. Historically, the Company's provision for income taxes has differed from the tax computed at the U.S. federal statutory income tax rate due to state taxes, the effect of non-U.S. operations, non-deductible stock-based compensation expense, non-deductible acquisition-related costs, and adjustments to unrecognized tax benefits.

The Company recorded an income tax benefit of \$93 million and \$106 million for the three months ended September 30, 2015 and 2016, respectively. The Company recorded an income tax benefit of \$76 million and \$125 million for the nine months ended September 30, 2015 and 2016, respectively. For the three and nine months ended September 30, 2015, the income tax benefit was primarily a result of the Company's loss before income taxes and earnings in equity interests. The income tax benefit for the three months ended September 30, 2016 included tax expense associated with the Company's intention to repatriate earnings from its wholly-owned foreign subsidiaries, offset by the benefit of foreign tax credits and the Company's loss before income taxes and earnings in equity interest. In addition, the tax benefit for the nine months ended September 30, 2016 also included tax expenses associated with gain from sale of the Company's real estate property in Santa Clara, California, offset by tax benefits from Tumblr intangible assets impairment charge.

As of September 30, 2016, the Company intends to repatriate cumulative and future earnings from its wholly-owned foreign subsidiaries. The tax implications of this repatriation (namely a \$149 million increase to U.S. taxable income with an associated \$66 million U.S. tax credit for foreign income taxes that have been paid on such earnings) have been included in the Company's income tax benefit for the three and nine months ended September 30, 2016. The Company does not have a plan to repatriate approximately \$3.1 billion of earnings related to its equity method investment in Yahoo Japan. If those earnings were to be repatriated in the future, the Company may be subject to additional U.S. income taxes (subject to an adjustment for foreign tax credits). It is not practicable to determine the income tax liability that might be incurred if these earnings were to be repatriated.

During the nine months ended September 30, 2016, the Company received a cash tax refund of \$190 million associated with the Company's claim to carry back its 2015 losses and tax attributes to earlier taxable years.

The Company's gross amount of unrecognized tax benefits as of September 30, 2016 was \$1.1 billion, of which \$1.0 billion is recorded on the condensed consolidated balance sheets. The gross unrecognized tax benefits as of September 30, 2016 decreased by \$8 million from the recorded balance as of December 31, 2015. The decrease is mainly related to audit settlements for prior tax years.

The Company is in various stages of examination and appeal in connection with its taxes both in the United States and in foreign jurisdictions. Those audits generally span tax years 2005 through 2014. As of September 30, 2016, the Company's 2011 through 2013 U.S. federal income tax returns are currently under examination. The Company has appealed the California Franchise Tax Board's proposed adjustments to the 2005 through 2008 returns, but no formal conclusions have been received to date. While it is difficult to determine when the examinations will be settled or their final outcomes, certain examinations in various jurisdictions are expected to be resolved in the foreseeable future. The Company believes that it has adequately provided for any reasonably foreseeable adverse adjustment to its tax returns and that any settlement will not have a material adverse effect on its consolidated financial position, results of operations, or cash flows. It is reasonably possible that the Company's unrecognized tax benefits could be reduced by up to approximately \$24 million in the next twelve months.

In the nine months ended September 30, 2015, the Company satisfied the \$3.3 billion income tax liability related to the sale by Yahoo! Hong Kong Holdings Limited, the Company's wholly-owned subsidiary, of Alibaba Group American Depositary Shares ("ADSs") in the Alibaba Group IPO on September 24, 2014. As of September 30, 2016 the Company accrued deferred tax liabilities of \$16.4 billion associated with the 384 million ordinary shares of Alibaba Group ("Alibaba Group shares") retained by the Company. Such deferred tax liabilities are subject to periodic adjustments due to changes in the fair value of the Alibaba Group shares.

The Company may have additional tax liabilities in China related to the sale to Alibaba Group of 523 million Alibaba Group shares that took place during the year ended December 31, 2012 and related to the sale of the 140 million Alibaba Group ADSs sold in the Alibaba Group IPO that took place during the year ended December 31, 2014. Any taxes assessed and paid in China are expected to be ultimately offset and recovered in the United States through the use of foreign tax credits.

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Tax authorities from the Brazilian State of Sao Paulo have assessed certain indirect taxes against the Company's Brazilian subsidiary, Yahoo! do Brasil Internet Ltda., related to online advertising services. The assessment is for calendar years 2008 through 2011 and as of September 30, 2016 totals approximately \$115 million. The Company currently believes the assessment is without merit. The Company believes the risk of loss is remote and has not recorded an accrual for the assessment.

## Note 16 Segments

The Company continues to manage its business geographically. The primary areas of measurement and decision-making are Americas, EMEA (Europe, Middle East, and Africa), and Asia Pacific. Management relies on an internal reporting process that provides revenue, revenue ex-TAC (which is defined as revenue less cost of revenue—TAC), direct costs excluding TAC by segment, and consolidated loss from operations for making decisions related to the evaluation of the financial performance of, and allocating resources to, the Company's segments.

The following tables present summarized information by segment (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2016	September 30, 2015	September 30, 2016
<b>Revenue by segment (1) :</b>				
Americas	\$ 987,374	\$ 1,058,416	\$ 2,964,305	\$ 2,975,023
EMEA	79,614	98,654	246,530	278,711
Asia Pacific	158,685	148,136	484,073	446,261
<b>Total Revenue</b>	<b>\$ 1,225,673</b>	<b>\$ 1,305,206</b>	<b>\$ 3,694,908</b>	<b>\$ 3,699,995</b>
<b>TAC by segment (1) :</b>				
Americas	\$ 201,855	\$ 394,838	\$ 549,332	\$ 1,012,903
EMEA	12,745	41,948	37,399	96,787
Asia Pacific	8,629	10,751	19,867	32,096
<b>Total TAC</b>	<b>\$ 223,229</b>	<b>\$ 447,537</b>	<b>\$ 606,598</b>	<b>\$ 1,141,786</b>
<b>Revenue ex-TAC by segment:</b>				
Americas	\$ 785,519	\$ 663,578	\$ 2,414,973	\$ 1,962,120
EMEA	66,869	56,706	209,131	181,924
Asia Pacific	150,056	137,385	464,206	414,165
<b>Total Revenue ex-TAC</b>	<b>1,002,444</b>	<b>857,669</b>	<b>3,088,310</b>	<b>2,558,209</b>
<b>Direct costs by segment (2) :</b>				
Americas	74,495	63,069	214,079	201,343
EMEA	23,196	7,587	63,947	47,090
Asia Pacific	47,214	45,607	149,766	137,399
Global operating costs (3)	613,302	539,403	1,942,565	1,676,710
Gain on sale of patents and land	-	-	(11,100)	(121,559)
Asset impairment charge	41,699	-	41,699	-
Goodwill impairment charge	-	-	-	394,901
Intangible assets impairment charge	-	-	-	87,335
Depreciation and amortization	152,412	115,468	457,630	388,360
Stock-based compensation expense	110,426	128,892	351,252	369,263
Restructuring charges, net	26,012	9,962	96,932	86,576
<b>Loss from operations</b>	<b>\$ (86,312)</b>	<b>\$ (52,319)</b>	<b>\$ (218,460)</b>	<b>\$ (709,209)</b>

- (1) Commencing in the second quarter of 2016, TAC payments related to the Microsoft Search Agreement, which previously would have been recorded as a reduction to revenue, began to be recorded as cost of revenue—TAC due to a required change in revenue presentation. See Note 1—"The Company and Summary of Significant Accounting Policies" and Note 17—"Microsoft Search Agreement" for additional information.

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- (2) Direct costs for each segment include certain cost of revenue—other and costs associated with the local sales teams. Prior to the second quarter of 2016, certain account management costs associated with Yahoo Properties were managed locally and included as direct costs for each segment. Prior period amounts have been revised to conform to the current presentation.
- (3) Global operating costs include product development, marketing, real estate workplace, general and administrative, account management costs, and other corporate expenses that are managed on a global basis and that are not directly attributable to any particular segment. Beginning in the second quarter of 2016, certain account management costs associated with Yahoo Properties are managed globally and included as global costs. Prior period amounts have been revised to conform to the current presentation.

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2016	September 30, 2015	September 30, 2016
Capital expenditures, net:				
Americas (1)	\$ 139,796	\$ 35,407	\$ 378,516	\$ (77,128)
EMEA	4,616	2,606	19,265	11,425
Asia Pacific	5,969	3,957	19,495	14,122
Total capital expenditures, net	\$ 150,381	\$ 41,970	\$ 417,276	\$ (51,581)

- (1) The nine months ended September 30, 2016 includes net proceeds of \$246 million associated with the sale of certain property assets located in Santa Clara, California. See Note 4—“Acquisitions and Dispositions” for additional information.

	December 31, 2015	September 30, 2016
	Property and equipment, net:	
Americas:		
U.S.	\$ 1,447,995	\$ 1,177,265
Other	353	2,890
Total Americas	\$ 1,448,348	\$ 1,180,155
EMEA	33,940	31,213
Asia Pacific	65,035	61,959
Total property and equipment, net	\$ 1,547,323	\$ 1,273,327

See Note 5—“Goodwill” and Note 14—“Restructuring Charges, Net” for additional information regarding segments.

*Enterprise Wide Disclosures*

The following tables present revenue for groups of similar services and revenue by U.S. and international markets (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2016	September 30, 2015	September 30, 2016
Search (1)(2)	\$ 515,841	\$ 703,130	\$ 1,586,148	\$ 1,906,507
Display (1)	511,356	476,263	1,481,622	1,408,818
Other (1)	198,476	125,813	627,138	384,670
Total revenue	\$ 1,225,673	\$ 1,305,206	\$ 3,694,908	\$ 3,699,995

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2016	September 30, 2015	September 30, 2016
Revenue: (2)				
U.S.	\$ 958,394	\$ 1,026,868	\$ 2,887,134	\$ 2,894,207
International	267,279	278,338	807,774	805,788
Total revenue	<u>\$ 1,225,673</u>	<u>\$ 1,305,206</u>	<u>\$ 3,694,908</u>	<u>\$ 3,699,995</u>

- (1) At the beginning of 2016, the Company reclassified certain amounts from other revenue to either search or display revenue. Prior period amounts have been revised to conform to the current presentation. For the three months ended September 30, 2015, to conform to the current presentation, the Company reclassified \$6.4 million and \$2.7 million to search and display revenue, respectively, previously included in other revenue. For the nine months ended September 30, 2015, to conform to the current presentation, the Company reclassified \$23.9 million and \$8.9 million to search and display revenue, respectively, previously included in other revenue.
- (2) Commencing in the second quarter of 2016, TAC payments related to the Microsoft Search Agreement, which previously would have been recorded as a reduction to revenue, began to be recorded as cost of revenue—TAC due to a required change in revenue presentation. See Note 1—“The Company and Summary of Significant Accounting Policies” and Note 17—“Microsoft Search Agreement” for additional information.

Revenue is attributed to individual countries according to the online property that generated the revenue. No single foreign country accounted for more than 10 percent of the Company's revenue for the three or nine months ended September 30, 2015 and 2016.

## Note 17 Microsoft Search Agreement

On December 4, 2009, the Company entered into the Microsoft Search Agreement. On February 18, 2010, the Company received regulatory clearance from both the U.S. Department of Justice and the European Commission and on February 23, 2010 the Company commenced implementation of the Microsoft Search Agreement on a market-by-market basis.

On April 15, 2015, the Company and Microsoft entered into the Eleventh Amendment pursuant to which the terms of the Microsoft Search Agreement were amended. Previously under the Microsoft Search Agreement, Microsoft was the exclusive algorithmic and paid search services provider to Yahoo on personal computers for Yahoo Properties and for search services provided by Yahoo to Affiliate sites. Microsoft was the non-exclusive provider on mobile devices. Pursuant to the Eleventh Amendment, Microsoft will provide such services on a non-exclusive basis for Yahoo Properties and Affiliate sites on all devices. Commencing on May 1, 2015, Yahoo agreed to the Volume Commitment and displays only Microsoft's paid search results on such search result pages.

Prior to the Eleventh Amendment, the Company was entitled to receive the Revenue Share Rate with respect to revenue generated from paid search results on Yahoo Properties and on Affiliate sites after deduction of the Affiliate sites' share of revenue and certain Microsoft costs. The Revenue Share Rate was 88 percent for the first five years of the Microsoft Search Agreement and then increased to 90 percent on February 23, 2015. Pursuant to the Eleventh Amendment, the Revenue Share Rate increased to 93 percent, but Microsoft now receives its 7 percent revenue share before deduction of the Affiliate site's share of revenue. The Company is responsible for paying the Affiliate for the Affiliate site's share of revenue.

Additionally, pursuant to the Eleventh Amendment, the Company has the ability in response to queries on both personal computers and mobile devices to request algorithmic listings only, paid listings only or both algorithmic and paid listings from Microsoft. To the extent the Company requests algorithmic listings only or requests paid listings but elects not to display such paid listings, the Company pays Microsoft serving costs but not a revenue share. In other cases and with respect to the Volume Commitment, the Revenue Share Rate applies.

Previously under the Microsoft Search Agreement, Yahoo had sales exclusivity for both the Company's and Microsoft's premium advertisers. For reporting periods ending December 31, 2014 and 2015, and March 31, 2016, TAC related to the Company's Microsoft Search Agreement was recorded as a reduction to revenue. Pursuant to the Eleventh Amendment, the Company completed the transition of its exclusive sales responsibilities to Microsoft for Microsoft's paid search services to premium advertisers in the United States, Canada, and Europe on April 1, 2016 and in its remaining markets (other than Taiwan and Hong Kong) on June 1, 2016. Following the transition in each respective market, Yahoo is considered the principal in the sale of traffic to Microsoft and other customers because Yahoo is the primary obligor in its arrangements with Microsoft and has discretion in how search queries from Affiliate sites will be fulfilled and monetized. As a result, the amounts paid to Affiliates under the Microsoft Search Agreement in the transitioned markets are recorded as cost of revenue—TAC rather than as a reduction to GAAP revenue, resulting in GAAP revenue from the Microsoft Search Agreement being reported on a gross rather than net basis.

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Effective June 3, 2016, the Company and Microsoft further amended the Microsoft Search Agreement to provide that sales responsibilities for premium advertisers in Taiwan and Hong Kong will not be transitioned. TAC in those markets will continue to be reported as a reduction to revenue.

The term of the Microsoft Search Agreement is 10 years from its commencement date, February 23, 2010, subject to earlier termination as provided in the Microsoft Search Agreement. As October 1, 2015, either the Company or Microsoft may terminate the Microsoft Search Agreement by delivering a written notice of termination to the other party. The Microsoft Search Agreement will remain in effect for four months from the date of the termination notice to provide for a transition period; however, the Company's Volume Commitment will not apply in the third and fourth months of this transition period.

Approximately 33 percent and 39 percent of the Company's revenue for the three months ended September 30, 2015 and 2016, respectively, was attributable to the Microsoft Search Agreement, and approximately 36 percent of the Company's revenue for both the nine months ended September 30, 2015 and 2016 was attributable to the Microsoft Search Agreement. Commencing in the second quarter of 2016, TAC payments related to the Microsoft Search Agreement for transitioned markets, which previously would have been recorded as a reduction to revenue, began to be recorded as a cost of revenue due to a required change in revenue presentation. During the three and nine months ended September 30, 2016, \$258 million and \$510 million of GAAP revenue and cost of revenue—TAC, respectively, was due to the change in revenue presentation. See Note 1—"The Company and Summary of Significant Accounting Policies" for additional information on change in revenue presentation.

The Company's uncollected revenue share in connection with the Microsoft Search Agreement was \$267 million and \$335 million, which is included in accounts receivable, net, as of December 31, 2015 and September 30, 2016, respectively.

On December 4, 2009, in connection with entering into the Microsoft Search Agreement, the Company also entered into a License Agreement with Microsoft (as amended, the "License Agreement"). Under the License Agreement, Microsoft acquired an exclusive 10-year license to the Company's core search technology and has the ability to integrate this technology into its existing Web search platforms. Pursuant to the Eleventh Amendment, the exclusive licenses granted to Microsoft under the License Agreement became non-exclusive. The Company also agreed pursuant to the Eleventh Amendment to license certain sales tools to Microsoft to use solely in connection with Microsoft's paid search services pursuant to the terms of the License Agreement.

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

### Overview

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Yahoo! Inc., together with its consolidated subsidiaries (“Yahoo,” the “Company,” “we,” or “us”), is a guide to digital information discovery, focused on informing, connecting, and entertaining our users through our search, communications, and digital content products. By creating highly personalized experiences, we help users discover the information that matters most to them around the world — on mobile or desktop. We create value for advertisers with a streamlined, simple advertising technology stack that leverages Yahoo’s data, content, and technology to connect advertisers with their target audiences. Advertisers can build their businesses through advertising to targeted audiences on our online properties and services (“Yahoo Properties”) and a distribution network of third party entities (“Affiliates”) who integrate our advertising offerings into their websites or other offerings (“Affiliate sites”). Our revenue is generated principally from search and display advertising. We continue to manage and measure our business geographically, principally in the Americas, EMEA (Europe, Middle East, and Africa), and Asia Pacific. As of September 30, 2016, we had approximately 8,500 full-time employees and approximately 600 contractors.

In the following Management’s Discussion and Analysis, we provide information regarding the following areas:

- Recent Developments;
- Significant Transactions;
- Key Financial Metrics;
- Results of Operations;
- Segment Reporting;
- Liquidity and Capital Resources;
- Critical Accounting Policies and Estimates; and
- Recent Accounting Pronouncements.

### Recent Developments

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#### *Strategic Plan*

On February 2, 2016, we announced a strategic plan to simplify Yahoo, narrowing our focus on areas of strength to fuel growth, drive revenue, and increase efficiency in 2016 and beyond. This plan includes simplifying our product portfolio, reducing costs and exploring divestiture of non-core assets.

In the first half of 2016, we began simplifying our product portfolio and exited our Food, Health, Parenting, Makers, and Travel digital magazines, as well as our Autos, Games, Real Estate and Smart TV products, and focused on our core verticals (News, Sports, Finance and Lifestyle). In the nine months ended September 30, 2016, we substantially completed six planned office closures and reduced our workforce by 15 percent. Additionally, we completed the sale of our Santa Clara land and received \$246 million in net cash proceeds.

#### *Pending Sale of the Operating Business to Verizon Communications Inc.*

On July 23, 2016, we entered into a Stock Purchase Agreement (the “Stock Purchase Agreement”) with Verizon Communications Inc. (“Verizon”), pursuant to which we have agreed to sell, and Verizon has agreed to purchase (the “Sale”), all of the outstanding shares of Yahoo Holdings, Inc., a newly formed wholly-owned subsidiary of Yahoo (“Yahoo Holdings”) (and, if elected by Verizon, prior to the sale of Yahoo Holdings to cause Yahoo Holdings to sell to a foreign subsidiary of Verizon all of the equity interests in a foreign subsidiary of Yahoo Holdings that will hold certain foreign subsidiaries relating to the operating business), which, immediately prior to the consummation of the Sale, will own our operating business. The aggregate consideration to be paid to us by Verizon in connection with the Sale is \$4,825,800,000 in cash, subject to certain adjustments as provided in the Stock Purchase Agreement.

Concurrently with the execution of the Stock Purchase Agreement, we entered into a Reorganization Agreement (the “Reorganization Agreement”) with Yahoo Holdings, pursuant to which we will transfer to Yahoo Holdings prior to the consummation of the Sale all of our assets and liabilities relating to our operating business, other than specified excluded assets and retained liabilities, (the “Reorganization”). Upon completion of the Sale, Verizon will also receive for its benefit and that of its current and certain of its future affiliates, a non-exclusive, worldwide, perpetual, royalty-free license to certain intellectual property not core to the operating business held by Excalibur IP, LLC, a wholly-owned subsidiary of the Company (“Excalibur”), that is not being transferred to Yahoo Holdings with the operating business.

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The excluded assets include our cash and marketable securities as of the closing of the Sale, our shares in Alibaba Group and Yahoo Japan, certain other minority equity investments, and all of the equity in Excalibur. The retained liabilities will include the 0.00% Convertible Senior Notes due 2018 (“Notes”) we issued in November 2013, securityholder litigation, and certain director and officer indemnification obligations. Following the closing of the Sale, the excluded assets and retained liabilities will remain in Yahoo which will be renamed and will become an independent, publicly traded, management investment company registered under the Investment Company Act of 1940.

The closing of the Sale is subject to certain conditions, including, among others, the approval of the Sale by our stockholders, antitrust approvals, the closing of the Reorganization, and certain other customary closing conditions.

The Stock Purchase Agreement may be terminated by us or Verizon in certain circumstances. If the Stock Purchase Agreement is terminated, we may be required to pay Verizon a termination fee of \$144,774,000 in certain circumstances, including if we terminate the Stock Purchase Agreement to enter into a superior proposal satisfying certain requirements.

Under the terms of the Stock Purchase Agreement, each of our stock options outstanding immediately prior to the closing will, if not already vested, become fully vested as of the closing and will remain outstanding in accordance with its terms, and we will retain all liabilities and obligations with respect to such outstanding stock options. Each restricted stock unit (an “RSU”) of the Company that is outstanding immediately prior to the closing generally will be replaced with a cash-settled Verizon RSU award, and will be subject to the same vesting and other terms and conditions as the Yahoo RSUs.

The Sale is expected to close in the first quarter of 2017.

We filed a preliminary proxy statement regarding the Sale with the U.S. Securities and Exchange Commission on September 9, 2016.

## **Security Incident**

### *Description of Event*

On September 22, 2016, we disclosed that, based on an ongoing investigation, a copy of certain user account information for at least 500 million user accounts was stolen from Yahoo’s network in late 2014 (the “Security Incident”). We believe the user account information was stolen by a state-sponsored actor. The user account information taken included names, email addresses, telephone numbers, dates of birth, hashed passwords (the vast majority with bcrypt) and, in some cases, encrypted or unencrypted security questions and answers. Our investigation to date indicates that the stolen information did not include unprotected passwords, payment card data, or bank account information. Payment card data and bank account information are not stored in the system that the investigation found to be affected. Based on the investigation to date, we do not have evidence that the state-sponsored actor is currently in or accessing the Company’s network.

### *Investigation*

In late July 2016, a hacker claimed to have obtained certain Yahoo user data. After investigating this claim with the assistance of an outside forensic expert, the Company could not substantiate the hacker’s claim. Following this investigation, the Company intensified an ongoing broader review of the Company’s network and data security, including a review of prior access to the Company’s network by a state-sponsored actor that the Company had identified in late 2014. Based on further investigation with an outside forensic expert, the Company disclosed the Security Incident on September 22, 2016, and began notifying potentially affected users, regulators, and other stakeholders.

The Company, with the assistance of outside forensic experts, continues to investigate the Security Incident and related matters. The Company is actively working with U.S. law enforcement authorities on this matter.

As described above, the Company had identified that a state-sponsored actor had access to the Company’s network in late 2014. An Independent Committee of the Board, advised by independent counsel and a forensic expert, is investigating, among other things, the scope of knowledge within the Company in 2014 and thereafter regarding this access, the Security Incident, the extent to which certain users’ account information had been accessed, the Company’s security measures, and related incidents and issues.

In addition, the forensic experts are currently investigating certain evidence and activity that indicates an intruder, believed to be the same state-sponsored actor responsible for the Security Incident, created cookies that could have enabled such intruder to bypass the need for a password to access certain users’ accounts or account information.

Separately, on November 7, 2016, law enforcement authorities began sharing certain data that they indicated was provided by a hacker who claimed the information was Yahoo user account data. Yahoo will, with the assistance of its forensic experts, analyze and investigate the hacker’s claim that the data is Yahoo user account data.

### *Current and Future Expenses and Losses*

We recorded expenses of \$1 million related to the Security Incident in the quarter ended September 30, 2016. The Security Incident did not have a material adverse impact on our business, cash flows, financial condition, or results of operations for the quarter ended September 30, 2016. However, we have subsequently incurred expenses related to the

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Security Incident to investigate and take remedial actions to notify and protect our users, and expect to continue to incur investigatory, legal, and other expenses associated with the Security Incident in the foreseeable future. We will recognize and include these expenses as part of our operating expenses as they are incurred. The Company does not have cybersecurity liability insurance.

### *Litigation, Claims, and Governmental Investigations*

To date, 23 putative consumer class action lawsuits have been filed against the Company in U.S. federal and state courts, and in foreign courts relating to the Security Incident. The plaintiffs, who purport to represent various classes of users, generally claim to have been harmed by the Company's alleged actions and/or omissions in connection with the Security Incident and assert a variety of common law and statutory claims seeking monetary damages or other related relief. Additional lawsuits and claims related to the Security Incident may be asserted by or on behalf of users, partners, shareholders, or others seeking damages or other related relief.

In addition, the Company is cooperating with federal, state, and foreign governmental officials and agencies seeking information and/or documents about the Security Incident and related matters, including the U.S. Federal Trade Commission, the U.S. Securities and Exchange Commission, a number of State Attorneys General, and the U.S. Attorney's office for the Southern District of New York.

## Significant Transactions

### *Microsoft Search Agreement*

The term of the Search and Advertising Services and Sales Agreement ("Microsoft Search Agreement") with Microsoft Corporation ("Microsoft") is 10 years from its commencement date, February 23, 2010, subject to earlier termination as provided in the Microsoft Search Agreement. Under the current terms of the Microsoft Search Agreement, as amended on April 15, 2015 by the Eleventh Amendment to the Microsoft Search Agreement (the "Eleventh Amendment"), we are entitled to receive a percentage of the revenue (the "Revenue Share Rate") generated from Microsoft's services on Yahoo Properties and on Affiliate sites equal to 93 percent. Microsoft receives its 7 percent revenue share before deduction of the Affiliate site's share of revenue. Yahoo is responsible for paying the Affiliate for the Affiliate site's share of revenue. Pursuant to the Eleventh Amendment, commencing on May 1, 2015, we also agreed to request paid search results from Microsoft for 51 percent of our search queries originating from personal computers accessing Yahoo Properties and our Affiliate sites and will display only Microsoft's paid search results on such search result pages.

Traffic acquisition costs ("TAC") related to our Microsoft Search Agreement were recorded as a reduction to revenue through March 31, 2016. Pursuant to the Eleventh Amendment to the Microsoft Search Agreement, we completed the transition of our exclusive sales responsibilities to Microsoft for Microsoft's paid search services to premium advertisers in the United States, Canada, and Europe on April 1, 2016 and in the remaining markets (other than Taiwan and Hong Kong) on June 1, 2016. Following the transition in each respective market, we are considered the principal in the sale of traffic to Microsoft and other customers because we are the primary obligor in our arrangements with Microsoft and have discretion in how search queries from Affiliate sites will be fulfilled and monetized. As a result, amounts paid to Affiliates under the Microsoft Search Agreement in the transitioned markets are recorded as cost of revenue — TAC rather than as a reduction to revenue, resulting in GAAP revenue from the Microsoft Search Agreement being reported on a gross rather than a net basis.

Effective June 3, 2016, Yahoo and Microsoft further amended the Microsoft Search Agreement to provide that sales responsibilities for premium advertisers in Taiwan and Hong Kong will not be transitioned. TAC in those markets will continue to be reported as a reduction to revenue.

The table below presents how we accounted for amounts paid to Affiliates related to the Microsoft Search Agreement in transitioned markets, and shows the impact of the implementation of the Eleventh Amendment in transitioned markets (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Cost of revenue — TAC in transitioned markets (*)	\$ -	\$ 257,601	\$ -	\$ 509,932
Reduction to revenue in transitioned markets	\$ 299,710	\$ -	\$ 987,601	\$ 273,705

(\*) For the three months ended September 30, 2016, cost of revenue — TAC included \$222 million in the Americas segment, \$34 million in the EMEA segment and \$2 million in the Asia Pacific segment. For the nine months ended September 30, 2016, cost of revenue — TAC included \$440 million in the Americas segment, \$67 million in the EMEA segment and \$3 million in the Asia Pacific segment.

Revenue under the Microsoft Search Agreement represented approximately 33 percent and 39 percent of our revenue for the three months ended September 30, 2015 and 2016, respectively. The increase in revenue from Microsoft year-over-year is due to the change in revenue presentation related to the Eleventh Amendment that took place in the second quarter of 2016 for which we now account for amounts paid to Affiliates in transitioned markets as cost of

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revenue — TAC rather than as a reduction to GAAP revenue, resulting in revenue from the Microsoft Search Agreement being reported on a gross rather than net basis. This was partially offset by a shift in composition of revenue due to the use of Google and Gemini (our unified marketplace for search and native advertising on Yahoo Properties and Affiliate sites) to source search results and advertisements as allowed by the Eleventh Amendment.

Revenue under the Microsoft Search Agreement represented approximately 36 percent of our revenue for both the nine months ended September 30, 2015 and 2016.

See Note 17—“Microsoft Search Agreement” in the Notes to our condensed consolidated financial statements for additional information.

## Key Financial Metrics

The key financial metrics we use are as follows: revenue; revenue less traffic acquisition costs, or revenue ex-TAC; loss from operations; net income (loss) attributable to Yahoo! Inc.; adjusted EBITDA; net cash provided by (used in) operating activities; and free cash flow. Revenue ex-TAC, adjusted EBITDA, and free cash flow are financial measures that are not defined in accordance with U.S. generally accepted accounting principles (“GAAP”). We use these non-GAAP financial measures for internal managerial purposes and to facilitate period-to-period comparisons.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
	(in thousands)			
Revenue	\$ 1,225,673	\$ 1,305,206	\$ 3,694,908	\$ 3,699,995
Revenue ex-TAC	\$ 1,002,444	\$ 857,669	\$ 3,088,310	\$ 2,558,209
Loss from operations (1)	\$ (86,312)	\$ (52,319)	\$ (218,460)	\$ (709,209)
Net income (loss) attributable to Yahoo! Inc.	\$ 76,261	\$ 162,826	\$ 75,905	\$ (376,319)
Adjusted EBITDA	\$ 244,237	\$ 229,153	\$ 737,053	\$ 548,594
Net cash provided by (used in) operating activities	\$ 137,275	\$ 217,906	\$ (2,515,712)	\$ 993,604
Free cash flow (2)(3)	\$ 18,028	\$ 167,119	\$ (3,041,674)	\$ 889,960
(1) Includes:				
Stock-based compensation expense	\$ 110,426	\$ 128,892	\$ 351,252	\$ 369,263
Restructuring charges, net	\$ 26,012	\$ 9,962	\$ 96,932	\$ 86,576
Asset impairment charge	\$ 41,699	\$ -	\$ 41,699	\$ -
Goodwill impairment charge	\$ -	\$ -	\$ -	\$ 394,901
Intangible assets impairment charge	\$ -	\$ -	\$ -	\$ 87,335

(2) During the nine months ended September 30, 2015, we satisfied the \$3.3 billion income tax liability related to the sale of Alibaba Group Holding Limited (“Alibaba Group”) American Depositary Shares (“ADSs”) in September 2014.

(3) During the nine months ended September 30, 2016, we received net cash proceeds from the sale of land of \$246 million and a cash tax refund of \$190 million associated with our claim to carry back our 2015 losses and tax attributes to earlier taxable years.

**Revenue ex-TAC.** Revenue ex-TAC is a non-GAAP financial measure defined as GAAP revenue less TAC that has been recorded as a cost of revenue. TAC consists of payments made to Affiliates and payments made to companies that direct consumer and business traffic to Yahoo Properties. TAC is recorded either as a reduction to revenue or as cost of revenue.

**Adjusted EBITDA .** Adjusted EBITDA is a non-GAAP financial measure defined as net income (loss) attributable to Yahoo! Inc. before taxes, depreciation, amortization of intangible assets, stock-based compensation expense, other expense, net (which includes interest), earnings in equity interests, net income attributable to noncontrolling interests, and other gains, losses, and expenses that we do not believe are indicative of our ongoing results.

**Free Cash Flow.** Free cash flow is a non-GAAP financial measure defined as net cash provided by (used in) operating activities (adjusted to include excess tax benefits from stock-based awards), less acquisition of property and equipment, net (i.e., acquisition of property and equipment less proceeds received from disposition of property and equipment including land), and dividends received from equity investees.

For additional information about these non-GAAP financial measures, see “Non-GAAP Financial Measures” included in our Annual Report on Form 10-K for the year ended December 31, 2015 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

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In this Management's Discussion and Analysis, we also present adjusted GAAP revenue and cost of revenue — TAC amounts for the three and nine months ended September 30, 2016 that exclude the effect of the change in revenue presentation related to implementation of the Eleventh Amendment to the Microsoft Search Agreement. We believe providing this additional information to investors is useful because it provides investors with comparable revenue and cost of revenue — TAC measures for comparison to our historical reported financial information.

**Revenue and Revenue ex-TAC (a Non-GAAP Financial Measure)**

	Three Months Ended September 30,		% Change	Nine Months Ended September 30,		% Change
	2015	2016		2015	2016	
	(dollars in thousands)					
Revenue	\$ 1,225,673	\$ 1,305,206	6%	\$ 3,694,908	\$ 3,699,995	0%
Less: TAC	223,229	447,537	100%	606,598	1,141,786	88%
Revenue ex-TAC	\$ 1,002,444	\$ 857,669	(14)%	\$ 3,088,310	\$ 2,558,209	(17)%

For the three months ended September 30, 2016, revenue and TAC increased \$80 million and \$224 million, respectively, compared to the same period of 2015. For the three months ended September 30, 2016, revenue ex-TAC decreased \$145 million compared to the same period of 2015. The increase in revenue for the three months ended September 30, 2016 was primarily attributable to an increase in search revenue of \$187 million, partially offset by a decline in display and other revenue of \$35 million and \$73 million, respectively. The increase in search revenue was primarily due to the change in revenue presentation related to the implementation of the Eleventh Amendment to the Microsoft Search Agreement that took place in the second quarter of 2016 for which we now record amounts paid to Affiliates in transitioned markets as cost of revenue — TAC rather than as a reduction to GAAP revenue, resulting in revenue from the Microsoft Search Agreement being reported on a gross rather than net basis. The revenue and TAC increase from the change in revenue presentation was \$258 million for the three months ended September 30, 2016. See "Significant Transactions—Microsoft Search Agreement", above, for further detail. Excluding the impact of the change in revenue presentation, noted above, search revenue declined \$70 million, or 14 percent, primarily in the Americas segment due to a decline in Paid Clicks on Yahoo Properties and Affiliate sites driven by a decline in traffic, partially offset by improved pricing on Affiliate sites. The decline in display revenue was primarily due to a decline in revenue from Affiliate sites partially offset by an increase in revenue from Yahoo Properties. The decline in revenue from Affiliate sites was primarily driven by a decline in video advertising and, to a lesser extent, audience and native advertising. The increase in revenue from Yahoo Properties was primarily driven by an increase in audience advertising and, to a lesser extent, video advertising, partially offset by a decline in premium advertising. The decline in other revenue was primarily attributable to the completion of recognition of deferred revenue under the Technology and Intellectual Property License Agreement (the "TIPLA") with Alibaba Group pursuant to which we recognized \$60 million in the three months ended September 30, 2015 (for which no similar revenue was recognized in 2016), and a decline in listings-based revenue of \$8 million.

For the nine months ended September 30, 2016, revenue increased \$5 million and TAC increased \$535 million compared to the same period of 2015. For the nine months ended September 30, 2016, revenue ex-TAC decreased \$530 million, compared to the same period of 2015. The increase in revenue for the nine months ended September 30, 2016 was primarily attributable to an increase in search revenue of \$320 million, partially offset by declines in display revenue and other revenue of \$73 million and \$243 million, respectively. The increase in search revenue was primarily due to the change in revenue presentation related to the implementation of the Eleventh Amendment to the Microsoft Search Agreement, as noted above. The revenue and TAC increase from the change in revenue presentation was \$510 million for the nine months ended September 30, 2016. Excluding the impact of the change in revenue presentation, search revenue declined \$190 million, or 12 percent, primarily in the Americas segment due to a decline in Paid Clicks on Yahoo Properties and Affiliate sites driven by a decline in traffic, partially offset by an increase in Affiliate site revenue due to improved pricing. The decline in display revenue was primarily associated with a decline in revenue on Affiliate sites due to a decline in video advertising and, to a lesser extent, audience advertising, partially offset by an increase in native advertising. Additionally, display revenue on Yahoo Properties declined slightly for the nine months ended September 30, 2016 primarily due to a decline in premium advertising and, to a lesser extent, native advertising, partially offset by an increase in audience advertising. The decline in other revenue was primarily attributable to the completion of recognition of deferred revenue under the TIPLA with Alibaba Group pursuant to which we recognized \$199 million in the nine months ended September 30, 2015 (for which no similar revenue was recognized in 2016), and a decline in listings-based revenue of \$26 million.

Total revenue noted above included declines of \$21 million and \$56 million in revenue for the three and nine months ended September 30, 2016, respectively, as compared to the same periods of 2015, associated with the agreement we entered into with Mozilla Corporation ("Mozilla") in November 2014 to compensate Mozilla for making us the default search provider on certain of Mozilla's products in the United States. Total TAC noted above included declines of \$20 million in TAC for both the three and nine months ended September 30, 2016, as compared to the same periods of 2015, associated with an amendment to the agreement with Mozilla in the third quarter of 2016.

See "Results of Operations" for a more detailed discussion of the factors that contributed to the changes in revenue and TAC during these periods.

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We expect 2016 revenue to be slightly higher than the amount reported in 2015 primarily due to the change in revenue presentation related to the Microsoft Search Agreement. Excluding the impact of the change in revenue presentation related to the Microsoft Search Agreement, revenue is expected to decline from the amount reported in 2015 as a result of the completion of recognition of deferred revenue under the TIPLA with Alibaba Group, strategic product exits, declines in our legacy desktop display business and a decline in mobile and desktop search.

### *Mavens Revenue*

One of our primary strategies is to invest in and grow our Mavens offerings. Revenue from our Mavens offerings is generated from, without duplication, (i) mobile (as defined below), (ii) video ads and video ad packages, (iii) native ads, and (iv) Tumblr and Polyvore ads and fees.

Mavens revenue for the three months ended September 30, 2016 increased to \$524 million, compared to \$422 million for the three months ended September 30, 2015. Mavens revenue for the nine months ended September 30, 2016 increased to \$1,420 million, compared to \$1,189 million for the nine months ended September 30, 2015. The change in revenue presentation associated with the Eleventh Amendment to the Microsoft Search Agreement contributed \$127 million and \$246 million to Mavens revenue in the three and nine months ended September 30, 2016, respectively. Excluding the impact of the revenue presentation noted above, Mavens revenue would have been \$397 million and \$1,174 million, respectively, for the three and nine months ended September 30, 2016. For the three and nine months ended September 30, 2016, excluding the change in revenue presentation, Mavens revenue declined \$25 million, or 6 percent, and \$15 million, or 1 percent, respectively, compared to the same periods of 2015. This decline in Mavens revenue for the three months ended September 30, 2016 was primarily attributable to a decline in video advertising on Affiliate sites associated with pricing and demand. The decline in Mavens revenue for the nine months ended September 30, 2016 was primarily attributable to a decline in video advertising on Affiliate sites associated with pricing and demand, partially offset by an increase in mobile advertising and social advertising.

We expect our Mavens revenue to be higher in 2016 from the amount reported in 2015. Excluding the impact of the change in revenue presentation related to the Microsoft Search Agreement, Mavens revenue is expected to decline from the amount reported in 2015 based on trends observed through the third quarter of 2016.

### *Mobile Revenue*

With the significant platform shift to mobile devices, including smartphones and tablets, we continue to focus on mobile products and mobile ad formats. In the third quarter of 2016, we continued to refresh the user experience on mobile with the launch of Yahoo Newsroom, Yahoo View, and Yahoo Fantasy Sports apps. As of September 30, 2016, we had more than 600 million monthly mobile users (including mobile Tumblr users).

Mobile revenue is generated in connection with user activity on mobile devices, including smartphones and tablets (a “device-based” approach), regardless of whether the device is accessing a mobile-optimized service. Mobile revenue is primarily generated by search and display advertising. Mobile revenue also includes leads, listings and fees revenue and e-commerce revenue allocated to user activity on mobile devices. For additional information about how we generate and recognize mobile revenue, see “Key Financial Metrics — Revenue — Mobile Revenue” included in our Annual Report on Form 10-K for the year ended December 31, 2015 under the caption “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Mobile revenue for the three months ended September 30, 2016 increased to \$396 million, compared to \$271 million for the three months ended September 30, 2015. Mobile revenue for the nine months ended September 30, 2016 increased to \$1,035 million, compared to \$757 million for the nine months ended September 30, 2015. The change in revenue presentation associated with the Eleventh Amendment to the Microsoft Search Agreement contributed \$127 million and \$246 million to mobile revenue in the three and nine months ended September 30, 2016, respectively. Excluding the impact of the revenue presentation, noted above, mobile revenue would have been \$269 million and \$789 million, respectively, for the three and nine months ended September 30, 2016. For the three and nine months ended September 30, 2016, excluding the change in revenue presentation, mobile revenue decreased \$2 million, or 1 percent, and increased \$32 million, or 4 percent, respectively, compared to the same periods of 2015. The increase in mobile revenue for the nine months ended September 30, 2016 was primarily attributable to growth in native advertising as well as an increase in search advertising revenue (excluding the impact of the change in revenue presentation).

We expect our mobile revenue to be higher in 2016 from the amount reported in 2015. Excluding the impact of the change in revenue presentation related to the Microsoft Search Agreement, mobile revenue is expected to increase slightly from the amount reported in 2015 based on trends observed through the third quarter of 2016.

TAC rates that we pay to Affiliates for Mavens and mobile are substantially consistent with our TAC rates for our other revenue streams.

## Results of Operations

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
	(dollars in thousands)			
Total revenue	\$ 1,225,673	\$ 1,305,206	\$ 3,694,908	\$ 3,699,995
Total operating expenses (1)	1,311,985	1,357,525	3,913,368	4,409,204
Loss from operations	<u>\$ (86,312)</u>	<u>\$ (52,319)</u>	<u>\$ (218,460)</u>	<u>\$ (709,209)</u>
(1) Includes:				
Stock-based compensation expense	\$ 110,426	\$ 128,892	\$ 351,252	\$ 369,263
Restructuring charges, net	\$ 26,012	\$ 9,962	\$ 96,932	\$ 86,576
Asset impairment charge	\$ 41,699	\$ -	\$ 41,699	\$ -
Goodwill impairment charge	\$ -	\$ -	\$ -	\$ 394,901
Intangible assets impairment charge	\$ -	\$ -	\$ -	\$ 87,335
Items as a percentage of revenue:				
Total revenue	100%	100%	100%	100%
Total operating expenses	107%	104%	106%	119%
Loss from operations	<u>(7)%</u>	<u>(4)%</u>	<u>(6)%</u>	<u>(19)%</u>
Includes:				
Stock-based compensation expense	9%	10%	10%	10%

## Revenue

We generate revenue principally from search and display advertising on Yahoo Properties and Affiliate sites, with the majority of our revenue coming from advertising on Yahoo Properties. Our margins on revenue from advertising on Yahoo Properties are higher than our margins on revenue from advertising on Affiliate sites, as we pay TAC to our Affiliates. Additionally, we generate revenue from other sources including listings-based services, e-commerce transactions, royalties, patent licenses, and consumer and business fee-based services. For additional information about how we generate and recognize revenue, see "Results of Operations — Revenue — Search Revenue," "—Display Revenue," and "—Other Revenue" included in our Annual Report on Form 10-K for the year ended December 31, 2015, under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations."

In the first quarter of 2016, we reclassified certain amounts from other revenue to either search or display revenue. To conform to the current presentation, we reclassified \$6.4 million and \$2.7 million to search and display revenue, respectively, previously included in other revenue for the three months ended September 30, 2015, and we reclassified \$23.9 million and \$8.9 million to search and display revenue, respectively, previously included in other revenue for the nine months ended September 30, 2015.

### Search Revenue

The following table presents search revenue and search revenue as a percentage of total revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Search				
Yahoo Properties	\$ 441,979	\$ 456,370	\$ 1,397,961	\$ 1,343,967
Affiliate sites	73,862	246,760	188,187	562,540
Total search revenue	<u>\$ 515,841</u>	<u>\$ 703,130</u>	<u>\$ 1,586,148</u>	<u>\$ 1,906,507</u>
Search as a percentage of total revenue				
Yahoo Properties	36%	35%	38%	37%
Affiliate sites	6%	19%	5%	15%
Total search revenue	<u>42%</u>	<u>54%</u>	<u>43%</u>	<u>52%</u>

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Search revenue for the three and nine months ended September 30, 2016 increased \$187 million and \$320 million, respectively, compared to the same periods of 2015. The increase in search revenue was primarily due to the change in the revenue presentation associated with the Eleventh Amendment to the Microsoft Search Agreement that took place in the second quarter of 2016 for which we now record amounts paid to Affiliates in transitioned markets as cost of revenue — TAC rather than as a reduction to GAAP revenue, resulting in revenue from the Microsoft Search Agreement being reported on a gross rather than net basis. The revenue and TAC increase from the change in revenue presentation was \$258 million and \$510 million for the three and nine months ended September 30, 2016, respectively. See “Significant Transactions—Microsoft Search Agreement,” above, for further detail. Excluding the impact of the change in revenue presentation, noted above, search revenue for the three and nine months ended September 30, 2016 declined \$70 million, or 14 percent, and \$190 million, or 12 percent, respectively, primarily in the Americas segment due to a decline in Paid Clicks on Yahoo Properties and Affiliate sites driven by a decline in traffic. For the three and nine months ended September 30, 2016, despite the decline in Paid Clicks on Affiliate sites, advertising revenue on Affiliate sites grew by \$21 million and \$82 million, respectively (excluding the impact of the change in revenue presentation), from improved Price-per-Click in the Americas segment due to a significant reduction in lower monetizing Affiliate clicks as compared to the same periods of 2015.

*Display Revenue*

The following table presents display revenue and display revenue as a percentage of total revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
<b>Display</b>				
Yahoo Properties	\$ 349,636	\$ 384,054	\$ 1,069,260	\$ 1,063,954
Affiliate sites	161,720	92,209	412,362	344,864
Total display revenue	\$ 511,356	\$ 476,263	\$ 1,481,622	\$ 1,408,818
<b>Display as a percentage of total revenue</b>				
Yahoo Properties	29%	29%	29%	29%
Affiliate sites	13%	7%	11%	9%
Total display revenue	42%	36%	40%	38%

During the first quarter of 2016, we changed the account coding for certain transactions to properly reflect the allocation of display revenue between Yahoo Properties and Affiliate sites. Prior period amounts have been revised to conform to the current presentation, as follows: Yahoo Properties display revenue should have been \$357 million, \$363 million, \$350 million and \$421 million for the first, second, third and fourth quarters of 2015, respectively. Affiliate display revenue should have been \$110 million, \$140 million, \$162 million, and \$183 million for the first, second, third and fourth quarters of 2015, respectively.

Display revenue for the three months ended September 30, 2016 decreased \$35 million, or 7 percent, compared to the same period of 2015. The decline in display revenue for the three months ended September 30, 2016 was due to a decline on Affiliate sites of \$70 million, partially offset by an increase in advertising revenue from Yahoo Properties of \$35 million, respectively. The decline in revenue from Affiliate sites was primarily associated with a decline in video advertising due to declines in volume and pricing and, to a lesser extent, declines in volume of audience advertising and pricing of native advertising. The increase in revenue from Yahoo Properties was primarily associated with an increase in audience advertising due to increases in volume and pricing and, to a lesser extent, video advertising due to an increase in volume, which was partially offset by a decline in premium advertising driven by both volume and pricing declines.

Display revenue for the nine months ended September 30, 2016 decreased \$73 million, or 5 percent, compared to the same period of 2015. The decline in display revenue for the nine months ended September 30, 2016 was due to a decline on Yahoo Properties and Affiliate sites of \$5 million and \$67 million, respectively. The decline in revenue on Affiliate sites was primarily attributable to a decline in video advertising driven by volume and pricing declines and, to a lesser extent, audience advertising due to lower volume, partially offset by an increase in native advertising due to higher volume. The slight decline in display revenue on Yahoo Properties was primarily due to a decline in premium advertising and, to a lesser extent, native advertising, partially offset by an increase in audience advertising.

The total decrease in display revenue for the three and nine months ended September 30, 2016 described above included the impact of unfavorable foreign exchange fluctuations of \$4 million and \$18 million, respectively, for the three and nine months ended September 30, 2016, using the foreign currency exchange rates from the three and nine months ended September 30, 2015.

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## Other Revenue

The following table presents other revenue and other revenue as a percentage of total revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Other revenue	\$ 198,476	\$ 125,813	\$ 627,138	\$ 384,670
Other revenue as a percentage of total revenue	16%	10%	17%	10%

Other revenue for the three and nine months ended September 30, 2016 decreased \$73 million, or 37 percent, and \$242 million, or 39 percent, respectively, compared to the same periods of 2015. The decrease in other revenue was attributable to a decline in fees and listings-based revenue of \$64 million and \$8 million, respectively, for the three months ended September 30, 2016, and a decline in fees and listings-based revenue of \$216 million and \$26 million, respectively, for the nine months ended September 30, 2016. The decline in fees revenue was primarily due to the completion of recognition of deferred revenue under the TIPLA with Alibaba Group pursuant to which we recognized \$60 million and \$199 million, respectively, in the three and nine months ended September 30, 2015. The decline in listings-based revenue for the three and nine months ended September 30, 2016 was primarily attributable to partner agreements that ended in 2015 for which we have no similar revenue in 2016.

We expect other revenue to decline in 2016, as compared to 2015, as a result of completing the recognition of deferred revenue under the TIPLA with Alibaba Group in the third quarter of 2015, for which we no longer recognize associated fees revenue.

## Search and Display Metrics

We present information below regarding the number of "Paid Clicks" and "Price-per-Click" for search and the number of "Ads Sold" and "Price-per-Ad" for display. This information is derived from internal data.

"Paid Clicks" are defined as clicks by end-users on sponsored search listings (excluding native ad units, which are defined as display ads that appear in the content streams viewed by users) on Yahoo Properties and Affiliate sites. Advertisers generally pay for sponsored search listings on a per-click basis. "Search click-driven revenue" is gross search revenue (GAAP search revenue plus the related revenue share with third parties), excluding search revenue from Yahoo Japan. "Price-per-Click" is defined as search click-driven revenue divided by our total number of Paid Clicks.

"Ads Sold" consist of display ad impressions for paying advertisers on Yahoo Properties and Affiliate sites. "Price-per-Ad" is defined as display revenue from Yahoo Properties and Affiliate sites divided by our total number of Ads Sold. Our price and volume metrics for display are based on display revenue which we report on a gross basis (before TAC), and include data for graphical, sponsorship, and native ad units on Yahoo Properties and Affiliate sites.

We periodically review, refine and update our methodologies for monitoring, gathering, and counting number of Paid Clicks and Ads Sold and for calculating search click-driven revenue, Price-per-Click, and Price-per-Ad. Prior period amounts have been updated to conform to the current presentation.

### Search Metrics

For both the three and nine months ended September 30, 2016, Paid Clicks decreased 22 percent compared to the same periods of 2015, primarily due to a decline in Paid Clicks from Affiliate and Yahoo traffic, including on desktop.

For the three and nine months ended September 30, 2016, Price-per-Click increased 9 percent and 8 percent, respectively, compared to the same periods of 2015, due to a mix shift toward Yahoo Properties and higher monetizing Affiliate clicks, which resulted from a significant reduction in lower monetizing Affiliate clicks.

Search click-driven revenue declined 15 percent and 16 percent for the three and nine months ended September 30, 2016, respectively, as compared to the same periods of 2015, driven by the decline in traffic on Yahoo Properties.

### Display Metrics

For the three months ended September 30, 2016, the number of Ads Sold and Price-per-Ad decreased 5 percent and increased 1 percent, respectively, compared to the same period of 2015. The decline in number of Ads Sold was primarily attributable to a decline in premium Ads Sold on Yahoo Properties. The increase in Price-per-Ad was primarily due to an increase in pricing of audience ads on both Yahoo Properties and Affiliate sites, offset by a decline in overall pricing of premium, video and native ad units sold.

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For the nine months ended September 30, 2016, the number of Ads Sold and Price-per-Ad increased 4 percent and decreased 7 percent, respectively, compared to the same period of 2015. The increase in number of Ads Sold was primarily due to an increase in native and audience Ads Sold, partially offset by a decline in premium Ads Sold. Native Ads Sold grew primarily due to our syndication (third-party, affiliate) business and an increase in native Ads Sold internationally. The decrease in Price-per-Ad was primarily due to a decline in overall pricing of premium, video and native ads units sold, partially offset by an increase in pricing of audience Ads Sold on both Yahoo Properties and Affiliate sites.

Native ad units represented approximately 46 percent of total Ads Sold for both the three and nine months ended September 30, 2016 compared to 45 percent and 42 percent of total Ads Sold for the three and nine months ended September 30, 2015, respectively.

## Operating Costs and Expenses

### Cost of Revenue — TAC

TAC consists of payments made to third-party entities that have integrated our advertising offerings into their Websites or other offerings and payments made to companies that direct consumer and business traffic to Yahoo Properties. We also have an agreement to compensate Mozilla to make us the default search provider on certain of Mozilla's products in the United States. We record those payments as cost of revenue — TAC.

The following table presents cost of revenue — TAC and those expenses as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Cost of revenue — TAC	\$ 223,229	\$ 447,537	\$ 606,598	\$ 1,141,786
Cost of revenue — TAC as a percentage of revenue	18%	34%	16%	31%

Cost of revenue — TAC for the three and nine months ended September 30, 2016 increased \$224 million and \$535 million, respectively, compared to the same periods of 2015, primarily due to the change in revenue presentation related to the implementation of the Eleventh Amendment to the Microsoft Search Agreement that took place in the second quarter of 2016 for which we now record amounts paid to Affiliates in transitioned markets as cost of revenue — TAC rather than as a reduction to GAAP revenue, resulting in revenue from the Microsoft Search Agreement being reported on a gross rather than net basis. The revenue and TAC increase from the change in revenue presentation was \$258 million and \$510 million for the three and nine months ended September 30, 2016, respectively. See "Significant Transactions—Microsoft Search Agreement" above for further detail. For the three and nine months ended September 30, 2016, excluding the impact of the change in revenue presentation, TAC decreased \$33 million, or 15 percent, and increased \$25 million, or 4 percent, respectively. The decline in TAC excluding the impact of the change in revenue presentation for the three months ended September 30, 2016 was primarily due to a decline in display TAC, partially offset by an increase in search TAC from Google and Gemini. The remaining increase in cost of revenue — TAC for the nine months ended September 30, 2016 was attributable to an increase in search TAC from Google and Gemini, partially offset by a decrease in display TAC. Additionally, search TAC for the three and nine months ended September 30, 2016 was impacted by a \$20 million decline associated with an amendment to our agreement with Mozilla.

### Cost of Revenue — Other

Cost of revenue — other consists of bandwidth costs, stock-based compensation, content and other expenses associated with the production and usage of Yahoo Properties, including content expense and amortization of developed technology and patents. Cost of revenue — other also includes costs for Yahoo's technology platforms and infrastructure, including depreciation expense and other operating costs, directly related to revenue generating activities.

The following table presents cost of revenue — other and those expenses as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Cost of revenue — other	\$ 302,846	\$ 255,421	\$ 884,041	\$ 806,491
Cost of revenue — other as a percentage of revenue	25%	20%	24%	22%

Cost of revenue — other for the three months ended September 30, 2016 decreased \$47 million, or 16 percent, compared to the same period of 2015, primarily due to declines in content expense of \$19 million, depreciation and amortization expense of \$9 million, compensation costs of \$7 million, credit card costs of \$4 million, and lower cost of revenue of \$5 million related to a decline in algorithmic serving costs partially offset by an increase in costs associated with specialized ad campaigns, fraud prevention and ad verification fees. The decline in content expense was primarily due to original content production costs in 2015 for which we have no similar costs in 2016.

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Cost of revenue — other for the nine months ended September 30, 2016 decreased \$78 million, or 9 percent, compared to the same period of 2015. The decrease for the nine months ended September 30, 2016, compared to 2015, was primarily due to declines in content expense of \$38 million, compensation costs of \$21 million, credit card costs of \$15 million, partially offset by increases in other cost of revenue of \$5 million related to an increase in costs associated with specialized ad campaigns, fraud prevention and ad verification fees partially offset by lower algorithmic serving costs. The decline in content expense primarily due to original content production costs in 2015 for which we have no similar costs in 2016.

### Sales and Marketing

Sales and marketing expenses consist primarily of advertising and other marketing-related expenses, compensation-related expenses (including stock-based compensation expense), sales commissions, and travel costs.

The following table presents sales and marketing expenses and those expenses as a percentage of revenue for the periods presented (dollars in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2015</u>	<u>2016</u>	<u>2015</u>	<u>2016</u>
Sales and marketing expenses	\$ 274,329	\$ 212,654	\$ 823,990	\$ 674,711
Sales and marketing expenses as a percentage of revenue	22%	16%	22%	18%

Sales and marketing expenses for the three months ended September 30, 2016 decreased \$62 million, or 22 percent, compared to the same period of 2015, primarily due to declines in compensation costs of \$25 million, marketing and public relations expense of \$23 million, and bad debt expense of \$9 million. The decline in compensation costs was primarily attributable to a 22 percent decrease in headcount year-over-year, as well as a decline in commissions. The decline in marketing and public relations expense was primarily attributable to brand marketing campaigns in 2015 for which there were no similar campaigns in 2016. The decline in bad debt expense reflected improved collections of total and aged accounts receivable balances.

Sales and marketing expenses for the nine months ended September 30, 2016 decreased \$149 million, or 18 percent, compared to the same period of 2015, primarily due to declines in compensation costs of \$72 million, marketing and public relations expense of \$43 million, bad debt expense of \$10 million, travel and entertainment expense of \$8 million, and outside service provider expense of \$7 million. The decline in compensation costs was primarily attributable to a 22 percent decrease in headcount year-over-year, as well as a decline in commissions. The decline in marketing and public relations expense was primarily attributable to brand marketing campaigns in 2015 for which there were no similar campaigns in 2016. The decline in bad debt expense reflected improved collections of total and aged accounts receivable balances.

### Product Development

Product development expenses consist primarily of compensation-related expenses (including stock-based compensation expense) incurred for the development of, enhancements to and maintenance of Yahoo Properties, research and development, and Yahoo's technology platforms and infrastructure. Depreciation expense and other operating costs are also included in product development.

The following table presents product development expenses and those expenses as a percentage of revenue for the periods presented (dollars in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2015</u>	<u>2016</u>	<u>2015</u>	<u>2016</u>
Product development expenses	\$ 272,285	\$ 243,644	\$ 905,460	\$ 801,708
Product development expenses as a percentage of revenue	22%	19%	25%	22%

Product development expenses for the three months ended September 30, 2016 decreased \$29 million, or 11 percent, compared to the same period of 2015, primarily attributable to declines in depreciation and amortization expense of \$20 million, compensation costs of \$18 million, partially offset by an increase in stock-based compensation expense of \$8 million. The decline in depreciation and amortization expense is primarily associated with a decrease in depreciation from capitalized labor. The decline in compensation costs is primarily attributable to a 20 percent decline in headcount year-over-year. The increase in stock-based compensation expense was primarily due to higher expense in the current year related to retention grants and performance equity awards.

Product development expenses for the nine months ended September 30, 2016 decreased \$104 million, or 11 percent, compared to the same period of 2015, primarily attributable to declines in compensation costs of \$72 million, depreciation and amortization expense of \$53 million, and facilities and equipment expense of \$13 million. These declines were partially offset by an increase in stock-based compensation expense of \$16 million, and an increase of \$13 million related to product initiatives to drive search volume. The decline in compensation costs is primarily attributable to a 20 percent decline in headcount year-over-year. The decline in depreciation and amortization expense is primarily associated with a decrease in depreciation from capitalized labor. The increase in stock-based compensation expense was primarily due to higher expense in the current year related to retention grants and performance equity awards.

[Table of Contents](#)**General and Administrative**

General and administrative expenses consist primarily of compensation-related expenses (including stock-based compensation expense) related to other corporate departments and fees for professional services.

The following table presents general and administrative expenses and those expenses as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
General and administrative expenses	\$ 151,963	\$ 176,713	\$ 506,071	\$ 490,519
General and administrative expenses as a percentage of revenue	12%	14%	14%	13%

General and administrative expenses for the three months ended September 30, 2016 increased \$25 million, or 16 percent, compared to the same period of 2015, primarily attributable to increases in outside service provider expense of \$24 million (including advisory fees) and stock-based compensation expense of \$7 million, partially offset by a decline in facilities and equipment expense of \$7 million.

General and administrative expenses for the nine months ended September 30, 2016 decreased \$16 million, or 3 percent, compared to the same period of 2015, primarily attributable to declines in compensation costs of \$23 million, facilities and equipment expense of \$19 million, and travel and entertainment expense of \$6 million, partially offset by an increase in outside service provider expense of \$30 million (including advisory fees). The decline in compensation costs was primarily attributable to a 15 percent decline in headcount year-over-year.

**Amortization of Intangibles**

We have purchased, and may continue purchasing, assets and/or businesses, which may include the purchase of intangible assets. Intangible assets include customer, affiliate, and advertiser-related relationships and tradenames, trademarks and domain names. Amortization of developed technology and patents is included in the cost of revenue — other and not in amortization of intangibles.

The following table presents amortization of intangibles and those expenses as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Amortization of intangibles	\$ 19,622	\$ 11,594	\$ 59,677	\$ 46,736
Amortization of intangibles as a percentage of revenue	2%	1%	2%	1%

Amortization of intangibles for the three and nine months ended September 30, 2016 decreased \$8 million, or 41 percent, and \$13 million, or 22 percent, respectively, compared to the same periods of 2015, driven primarily by a decline in amortizable Tumblr assets as a result of the impairment recorded in the second quarter of 2016.

**Gain on Sale of Patents and Land**

The following table presents gain on sale of patents and land and those gains as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Gain on sale of patents and land	\$ —	\$ —	\$ (11,100)	\$ (121,559)
Gain on sale of patents and land as a percentage of revenue	0%	0%	0%	(3)%

During the three months ended September 30, 2016 and 2015, we did not have any patent or land sales.

During the nine months ended September 30, 2016, we sold certain property located in Santa Clara, California and recorded a gain on sale of land of \$120 million. See Note 4—“Acquisitions and Dispositions” in the Notes to our condensed consolidated financial statements for additional information. Also, during the nine months ended September 30, 2016, we sold certain patents and recorded gain on sale of patents of approximately \$2 million. During the nine months ended September 30, 2015, we sold certain patents and recorded gain on sale of patents of approximately \$11 million.

[Table of Contents](#)**Asset Impairment Charge**

The following table presents asset impairment charge and those charges as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Asset impairment charge	\$ 41,699	\$ —	\$ 41,699	\$ —
Asset impairment charge as a percentage of revenue	4%	0%	1%	0%

During the three and nine months ended September 30, 2015, we recorded an asset impairment charge of \$14 million related to originally developed content equal to the amount by which the unamortized cost of the originally developed content exceeded its estimated fair value and \$28 million for acquired content equal to the amount by which the unamortized cost of the acquired content exceeded its net realizable value. This content included programming such as Community and Sin City Saints.

**Goodwill Impairment Charge**

The following table presents goodwill impairment charge and those charges as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Goodwill impairment charge	\$ —	\$ —	\$ —	\$ 394,901
Goodwill impairment charge as a percentage of revenue	0%	0%	0%	11%

After recording the goodwill impairment charge as of October 31, 2015, for Tumblr during the fourth quarter of 2015, the fair value of the Tumblr reporting unit approximated its carrying value. As such, any significant unfavorable changes in the forecast would result in the fair value being less than the carrying value. Subsequent to the most recent annual goodwill impairment assessment performed as of October 31, 2015, we have continued to monitor the actual performance of our reporting units. During the three months ended June 30, 2016, we determined that there were indicators present to suggest that it was more likely than not that the fair value of the Tumblr reporting unit was less than its carrying amount. The significant changes for the Tumblr reporting unit subsequent to the annual goodwill impairment test performed as of October 31, 2015 included a decline in the 2016 and beyond forecasted revenue, operating income and cash flows.

As mentioned above, we recorded goodwill impairment charges in the Tumblr reporting unit during the second quarter of 2016. It is reasonably possible that future changes in judgments, assumptions and estimates we made in assessing the fair value of goodwill could cause us to consider some portion or all of the remaining goodwill of the Tumblr reporting unit to become impaired. For example, a future decline in market conditions, changes in our market share, and/or other factors could negatively impact the estimated future cash flows and discount rates used in the income approach to determine the fair value of the Tumblr reporting unit and could result in one or more additional impairment charges in the future.

During the nine months ended September 30, 2016, we recorded a goodwill impairment charge of \$395 million. See Note 5—"Goodwill" in the Notes to our condensed consolidated financial statements for additional information.

**Intangible Assets Impairment Charge**

The following table presents intangible assets impairment charge and those charges as a percentage of revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Intangible assets impairment charge	\$ —	\$ —	\$ —	\$ 87,335
Intangible assets impairment charge as a percentage of revenue	0%	0%	0%	2%

During the second quarter of 2016, we reviewed our Tumblr asset group for impairment as there were events and changes in circumstances that indicated that the carrying value of the long-lived assets may not be recoverable. As a result, we performed a quantitative test comparing the fair value of the Tumblr long-lived assets with the carrying amounts and recorded an impairment charge of \$87 million associated with its definite-lived intangible assets, which were included within customer, affiliate, and advertiser related relationships and tradenames, trademarks, and domain names. See Note 6—"Intangible Assets, Net" in the Notes to our condensed consolidated financial statements for additional information.

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**Restructuring Charges, Net**

Restructuring charges, net was comprised of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Employee severance pay and related costs	\$ 16,597	\$ 6,772	\$ 67,746	\$ 56,620
Non-cancelable lease, contract termination, and other charges	11,103	4,368	33,123	24,302
Reversals of previous charges	(2,590)	(1,029)	(6,611)	(2,947)
Non-cash accelerations of stock-based compensation expense	—	—	2,705	7,374
Other non-cash (credits) charges, net	902	(149)	(31)	1,227
Restructuring charges, net	\$ 26,012	\$ 9,962	\$ 96,932	\$ 86,576

We have implemented various restructuring plans to reduce our cost structure, align resources with our product strategy and improve efficiency, which have resulted in workforce reductions and the consolidation of certain real estate facilities and data centers. For the three months ended September 30, 2016, we recorded expense of \$5 million and \$5 million related to the Americas and EMEA segments, respectively. For the three months ended September 30, 2015, we recorded expense of \$9 million and \$17 million related to the Americas and EMEA segments, respectively. For the nine months ended September 30, 2016, we recorded expense of \$65 million, \$18 million, and \$4 million related to the Americas, EMEA, and Asia Pacific segments, respectively. For the nine months ended September 30, 2015, we recorded expense of \$62 million, \$31 million, and \$4 million related to the Americas, EMEA, and Asia Pacific segments, respectively.

The amounts recorded during the three and nine months ended September 30, 2016 were primarily related to the plans we announced in February 2016 to reduce our workforce by approximately 15 percent by the end of 2016 and exit six offices in Dubai, Mexico City, Buenos Aires, Madrid, Milan and Burbank, California, subject to applicable laws and consultation processes, as a part of the strategic plan to simplify our product portfolio. During the three months ended September 30, 2016, in connection with this action, we incurred pre-tax cash charges of \$1 million for severance pay expenses and related cash expenditures and pre-tax cash charges of \$1 million related to the consolidation and exit of facilities related to non-cancelable lease costs and other related costs. During the nine months ended September 30, 2016, in connection with this action, we incurred pre-tax cash charges of \$47 million for severance pay expenses and related cash expenditures, pre-tax cash charges of \$17 million related to the consolidation and exit of facilities related to non-cancelable lease costs and other related costs, pre-tax non-cash charges of \$7 million related to stock-based compensation expense and less than \$1 million related to impairment costs. The amounts recorded during the three and nine months ended September 30, 2015 were primarily related to severance, facility and other related costs pursuant to a restructuring plan that we initiated in 2015.

The \$54 million restructuring liability as of September 30, 2016 consisted of \$8 million for employee severance pay expenses, which we expect to pay out by the end of the second quarter of 2017, and \$46 million relating to non-cancelable lease costs, which we expect to pay over the terms of the related obligations through the fourth quarter of 2025, less estimated sublease income.

See Note 14—"Restructuring Charges, Net" in the Notes to our condensed consolidated financial statements for additional information.

**Other Expense, Net**

Other expense, net was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Interest and investment income	\$ 8,010	\$ 17,013	\$ 24,888	\$ 42,534
Interest expense	(18,411)	(18,513)	(53,540)	(55,238)
Loss on Hortonworks warrants	(12,782)	(8,493)	(19,241)	(49,930)
Foreign exchange (loss) gain	(1,490)	3,180	(21,017)	22,006
Other	718	691	2,151	2,152
Total other expense, net	\$ (23,955)	\$ (6,122)	\$ (66,759)	\$ (38,476)

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Interest and investment income increased \$9 million and \$18 million for the three and nine months ended September 30, 2016, respectively, compared to the same periods of 2015, primarily due to an increase in interest income.

Interest expense was flat and increased \$2 million for the three and nine months ended September 30, 2016, respectively, compared to the same periods of 2015. Interest expense is primarily related to the accreted non-cash interest expense related to the Notes we issued in November 2013.

During the three and nine months ended September 30, 2016, we recorded losses of \$8 million and \$50 million, respectively, due to the decline in fair value of the Hortonworks warrants.

Foreign exchange gain (loss) consists of foreign exchange gains and losses due to re-measurement of monetary assets and liabilities denominated in non-functional currencies, and unrealized and realized foreign currency transaction gains and losses, including gains and losses related to balance sheet hedges. The foreign exchange gain in the three and nine months ended September 30, 2016 compared to the foreign exchange loss in the three and nine months ended September 30, 2015 is attributable to the write off of foreign currency translation adjustments associated with liquidation of foreign subsidiaries.

Other consists of gains from other non-operational items.

## **Income Taxes**

Our effective tax rate is the result of the mix of income earned in various tax jurisdictions that apply a broad range of income tax rates. Historically, our provision for income taxes has differed from the tax computed at the U.S. federal statutory income tax rate due to state taxes, the effect of non-U.S. operations, non-deductible stock-based compensation expense and adjustments to unrecognized tax benefits.

We recorded an income tax benefit of \$93 million and \$106 million for the three months ended September 30, 2015 and 2016, respectively. We recorded an income tax benefit of \$76 million and \$125 million for the nine months ended September 30, 2015 and 2016, respectively. For the three and nine months ended September 30, 2015, the income tax benefit was primarily a result of our loss before income taxes and earnings in equity interests. The income tax benefit for the three months ended September 30, 2016 included tax expense associated with our intention to repatriate earnings from our wholly-owned foreign subsidiaries, offset by the benefit of foreign tax credits and our loss before income taxes and earnings in equity interest. In addition, our tax benefit for the nine months ended September 30, 2016 also included tax expenses associated with gain from sale of our real estate property in Santa Clara, California, offset by tax benefits from Tumblr intangible assets impairment charge.

As of September 30, 2016, we intend to repatriate cumulative and future earnings from our wholly-owned foreign subsidiaries. The tax implications of this repatriation (namely a \$149 million increase to U.S. taxable income with an associated \$66 million U.S. tax credit for foreign income taxes that have been paid on such earnings) have been included in our income tax benefit for the three and nine months ended September 30, 2016. As of September 30, 2016, we do not have a plan to repatriate approximately \$3.1 billion of earnings related to our equity method investment in Yahoo Japan. If those earnings were to be repatriated in the future, we may be subject to additional U.S. income taxes (subject to an adjustment for foreign tax credits). It is not practicable to determine the income tax liability that might be incurred if these earnings were to be repatriated.

In the first quarter of 2016, we received a cash tax refund of \$190 million associated with our claim to carry back 2015 losses and tax attributes to earlier taxable years.

Our gross amount of unrecognized tax benefits as of September 30, 2016 was \$1.1 billion, of which \$1.0 billion is recorded on our condensed consolidated balance sheets. The gross unrecognized tax benefits as of September 30, 2016 decreased by \$8 million from the recorded balance as of December 31, 2015. The decrease mainly related to audit settlements for prior tax years.

We are in various stages of examination and appeal in connection with our taxes both in the United States and in foreign jurisdictions. Those audits generally span tax years 2005 through 2014. As of September 30, 2016, our 2011 through 2013 U.S. federal income tax returns are currently under examination. We have appealed the proposed California Franchise Tax Board's adjustments to the 2005 through 2008 returns, but no conclusions have been reached to date. While it is difficult to determine when the examinations will be settled or their final outcomes, certain examinations in various jurisdictions are expected to be resolved in the foreseeable future. We believe that we have adequately provided for any reasonably foreseeable adverse adjustment to our tax returns and that any settlement will not have a material adverse effect on our consolidated financial position, results of operations, or cash flows. It is reasonably possible that our unrecognized tax benefits could be reduced by up to approximately \$24 million in the next twelve months.

In the first quarter of 2015, we satisfied the \$3.3 billion income tax liability related to the sale by Yahoo! Hong Kong Holdings Limited, our wholly-owned subsidiary, of Alibaba Group ADSs in the Alibaba Group IPO on September 24, 2014. As of September 30, 2016, we accrued deferred tax liabilities of \$16.4 billion associated with the Alibaba Group shares that we retained. Such deferred tax liabilities will be subject to periodic adjustments due to changes in the fair value of the Alibaba Group shares.

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We may have additional tax liabilities in China related to the sale to Alibaba Group of 523 million Alibaba Group shares that took place during the year ended December 31, 2012 and related to the sale of 140 million Alibaba Group ADSs sold in the Alibaba Group IPO that took place during the year ended December 31, 2014. Any taxes assessed and paid in China are expected to be ultimately offset and recovered in the United States through the use of foreign tax credits.

Tax authorities from the Brazilian State of Sao Paulo have assessed certain indirect taxes against our Brazilian subsidiary, Yahoo! do Brasil Internet Ltda., related to online advertising services. The assessment is for calendar years 2008 through 2011 and, translated into U.S. dollars as of September 30, 2016, totals approximately \$115 million. We currently believe the assessment is without merit. We believe the risk of loss is remote and have not recorded an accrual for the assessment.

## **Earnings in Equity Interests**

We record our share of the results of earnings in equity interests, including tax impacts, one quarter in arrears, within earnings in equity interests in the condensed consolidated statements of operations.

The following table presents earnings in equity interests for the periods presented (in thousands):

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2015</u>	<u>2016</u>	<u>2015</u>	<u>2016</u>
Earnings in equity interests	\$ 95,195	\$ 116,228	\$ 290,726	\$ 249,579

Earnings in equity interests for the three and nine months ended September 30, 2016 increased \$21 million and decreased \$41 million, respectively, compared to the same periods of 2015. See Note 8—"Investments in Equity Interests Using the Equity Method of Accounting" in the Notes to our condensed consolidated financial statements for additional information.

## **Noncontrolling Interests**

Noncontrolling interests represent the noncontrolling holders' percentage share of income or losses from the subsidiaries in which we hold a majority, but less than 100 percent, ownership interest and the results of which are consolidated in our condensed consolidated financial statements. Noncontrolling interests recorded in the three and nine months ended September 30, 2015 and 2016 were related to the Yahoo!7 venture in Australia and New Zealand.

## **Net Income (Loss) Attributable to Yahoo! Inc.**

Net income attributable to Yahoo! Inc. for the three months ended September 30, 2016 increased \$87 million to \$163 million, primarily attributable to an increase in earnings in equity interests and decreases in sales and marketing expense, cost of revenue — other, product development, restructuring charges, net, other expense, net and a decline in cost of revenue — TAC (excluding the impact of the change in revenue presentation associated with the Eleventh Amendment). Additionally, there were no asset impairment charges in the three months ended September 30, 2016 for which we recorded such expenses in 2015. This was partially offset by a decrease in revenue (excluding the impact of the change in revenue presentation associated with the Eleventh Amendment) and an increase in general and administrative expenses.

Net loss attributable to Yahoo! Inc. for the nine months ended September 30, 2016 was \$376 million, a decline of \$452 million compared to the same period of 2015, primarily attributable to a decrease in revenue (excluding the impact of the change in revenue presentation associated with the Eleventh Amendment), goodwill and intangible assets impairment charges, and, to a lesser extent, a decline in earnings in equity interests and an increase in cost of revenue — TAC (excluding the impact of the change in revenue presentation associated with the Eleventh Amendment). This was partially offset by a gain on sale of land, declines in sales and marketing, product development expense and cost of revenue — other and, to a lesser extent, declines in asset impairment charge and other expense, net, and an increase in benefit for income taxes.

**Adjusted EBITDA (a Non-GAAP Financial Measure)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
	(dollars in thousands)			
Net income (loss) attributable to Yahoo! Inc.	\$ 76,261	\$ 162,826	\$ 75,905	\$ (376,319)
Advisory fees	—	27,150	8,000	51,427
Gain on sale of land	—	—	—	(120,059)
Depreciation and amortization	152,412	115,468	457,630	388,360
Stock-based compensation expense	110,426	128,892	351,252	369,263
Asset impairment charge	41,699	—	41,699	—
Goodwill impairment charge	—	—	—	394,901
Intangible assets impairment charge	—	—	—	87,335
Restructuring charges, net	26,012	9,962	96,932	86,576
Other expense, net	23,955	6,122	66,759	38,476
Benefit for income taxes	(93,208)	(105,513)	(75,613)	(124,736)
Earnings in equity interests, net of tax	(95,195)	(116,228)	(290,726)	(249,579)
Net income attributable to noncontrolling interests	1,875	474	5,215	2,949
Adjusted EBITDA	<u>\$ 244,237</u>	<u>\$ 229,153</u>	<u>\$ 737,053</u>	<u>\$ 548,594</u>
Net income (loss) attributable to Yahoo! Inc. as a percentage of revenue	<u>6%</u>	<u>12%</u>	<u>2%</u>	<u>(10)%</u>
Adjusted EBITDA as a percentage of revenue ex-TAC (1)	<u>24%</u>	<u>27%</u>	<u>24%</u>	<u>21%</u>

(1) Revenue ex-TAC is calculated as GAAP revenue less cost of revenue — TAC.

For the three and nine months ended September 30, 2016, adjusted EBITDA decreased \$15 million, or 6 percent, and \$188 million or 26 percent, compared to the same periods of 2015, mainly due to a decline in revenue ex-TAC (as described above) partially offset by a decline in global operating costs as well as a decline in direct costs across the segments, as described in “Segment Reporting” below.

Revenue ex-TAC, as noted above, was impacted by the completion of recognition of deferred revenue under the TIPLA with Alibaba Group in the third quarter of 2015 for which no similar revenue was recognized in the three or nine months ended September 30, 2016.

## Segment Reporting

We continue to manage our business geographically. The primary areas of measurement and decision-making are currently the Americas, EMEA, and Asia Pacific. Management relies on an internal reporting process that provides revenue, revenue ex-TAC, direct costs excluding TAC by segment, and consolidated loss from operations for making decisions related to the evaluation of the financial performance of, and allocating resources to, our segments.

	<b>Three Months Ended September 30,</b>		<b>Percent Change</b>	<b>Nine Months Ended September 30,</b>		<b>Percent Change</b>
	<b>2015</b>	<b>2016</b>		<b>2015</b>	<b>2016</b>	
<b>(dollars in thousands)</b>						
<b>Revenue by segment (1) :</b>						
Americas	\$ 987,374	\$ 1,058,416	7%	\$ 2,964,305	\$ 2,975,023	0%
EMEA	79,614	98,654	24%	246,530	278,711	13%
Asia Pacific	158,685	148,136	(7)%	484,073	446,261	(8)%
Total revenue	<u>\$ 1,225,673</u>	<u>\$ 1,305,206</u>	6%	<u>\$ 3,694,908</u>	<u>\$ 3,699,995</u>	0%
<b>TAC by segment (1) :</b>						
Americas	\$ 201,855	\$ 394,838	96%	\$ 549,332	\$ 1,012,903	84%
EMEA	12,745	41,948	229%	37,399	96,787	159%
Asia Pacific	8,629	10,751	25%	19,867	32,096	62%
Total TAC	<u>\$ 223,229</u>	<u>\$ 447,537</u>	100%	<u>\$ 606,598</u>	<u>\$ 1,141,786</u>	88%
<b>Revenue ex-TAC by segment:</b>						
Americas	\$ 785,519	\$ 663,578	(16)%	\$ 2,414,973	\$ 1,962,120	(19)%
EMEA	66,869	56,706	(15)%	209,131	181,924	(13)%
Asia Pacific	150,056	137,385	(8)%	464,206	414,165	(11)%
Total revenue ex-TAC	<u>1,002,444</u>	<u>857,669</u>	(14)%	<u>3,088,310</u>	<u>2,558,209</u>	(17)%
<b>Direct costs by segment (2) :</b>						
Americas	74,495	63,069	(15)%	214,079	201,343	(6)%
EMEA	23,196	7,587	(67)%	63,947	47,090	(26)%
Asia Pacific	47,214	45,607	(3)%	149,766	137,399	(8)%
Global operating costs (3)	613,302	539,403	(12)%	1,942,565	1,676,710	(14)%
Gain on sale of patents and land	—	—	0%	(11,100)	(121,559)	995%
Asset impairment charge	41,699	—	(100)%	41,699	—	(100)%
Goodwill impairment charge	—	—	0%	—	394,901	100%
Intangible assets impairment charge	—	—	0%	—	87,335	100%
Depreciation and amortization	152,412	115,468	(24)%	457,630	388,360	(15)%
Stock-based compensation expense	110,426	128,892	17%	351,252	369,263	5%
Restructuring charges, net	26,012	9,962	(62)%	96,932	86,576	(11)%
Loss from operations	<u>\$ (86,312)</u>	<u>\$ (52,319)</u>	(39)%	<u>\$ (218,460)</u>	<u>\$ (709,209)</u>	225%

- (1) Commencing in the second quarter of 2016, TAC payments related to the Microsoft Search Agreement, which previously would have been recorded as a reduction to revenue, began to be recorded as cost of revenue — TAC due to a required change in revenue presentation. See Note 1 — “The Company and Summary of Significant Accounting Policies” and Note 17—“Microsoft Search Agreement” in the Notes to our condensed consolidated financial statements for additional information.
- (2) Direct costs for each segment include costs associated with the local sales teams and other cost of revenue. Prior to the second quarter of 2016, certain account management costs associated with Yahoo Properties were managed locally and included as direct costs for each segment. Prior period amounts have been revised to conform to the current presentation.
- (3) Global operating costs include product development, marketing, real estate workplace, general and administrative, account management costs and other corporate expenses that are managed on a global basis and that are not directly attributable to any particular segment. Beginning in the second quarter of 2016, certain account management costs associated with Yahoo Properties are managed globally and included as global costs. Prior period amounts have been revised to conform to the current presentation.

## **Revenue and Revenue ex-TAC by Segment**

### **Americas**

Americas revenue for the three and nine months ended September 30, 2016 increased \$71 million, or 7 percent, and \$11 million, roughly flat, respectively, compared to the same periods of 2015. The increase in Americas revenue for the three months ended September 30, 2016 was primarily attributable to an increase in search revenue of \$159 million, partially offset by declines in other revenue and display revenue of \$69 million and \$19 million, respectively. The increase in Americas revenue for the nine months ended September 30, 2016 was primarily attributable to an increase in search revenue of \$278 million, partially offset by declines in other revenue and display revenue of \$228 million and \$40 million, respectively. The increase in Americas search revenue was primarily due to the change in revenue presentation associated with the implementation of the Eleventh Amendment to the Microsoft Search Agreement. The revenue and TAC increase from the change in revenue presentation was \$222 million and \$440 million for the three and nine months ended September 30, 2016, respectively. See “Significant Transactions—Microsoft Search Agreement” above for further detail. Excluding the impact of the change in revenue presentation, noted above, search revenue declined \$62 million, or 14 percent, and \$161 million, or 12 percent, for the three and nine months ended September 30, 2016, respectively, primarily due to a decline in Paid Clicks on Yahoo Properties and Affiliate sites driven by a decline in traffic, partially offset by an increase in Affiliate site revenue due to improved pricing. The decline in Americas other revenue was primarily due to a decline in fees revenue and, to a lesser extent, a decline in listings-based revenue. The decline in fees revenue was primarily due to the completion of recognition of deferred revenue pursuant to the TIPLA with Alibaba Group in which we recognized \$60 million and \$199 million in the three and nine months ended September 30, 2015. Listings-based revenue for the three and nine months ended September 30, 2016 declined \$6 million and \$19 million, respectively, compared to the same periods of 2015, primarily as a result of the loss of revenue from partner agreements that terminated in 2015 for which we have no similar revenue in 2016. The decline in Americas display revenue for the three and nine months ended September 30, 2016 was attributable to a decline in premium advertising and, to a lesser extent, video and native advertising, partially offset by an increase in audience advertising.

Revenue in the Americas accounted for approximately 81 percent and 80 percent of total revenue for the three and nine months ended September 30, 2016, respectively, compared to 81 percent and 80 percent of total revenue for the three and nine months ended September 30, 2015, respectively.

Americas revenue ex-TAC for the three and nine months ended September 30, 2016 decreased \$122 million, or 16 percent, and \$453 million, or 19 percent, compared to the same periods of 2015, primarily due to declines in revenue of \$150 million and \$429 million excluding the impact of the change in revenue presentation (described further above). TAC for the three months ended September 30, 2016 decreased \$28 million (excluding the impact of the change in revenue presentation) due to a decline in display TAC partially offset by an increase in search TAC from Google and Gemini. TAC for the nine months ended September 30, 2016 increased \$24 million (excluding the impact of the change in revenue presentation) due to an increase in search TAC from Google and Gemini, partially offset by a decline in display TAC. Additionally, search TAC for the three and nine months ended September 30, 2016 was impacted by a \$20 million decline associated with an amendment to our agreement with Mozilla.

Revenue ex-TAC in the Americas accounted for approximately 77 percent of total revenue ex-TAC for both the three and nine months ended September 30, 2016, compared to 78 percent of total revenue ex-TAC for both the three and nine months ended September 30, 2015.

### **EMEA**

EMEA revenue for the three and nine months ended September 30, 2016 increased \$19 million, or 24 percent, and \$32 million, or 13 percent, respectively, compared to the same periods of 2015. The increase in EMEA revenue for the three months ended September 30, 2016 was attributable to an increase in search revenue of \$27 million, partially offset by a decline in display revenue of \$7 million. The increase in EMEA revenue for the nine months ended September 30, 2016 was attributable to an increase in search revenue of \$48 million, partially offset by a decline in display revenue of \$11 million and other revenue of \$4 million. The increase in EMEA search revenue was primarily due to the change in revenue presentation associated with the implementation of the Eleventh Amendment to the Microsoft Search Agreement. The revenue and TAC increase from the change in revenue presentation was \$34 million and \$67 million for the three and nine months ended September 30, 2016, respectively. Excluding the impact of the change in revenue presentation, noted above, search revenue declined \$7 million, or 26 percent, and \$20 million, or 23 percent, for the three and nine months ended September 30, 2016, respectively, primarily due to a decline in Paid Clicks. The decline in display revenue for the three and nine months ended September 30, 2016 was primarily due to a decline in premium advertising and, to a lesser extent, audience advertising, partially offset by an increase in native advertising.

Revenue in EMEA accounted for approximately 8 percent of total revenue for both the three and nine months ended September 30, 2016, compared to 6 percent and 7 percent of total revenue for the three and nine months ended September 30, 2015, respectively.

EMEA revenue ex-TAC for the three and nine months ended September 30, 2016 decreased \$10 million, or 15 percent, and \$27 million, or 13 percent, respectively, compared to the same periods of 2015, primarily due to revenue declines exceeding the TAC declines (excluding the impact of the change in revenue presentation).

Revenue ex-TAC in EMEA accounted for approximately 7 percent of total revenue for both the three and nine months ended September 30, 2016 and 2015.

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*Asia Pacific*

Asia Pacific revenue for the three and nine months ended September 30, 2016 decreased \$11 million, or 7 percent, and \$38 million, or 8 percent, respectively, compared to the same periods of 2015. The decline in Asia Pacific revenue for the three months ended September 30, 2016 was primarily due to declines in display revenue of \$9 million and other revenue of \$3 million. The decline in Asia Pacific revenue for the nine months ended September 30, 2016 was primarily due to declines in display, other, and search revenue of \$21 million, \$11 million, and \$6 million, respectively. The decline in display revenue for the nine months ended September 30, 2016 was primarily attributable to a decline in premium advertising partially offset by an increase in native advertising.

Revenue in Asia Pacific accounted for approximately 11 percent and 12 percent of total revenue for the three and nine months ended September 30, 2016, respectively, compared to 13 percent of total revenue for both the three and nine months ended September 30, 2015.

Asia Pacific revenue ex-TAC for the three and nine months ended September 30, 2016 decreased \$13 million, or 8 percent, and \$50 million, or 11 percent, respectively, compared to the same periods of 2015, primarily due to a decrease in revenue as discussed above. The decline in revenue ex-TAC for the nine months ended September 30, 2016 was also attributable to an increase in display TAC of \$10 million.

Revenue ex-TAC in Asia Pacific accounted for approximately 16 percent of total revenue ex-TAC for both the three and nine months ended September 30, 2016, compared to 15 percent of total revenue ex-TAC for both the three and nine months ended September 30, 2015.

**Direct Costs by Segment**

*Americas*

For the three and nine months ended September 30, 2016, direct costs attributable to the Americas segment decreased \$11 million, or 15 percent, and \$13 million, or 6 percent, respectively, compared to the same periods of 2015. The decline in direct costs attributable to the Americas segment for the three months ended September 30, 2016 was primarily related to declines in compensation costs of \$8 million and other cost of revenue of \$3 million. The decline in direct costs attributable to the Americas segment for the nine months ended September 30, 2016 was primarily attributable to declines in compensation costs of \$9 million, other cost of revenue of \$5 million, and bad debt expense of \$3 million, partially offset by an increase in marketing and public relations expense of \$5 million.

Direct costs attributable to the Americas segment represented approximately 10 percent of Americas revenue ex-TAC for both the three and nine months ended September 30, 2016, compared to 9 percent for both the three and nine months ended September 30, 2015.

*EMEA*

For the three and nine months ended September 30, 2016, direct costs attributable to the EMEA segment decreased \$16 million, or 67 percent, and \$17 million, or 26 percent, respectively, compared to the same periods of 2015. The decline in direct costs attributable to the EMEA segment for the three months ended September 30, 2016 was primarily attributable to declines in bad debt expense of \$8 million and compensation costs of \$7 million. The decline in direct costs attributable to the EMEA segment for the nine months ended September 30, 2016 was primarily related to declines in compensation costs of \$11 million, bad debt expense of \$7 million and other cost of revenue of \$2 million, partially offset by an increase in marketing and public relations expense of \$4 million.

Direct costs attributable to the EMEA segment represented approximately 13 percent and 26 percent of EMEA revenue ex-TAC for the three and nine months ended September 30, 2016, respectively, compared to 35 percent and 31 percent for the three and nine months ended September 30, 2015, respectively.

*Asia Pacific*

For the three and nine months ended September 30, 2016, direct costs attributable to the Asia Pacific segment decreased \$2 million, or 3 percent, and \$12 million, or 8 percent, respectively, compared to the same periods of 2015. The decline in direct costs attributable to the Asia Pacific segment for the three months ended September 30, 2016 was primarily attributable to declines in marketing and public relations expense and compensation costs, partially offset by an increase in other cost of revenue. The decline in direct costs attributable to the Asia Pacific segment for the nine months ended September 30, 2016 was primarily attributable to declines in compensation costs of \$9 million and marketing and public relations expense of \$4 million.

Direct costs attributable to the Asia Pacific segment represented approximately 33 percent of Asia Pacific revenue ex-TAC for both the three and nine months ended September 30, 2016, compared to 31 percent and 32 percent for the three and nine months ended September 30, 2015, respectively.

## Liquidity and Capital Resources

	December 31, 2015	September 30, 2016
	(dollars in thousands)	
Cash and cash equivalents	\$ 1,631,911	\$ 1,411,308
Short-term marketable securities	4,225,112	5,189,207
Long-term marketable securities	975,961	1,170,962
Total cash, cash equivalents, and marketable securities	<u>\$ 6,832,984</u>	<u>\$ 7,771,477</u>
Percentage of total assets	<u>15%</u>	<u>14%</u>

Cash Flow Highlights	Nine Months Ended	
	2015	2016
	(in thousands)	
Net cash (used in) provided by operating activities	\$ (2,515,712)	\$ 993,604
Net cash provided by (used in) investing activities	\$ 1,529,517	\$ (1,092,217)
Net cash used in financing activities	\$ (363,577)	\$ (156,549)

For the nine months ended September 30, 2016, our operating activities generated adequate cash to meet our operating needs. Our operating activities for the nine months ended September 30, 2015 did not generate positive cash flow as we satisfied the \$3.3 billion income tax liability related to the sale of Alibaba Group ADSs in September 2014.

As of September 30, 2016, we had cash, cash equivalents, and marketable securities (excluding Alibaba Group and Hortonworks equity securities) totaling \$7.8 billion compared to \$6.8 billion at December 31, 2015. During the nine months ended September 30, 2016, we received cash proceeds from the sale of certain property in Santa Clara, California of \$246 million (net of closing costs of \$4 million) and a cash tax refund of \$190 million associated with our claim to carry back 2015 losses and tax attributes to earlier taxable years.

Our foreign subsidiaries held \$426 million of our total \$7.8 billion of cash and cash equivalents and marketable securities (excluding Alibaba Group and Hortonworks equity securities) as of September 30, 2016. As of September 30, 2016, we intend to repatriate cumulative and future earnings from our wholly-owned foreign subsidiaries. The tax implications of the repatriation (namely a \$149 million increase to U.S. taxable income with an associated \$66 million U.S. tax credit for foreign income taxes that have been paid on such earnings) have been included in our income tax benefit for the three and nine months ended September 30, 2016. As of September 30, 2016, we do not have a plan to repatriate approximately \$3.1 billion of earnings related to our equity method investment in Yahoo Japan. If those earnings were to be repatriated in the future, we may be subject to additional U.S. income taxes (subject to an adjustment for foreign tax credits). It is not practicable to determine the income tax liability that might be incurred if these earnings were to be repatriated.

We currently hedge a portion of our net investment in Yahoo Japan with forward contracts to reduce the risk that our investment in Yahoo Japan will be adversely affected by foreign currency translation exchange rate fluctuations. The forward contracts are required to be settled in cash and the amount of cash payment we receive or could be required to pay upon settlement could be material.

We expect to continue to evaluate possible acquisitions of, or strategic investments in, businesses, products, and technologies that are complementary to our business, which acquisitions and investments may require the use of cash.

We use cash generated by operations as our primary source of liquidity and believe that existing cash, cash equivalents, and investments in marketable securities, together with any cash generated from operations, will be sufficient to meet normal operating requirements and capital expenditures for the next twelve months.

### Cash Flow Changes

**Net cash (used in) provided by operating activities** . Cash flows from operating activities for the nine months ended September 30, 2016 were driven by a net source of cash from working capital of \$445 million (which included a \$190 million cash tax refund), dividends received from equity investees of \$157 million and non-cash adjustments of \$1,015 million, reduced by a net loss of \$373 million and earnings in equity interests of \$250 million.

For the nine months ended September 30, 2015, cash flows from operating activities were reduced by changes in working capital of \$3,339 million (which included the reduction of the income tax liability related to the sale of Alibaba Group shares in September 2014) and earnings in equity interests of \$291 million offset by net income of \$81 million, dividends received from equity investees of \$142 million and non-cash adjustments of \$891 million.

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**Net cash provided by (used in) investing activities** . In the nine months ended September 30, 2016, the \$1,092 million used in investing activities was due to purchases of marketable securities, net of proceeds from sales and maturities, of \$1,175 million, partially offset by net proceeds from disposition of property and equipment of \$52 million and \$39 million in net proceeds from settlement of derivative hedge contracts.

In the nine months ended September 30, 2015, the \$1,530 million provided by investing activities was due to proceeds from sales and maturities of marketable securities, net of purchases, of \$1,983 million, \$29 million proceeds from the sale of patents, and \$114 million in net proceeds from settlement of derivative hedge contracts, partially offset by \$417 million used for capital expenditures, net, \$175 million used for acquisitions, and \$4 million used for the purchase of intangibles and other activities.

**Net cash used in financing activities** . In the nine months ended September 30, 2016, the \$157 million used in financing activities was due to \$168 million used for tax withholding payments related to net share settlements of restricted stock units and other financing activities and \$6 million used for distribution to noncontrolling interests. This use of cash was partially offset by \$16 million in cash proceeds received from employee stock option exercises.

In the nine months ended September 30, 2015, the \$364 million used in financing activities was due to \$204 million used for the repurchase of 4 million shares of common stock at an average price of \$47.65 per share, \$16 million used for distributions to non-controlling interests, and \$230 million used for tax withholding payments related to net share settlements of restricted stock units and other financing activities. This use of cash was partially offset by \$52 million in cash proceeds received from employee stock option exercises and employee stock purchases made through our employee stock purchase plan, and an excess tax benefit from stock-based awards of \$33 million.

### Capital Expenditures, Net

Capital expenditures, net are generally comprised of purchases of computer hardware, software, server equipment, furniture and fixtures, real estate, and capitalized software and labor for internal use software projects.

For the nine months ended September 30, 2016, we had a net benefit of \$52 million primarily associated with net cash proceeds of \$246 million received from the sale of land in Santa Clara, California. Excluding the proceeds received from the land sale, capital expenditures, net for the nine months ended September 30, 2016 were \$194 million. For the nine months ended September 30, 2015, capital expenditures, net were \$417 million. The \$223 million decrease in capital expenditures was a result of the completion of certain Company initiatives, facilities expansions and improvements in 2015 and more efficient use of existing data center capacity and overall increased controls over expense and capital expenditures.

Excluding the net cash proceeds of \$246 million received from the sale of land, we expect capital expenditures, net to be up to \$300 million for the year ending December 31, 2016. We expect these expenditures to be funded by our cash flows from operating activities.

### Free Cash Flow (a Non-GAAP Financial Measure)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
	(dollars in thousands)			
Net cash provided by (used in) operating activities	\$ 137,275	\$ 217,906	\$ (2,515,712)	\$ 993,604
Acquisition of property and equipment, net	(150,381)	(41,970)	(417,276)	51,581
Excess tax benefits from stock-based awards	31,509	(8,817)	33,359	1,743
Dividends received from equity investee	(375)	—	(142,045)	(156,968)
Free cash flow	\$ 18,028	\$ 167,119	\$ (3,041,674)	\$ 889,960

For the three months ended September 30, 2016, free cash flow increased \$149 million, as compared to the same period of 2015, primarily due to a decline in capital expenditures, net and a decline in cash outflow from working capital year-over-year.

For the nine months ended September 30, 2016, free cash flow increased \$3.9 billion, as compared to the same period of 2015, due to the satisfaction of the \$3.3 billion income tax liability related to the sale of Alibaba Group ADSs in the first quarter of 2015 for which there were no similar transactions in 2016, the net cash proceeds from disposition of property and equipment associated with the sale of land in the second quarter of 2016, and a cash tax refund of \$190 million associated with our claim to carry back our 2015 losses and tax attributes to earlier taxable years.

## Stock Repurchases

During the nine months ended September 30, 2016, we did not repurchase any shares of our common stock. The following table provides the remaining authorization and repurchases by program:

	November 2013 Program	March 2015 Program (in millions)	Total
January 1, 2016	\$ 726	\$ 2,000	\$ 2,726
Total repurchases in the first quarter	—	—	—
Total repurchases in the second quarter	—	—	—
Total repurchases in the third quarter	—	—	—
September 30, 2016	\$ 726	\$ 2,000	\$ 2,726

## Contractual Obligations and Commitments

The following table presents certain payments due under contractual obligations with minimum commitments as of September 30, 2016 (in millions):

	Payments Due by Period				
	Total	Due in 2016	Due in 2017-2018	Due in 2019-2020	Thereafter
Convertible notes (1)	\$ 1,438	\$ -	\$ 1,438	\$ -	\$ -
Note payable obligations	53	1	10	10	32
Operating lease obligations (2) (3)	437	31	174	108	124
Capital lease obligations	32	4	20	5	3
Affiliate commitments (4)	985	60	600	325	-
Non-cancelable obligations (5)	124	23	79	12	10
Intellectual property rights (6)	13	3	5	2	3
Uncertain tax positions, including interest and penalties (7)	1,153	-	-	-	1,153
Total contractual obligations	\$ 4,235	\$ 122	\$ 2,326	\$ 462	\$ 1,325

- (1) During the year ended December 31, 2013, we completed an offering of the Notes, which are due in 2018. The amount above represents the principal balance to be repaid. See Note 11—"Convertible Notes" in the Notes to our condensed consolidated financial statements for additional information.
- (2) We have entered into various non-cancelable operating lease agreements for our offices throughout the Americas, EMEA, and Asia Pacific regions with original lease periods up to 15 years, expiring between 2016 and 2025. See Note 12—"Commitments and Contingencies" in the Notes to our condensed consolidated financial statements for additional information.
- (3) In May 2013, we entered into a 12 year operating lease agreement for four floors of the former New York Times building in New York City with a total expected minimum lease commitment of \$125 million. We have the option to renew the lease for an additional five years.
- (4) We are obligated to make minimum payments under contracts to provide sponsored search and/or display advertising services to our Affiliates which represent TAC.
- (5) We are obligated to make payments under various arrangements with vendors and other business partners, principally for content, bandwidth, and marketing arrangements.
- (6) We are committed to make certain payments under various intellectual property arrangements.
- (7) As of September 30, 2016, unrecognized tax benefits and potential interest and penalties resulted in accrued liabilities of \$1,153 million, classified as deferred and other long-term tax liabilities, net on our condensed consolidated balance sheets. As of September 30, 2016, the settlement period for the \$1,153 million income tax liabilities cannot be determined. See Note 15—"Income Taxes" in the Notes to our condensed consolidated financial statements for additional information.

**Standby Letters of Credit** . As of September 30, 2016, we had outstanding potential obligations relating to standby letters of credit of \$38 million. Standby letters of credit are financial guarantees provided by third parties for ongoing operating liabilities such as leases, utility bills, taxes, and insurance. If any letter of credit is drawn upon by a beneficiary, we are obligated to reimburse the provider of the guarantee. The standby letters of credit generally renew annually.

**Other Commitments and Off-Balance Sheet Arrangements** . In the ordinary course of business, we may provide indemnifications of varying scope and terms to customers, vendors, lessors, joint ventures and business partners, purchasers of assets or subsidiaries and other parties with respect to certain matters, including, but not limited to, losses arising out of our breach of agreements or representations and warranties made by us, services to be provided by us, intellectual property infringement claims made by third parties or, with respect to the sale, lease, or assignment of assets or the sale of a subsidiary, matters related to our conduct of the business and tax matters prior to the sale, lease, or assignment of assets. In addition, we have entered into indemnification agreements with our directors and certain of our officers that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We have also agreed to indemnify certain former officers, directors, and employees of acquired companies in connection with the acquisition of such companies. We maintain director and officer insurance, which may cover certain liabilities arising from our obligation to indemnify our current and former directors and officers, and former directors and officers of acquired companies, in certain circumstances. It is not possible to determine the aggregate maximum potential loss under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements might not be subject to maximum loss clauses. Historically, we have not incurred material costs as a result of obligations under these agreements and we have not accrued any material liabilities related to such indemnification obligations in our condensed consolidated financial statements.

As of September 30, 2016, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly we are not exposed to any financing, liquidity, market, or credit risk that could arise if we had such relationships. In addition, we identified no variable interests currently held in entities for which we are the primary beneficiary. In addition, as of September 30, 2016, we had no off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our consolidated financial condition, results of operations, liquidity, capital expenditures, or capital resources.

## Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates, judgments, and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. Our estimates form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimate that are reasonably likely to occur, could materially impact the condensed consolidated financial statements. We believe that our critical accounting policies reflect the more significant estimates and assumptions used in the preparation of the condensed consolidated financial statements.

**Goodwill.** Goodwill is not amortized but is evaluated for impairment annually (as of October 31) or whenever we identify certain triggering events or circumstances that would more likely than not reduce the estimated fair value of a reporting unit below its carrying amount. Events or circumstances that might indicate an interim evaluation is warranted include, among other things, unexpected adverse business conditions, regulatory changes, loss of key personnel and reporting unit and macro-economic factors.

Goodwill is tested for impairment at the reporting unit level, which is one level below our operating segments. We identified U.S. & Canada, Latin America, and Tumblr as the reporting units below the Americas operating segment; Europe and Middle East as the reporting units below the EMEA operating segment; and Taiwan, Hong Kong, Australia & New Zealand, India & Southeast Asia as the reporting units below the Asia Pacific operating segment. These operating segments are the same as our reportable segments.

Determining the fair value of each reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates and operating margins, discount rates and future market conditions, among others. It is reasonably possible that a future decline in market conditions and/or changes in our market share could negatively impact the market comparables, estimated future cash flows and discount rates used in the market and income approaches to determine the fair value of each reporting unit and could result in some portion or all of the remaining goodwill to become impaired in the foreseeable future.

After recording the goodwill impairment charge as of October 31, 2015 for Tumblr during the fourth quarter of 2015, the fair value of the Tumblr reporting unit approximated its carrying value. As such, any significant unfavorable changes in the forecast would result in the fair value being less than the carrying value. Subsequent to the most recent annual goodwill impairment assessment performed as of October 31, 2015, we have continued to monitor actual performance of our reporting units. During the three months ended June 30, 2016, we determined that there were indicators present to suggest that it was more likely than not that the fair value of the Tumblr reporting unit was less than its carrying amount. The significant changes for the Tumblr reporting unit subsequent to the annual goodwill impairment test performed as of October 31, 2015 included a decline in the 2016 and beyond forecasted revenue, operating income and cash flows.

### *Step One*

To test the Tumblr reporting unit for impairment, we used the two-step quantitative test. Consistent with methodology used for the prior year's annual goodwill impairment testing, we estimated the fair value of the Tumblr reporting unit using an income approach which was deemed to be the most indicative of fair value in an orderly transaction between market participants. Under the income approach, we determined fair value based on estimated future cash flows of the Tumblr reporting unit discounted by an estimated weighted-average cost of capital, reflecting the overall level of inherent risk of the Tumblr reporting unit and the rate of return an outside investor would expect to earn. We base cash flow projections for the Tumblr reporting unit using a forecast of cash flows and a terminal value based on the Perpetuity Growth Model. The forecast and related assumptions were derived from an updated financial forecast prepared during the second quarter of 2016. As a result of the analysis, we concluded that the carrying value of the Tumblr reporting unit exceeded its estimated fair value.

### *Step Two*

As identified above, in step one, the Tumblr reporting unit's carrying value exceeded its estimated fair value. The second step of the quantitative test was performed by comparing the carrying value of the goodwill in the Tumblr reporting unit to its implied fair value. The implied fair value is calculated by allocating all of the assets and liabilities of the Tumblr reporting unit, including any unrecognized intangible assets, in a hypothetical analysis that calculates the implied fair value of goodwill in the same manner as if the reporting unit was being acquired in a business combination. An impairment charge is recognized for the excess of the carrying value of goodwill over its implied fair value.

The step two quantitative test for the Tumblr reporting unit resulted in an impairment for the Tumblr reporting unit and we recorded a goodwill impairment charge of \$395 million during the second quarter of 2016.

The remaining goodwill related to the Tumblr reporting unit as of September 30, 2016 was \$124 million, which is in the Americas operating segment. As of September 30, 2016, there was also goodwill remaining for Taiwan, Hong Kong, and Australia & New Zealand reporting units, which are included in the Asia Pacific operating segment.

In determining the fair value of the Tumblr reporting unit, we used the following assumptions:

- Expected cash flows underlying our business plans for the periods 2016 through 2027.
- Cash flows beyond 2026 are projected to grow at a perpetual growth rate.
- In order to risk adjust the cash flow projections in determining fair value, we utilized a discount rate of 15 percent.

As noted above, we recorded goodwill impairment charges in the Tumblr reporting unit during the second quarter of 2016. It is reasonably possible that future changes in judgments, assumptions and estimates we made in assessing the fair value of goodwill could cause us to consider some portion or all of the remaining goodwill of the Tumblr reporting unit to become impaired. For example, a future decline in market conditions, changes in our market share, and/or other factors could negatively impact the estimated future cash flows and discount rates used in the income approach to determine the fair value of the Tumblr reporting unit and could result in one or more additional impairment charges in the future.

See "Operating Costs and Expenses—Goodwill Impairment Charge" and Note 5—"Goodwill" in the Notes to our condensed consolidated financial statements for additional information.

**Long-lived Assets** . We amortize long-lived assets, including property and equipment and intangible assets, over their estimated useful lives. Identifiable long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Determination of recoverability is based on the lowest level of identifiable estimated undiscounted future cash flows resulting from use of the asset and its eventual disposition. Measurement of any impairment loss is based on the excess of the carrying value of the asset over its fair value. Fair value is determined based on the lowest level of identifiable estimated future cash flows using discount rates determined by our management to be commensurate with the risk inherent in our business model. Our estimates of future cash flows attributable to our long-lived assets require significant judgment based on our historical and anticipated results and are subject to many factors. Different assumptions and judgments such as revenue growth rates and operating margins, the estimation of the useful life over which the undiscounted cash flows will occur, and the terminal value of the asset group at the end of that useful life could materially affect estimated future cash flows relating to our long-lived assets which could trigger impairment. See "Operating Costs and Expenses—Intangible Assets Impairment Charge" and Note 5—"Goodwill" in the Notes to our condensed consolidated financial statements for additional information.

For a complete discussion of our critical accounting policies and estimates, see "Critical Accounting Policies and Estimates" included in our Annual Report on Form 10-K for the year ended December 31, 2015 under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations." Other than as discussed above, we have made no significant changes to our critical accounting policies and estimates from those described in our Annual Report on Form 10-K for the year ended December 31, 2015.

## Recent Accounting Pronouncements

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See Note 1—"The Company and Summary of Significant Accounting Policies" in the Notes to our condensed consolidated financial statements.

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## Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to financial market risks, including changes in currency exchange rates and interest rates and changes in the market values of our investments. We may use derivative financial instruments to mitigate certain risks in accordance with our investment and foreign exchange policies.

We have master netting arrangements, which are designed to reduce credit risk by permitting net settlement of transactions with the same counterparty. We present our derivative assets and liabilities at their gross fair values on the condensed consolidated balance sheets.

### Interest Rate Exposure

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Our exposure to market risk for changes in interest rates impacts our costs associated with hedging, and primarily relates to our cash and marketable securities portfolio. We invest excess cash in money market funds, time deposits, and liquid debt instruments of the U.S. and foreign governments and their agencies, and high-credit corporate issuers which are classified as marketable securities and cash equivalents.

In November 2013, we issued \$1.4375 billion of the Notes. We carry the Notes at face value less unamortized discount on our condensed consolidated balance sheets. The fair value of the Notes fluctuates from changes in interest rates, credit spreads, and time to maturity.

Investments in fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates or changes in credit quality. A hypothetical 100 basis point increase in interest rates would result in a \$28 million and \$34 million decrease in the fair value of our available-for-sale debt securities as of December 31, 2015 and September 30, 2016, respectively.

### Foreign Currency Exposure

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The objective of our foreign exchange risk management program is to identify material foreign currency exposures and identify methods to manage these exposures to minimize the potential effects of currency fluctuations on our reported condensed consolidated cash flows and results of operations. All counterparties to our derivative contracts are major financial institutions. See Note 9—"Foreign Currency Derivative Financial Instruments" in the Notes to our condensed consolidated financial statements for additional information on our hedging programs.

We transact business in various foreign currencies and have international revenue, as well as costs denominated in foreign currencies. This exposes us to the risk of fluctuations in foreign currency exchange rates.

We had net realized and unrealized foreign currency transaction losses of \$1 million and \$21 million for the three and nine months ended September 30, 2015, respectively. We had net realized and unrealized foreign currency transaction gains of \$3 million and \$22 million for the three and nine months ended September 30, 2016, respectively. These include the impact of balance sheet hedging and remeasurements of foreign denominated monetary assets and liabilities on our consolidated balance sheets.

**Translation Exposure.** We are also exposed to foreign exchange rate fluctuations as we convert the financial statements of our foreign subsidiaries and our investments in equity interests into U.S. dollars in consolidation. If there is a change in foreign currency exchange rates, the conversion of the foreign subsidiaries' financial statements into U.S. dollars results in a gain or loss which is recorded as a component of accumulated other comprehensive income which is part of stockholders' equity.

A Value-at-Risk ("VaR") sensitivity analysis was performed on all of our foreign currency derivative positions to assess the potential impact of fluctuations in exchange rates. The VaR model uses a Monte Carlo simulation to generate thousands of random price paths assuming normal market conditions. The VaR is the maximum expected one day loss in fair value, for a given statistical confidence

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level, to our foreign currency derivative positions due to adverse movements in rates. The VaR model is used as a risk management tool and is not intended to represent either actual or forecasted losses. Based on the results of the model using a 99 percent confidence interval, we estimate the maximum one-day loss in the net investment hedge portfolio was \$45 million and \$12 million at December 31, 2015 and September 30, 2016, respectively. The maximum one-day loss in the cash flow hedge portfolio was \$3 million and \$2 million at December 31, 2015 and September 30, 2016, respectively. The maximum one-day loss in the balance sheet hedge portfolio was \$11 million and \$3 million at December 31, 2015 and September 30, 2016, respectively. Actual future gains and losses associated with our derivative positions may differ materially from the sensitivity analysis performed as of September 30, 2016 due to the inherent limitations associated with predicting the timing and amount of changes in foreign currency exchange rates and our actual exposures and positions. In addition, the VaR sensitivity analysis may not reflect the complex market reactions that may arise from the market shifts modeled within this VaR sensitivity analysis.

Revenue ex-TAC and related expenses generated from our international subsidiaries are generally denominated in the currencies of the local countries. Primary currencies include Australian dollars, British pounds, Euros, Japanese yen, Taiwan dollars, and Singapore dollars. The statements of operations of our international operations are translated into U.S. dollars at exchange rates indicative of market rates during each applicable period. To the extent the U.S. dollar strengthens against foreign currencies, the translation of these foreign currency-denominated transactions results in reduced consolidated revenue and operating expenses. Conversely, our consolidated revenue and operating expenses will increase if the U.S. dollar weakens against foreign currencies. Using the foreign currency exchange rates from the three and nine months ended September 30, 2015, revenue ex-TAC for the Americas segment for the three and nine months ended September 30, 2016 would have been flat and higher than we reported by \$6 million, respectively; revenue ex-TAC for the EMEA segment would have been higher than we reported by \$5 million and \$10 million, respectively; and revenue ex-TAC for the Asia Pacific segment would have been lower than we reported by \$4 million and higher than we reported by \$3 million, respectively. Using the foreign currency exchange rates from the three and nine months ended September 30, 2015, direct costs for the Americas segment for the three and nine months ended September 30, 2016 would have been flat and higher than we reported by \$2 million, respectively; direct costs for the EMEA segment would have been higher than we reported by \$1 million and \$3 million, respectively; and direct costs for the Asia Pacific segment would have been flat and higher than we reported by \$5 million, respectively.

## Investment Exposure

We are exposed to investment risk as it relates to changes in the market value of our investments. We have investments in marketable securities and equity instruments of public and private companies. As of the date of the Alibaba Group IPO, we no longer account for our remaining investment in Alibaba Group using the equity method and no longer record our proportionate share of Alibaba Group's financial results in the consolidated financial statements. Instead, we now reflect our remaining investment in Alibaba Group as an available-for-sale equity security on the condensed consolidated balance sheet and adjust the investment to fair value each quarterly reporting period with changes in fair value recorded within other comprehensive loss, net of tax. The change in the classification of our investment in Alibaba Group from an equity method investment to an available-for-sale equity security exposes our investment portfolio to increased equity price risk. The fair value of the equity investment in Alibaba Group will vary over time and is subject to a variety of market risks including: company performance, macro-economic, regulatory, industry, and systemic risks of the equity markets overall.

The objective of our corporate investment policy is to preserve capital, meet liquidity requirements, and provide a reasonable rate of return. A large portion of our cash is managed by external managers according to the guidelines of our corporate investment policy. We protect and preserve invested funds by limiting default, market, and reinvestment risk. To achieve this objective, we maintain our portfolio of cash and cash equivalents and short-term and long-term investments in a variety of liquid fixed income securities, including both government and corporate obligations and money market funds. As of December 31, 2015, net unrealized losses on these investments were approximately \$5 million and as of September 30, 2016, net unrealized gains on these investments were approximately \$1 million. The increase to a net unrealized gain was primarily attributable to lower interest rates as of September 30, 2016 compared to December 31, 2015.

A sensitivity analysis was performed on our marketable equity security portfolio to assess the potential impact of fluctuations in stock price. Hypothetical declines in stock price of ten percent, twenty percent, and thirty percent were selected based on potential near-term changes in the stock price that could have an adverse effect on our marketable equity security portfolio. As of December 31, 2015 and September 30, 2016, the fair value of our marketable equity security portfolio was approximately \$31 billion and \$41 billion, respectively. As of September 30, 2016, declines in stock prices of ten percent, twenty percent and thirty percent would have resulted in a \$4 billion, \$8 billion and \$12 billion decline, respectively, in the total value of our marketable equity security portfolio.

We performed a separate sensitivity analysis on our Hortonworks warrants for which we estimate fair value using the Black-Scholes model. We have held all other inputs constant and determined the impact of hypothetical declines in stock price of ten percent, twenty percent, and thirty percent, based on potential near-term changes in the stock price that could have an adverse effect on the fair value of the warrants and result in a loss recorded to the consolidated statements of operations. As of December 31, 2015 and September 30, 2016, the fair value of the Hortonworks warrants was approximately \$79 million and \$29 million, respectively. As of September 30, 2016, declines in stock prices of ten percent, twenty percent and thirty percent would have resulted in a \$3 million, \$6 million and \$9 million decline, respectively, in the total value of the Hortonworks warrants.

## Item 4. Controls and Procedures

**Disclosure Controls and Procedures** . The Company's management, with the participation of the Company's principal executive officer and principal financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this Report. Based on such evaluation, the Company's principal executive officer and principal financial officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective.

**Internal Control Over Financial Reporting** . There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. Legal Proceedings

For a description of our material legal proceedings, see the section captioned “Legal Contingencies” included in Note 12 — “Commitments and Contingencies” in the Notes to our Condensed Consolidated Financial Statements, which reference is incorporated by reference herein. For a description of the litigation and government investigations related to the Security Incident we disclosed in September 2016, see Part I, Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Recent Developments—Security Incident—Litigation, Claims, Governmental Investigations,” and the section captioned “Security Incident Contingencies” included in Note 12 — “Commitments and Contingencies” in the Notes to our Condensed Consolidated Financial Statements.

### Item 1A. Risk Factors

We have updated the risk factors previously disclosed in Part I, Item 1A. of our Annual Report on Form 10-K for the year ended December 31, 2015, which was filed with the Securities and Exchange Commission on February 29, 2016 (“2015 Annual Report”), as set forth below. Other than the addition of a risk factor regarding our pending transaction with Verizon and a risk factor regarding the Security Incident, we do not believe any of the changes constitute material changes from the risk factors previously disclosed in our 2015 Annual Report.

*We face significant competition for users, advertisers, publishers, developers, and distributors.*

We face significant competition from online search engines, sites offering integrated internet products and services, social media and networking sites, e-commerce sites, companies providing analytics, monetization and marketing tools for mobile and desktop developers, and digital, broadcast and print media. In a number of international markets, especially those in Asia, Europe, the Middle East and Latin America, we face substantial competition from local Internet service providers and other entities that offer search, communications, and other commercial services.

Several of our competitors offer an integrated variety of Internet products, advertising services, technologies, online services and content in a manner similar to Yahoo. We compete against these and other companies to attract and retain users, advertisers, developers, and third-party website publishers as participants in our Affiliate network, and to obtain agreements with third parties to promote or distribute our services. We also compete with social media and networking sites which are increasingly used to communicate and share information, and which are attracting a substantial and increasing share of users, users’ online time, and online advertising dollars.

A key element of our strategy is focusing on increasing our revenue growth through our Mavens offerings. As part of this strategy, we are focusing on mobile products and mobile advertising formats, as well as increasing our revenue from mobile. A number of our competitors have devoted significant resources to the development of products, services and apps for mobile devices. Several of our competitors have mobile revenue significantly greater than ours. If we are unable to develop products for mobile devices that users find engaging and that help us grow our mobile revenue, our competitive position, our financial condition and operating results could be harmed.

In addition, a number of competitors offer products, services and apps that directly compete for users with our offerings, including e-mail, search, video, social, sports, news, finance, micro-blogging, and messaging. Similarly, our competitors or other participants in the online advertising marketplace offer advertising exchanges, ad networks, demand side platforms, ad serving technologies, sponsored search offerings, and other services that directly compete for advertisers with our offerings. Additionally, as the use of programmatic advertising continues to increase, we compete with companies that have also invested in programmatic platform offerings. We also compete with traditional print and broadcast media companies to attract domestic and international advertising spending. Some of our existing competitors and possible entrants have greater brand recognition for certain products, services and apps, more expertise in particular market segments, and greater operational, strategic, technological, financial, personnel, or other resources than we do. Many of our competitors have access to considerable financial and technical resources with which to compete aggressively, including by funding future growth and expansion and investing in acquisitions, technologies, and research and development. Further, emerging start-ups may be able to innovate and provide new products, services and apps faster than we can. In addition, competitors may consolidate or collaborate with each other, and new competitors may enter the market. Some of our competitors in international markets have a substantial competitive advantage over us because they have dominant market share in their territories, have greater local brand recognition, are focused on a single market, are more familiar with local tastes and preferences, or have greater regulatory and operational flexibility due to the fact that we may be subject to both U.S. and foreign regulatory requirements.

If our competitors are more successful than we are in developing and deploying compelling products or in attracting and retaining users, advertisers, publishers, developers, or distributors, our revenue and growth rates could decline.

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***We generate the majority of our revenue from search and display advertising, and the reduction in spending by or loss of current or potential advertisers would cause our revenue and operating results to decline.***

For both the three and nine months ended September 30, 2016, 90 percent of our total revenue came from search and display advertising. Our ability to retain and grow search and display revenue depends upon:

- increasing our daily active users, logged in users, page views and engagement;
- introducing engaging new products that are popular with users and distributable on mobile and other alternative devices and platforms;
- maintaining and expanding our advertiser base on PCs and mobile devices;
- achieving a better traffic mix from our Yahoo Properties and Affiliates and improving our monetization rates on such traffic;
- broadening our relationships with advertisers to small- and medium-sized businesses;
- successfully implementing changes and improvements to our advertising management platforms and formats and obtaining the acceptance of our advertising management platforms by advertisers, website publishers, and online advertising networks;
- successfully acquiring, investing in, and implementing new technologies;
- successfully implementing changes in our sales force, sales development teams, and sales strategy;
- continuing to innovate and improve the monetization capabilities of our display and native advertising and our mobile products;
- effectively monetizing mobile and other search queries;
- improving the quality of our user and advertiser products;
- continuing to innovate and improve users' search experiences;
- maintaining and expanding our Affiliate program for search and display advertising services; and
- deriving better demographic and other information about our users to enable us to offer better, more personalized and targeted experiences to both our users and advertisers.

In most cases, our agreements with advertisers have a term of one year or less, and may be terminated at any time by the advertiser or by us. Payments under our agreements with advertisers are often dependent upon performance and click-through levels. Accordingly, it is difficult to forecast search and display revenue accurately. In addition, our expense levels are based in part on expectations of future revenue, including any guaranteed minimum payments to our Affiliates in connection with search and/or display advertising, and in some cases, the expenses could exceed the revenue that we generate. The state of the global economy, growth rate of the online advertising market, and availability of capital impacts the advertising spending patterns of our existing and potential advertisers. Any reduction in spending by, or loss of, existing or potential advertisers would negatively impact our revenue and operating results. Further, we may be unable to adjust our expenses and capital expenditures quickly enough to compensate for any unexpected revenue shortfall.

***As more people access our products via mobile devices rather than PCs and mobile advertising continues to evolve, if we do not continue to attract and retain mobile users and grow mobile revenue, our financial results will be adversely impacted.***

The number of people who access the Internet through mobile devices rather than a PC, including mobile telephones, smartphones and tablets, is increasing and will likely continue to increase dramatically. More than 600 million of our monthly users are now joining us (including Tumblr) on mobile devices. In addition, search queries are increasingly being undertaken through mobile devices. As a result, our ability to grow advertising revenue is increasingly dependent on our ability to generate revenue from ads displayed on mobile devices.

A key element of our strategy is focusing on mobile devices, and we expect to continue to devote significant resources to the creation and support of developing new and innovative mobile products, services and apps. However, if our new mobile products, services and apps, including new forms of Internet advertising for mobile devices, do not continue to attract and retain mobile users, advertisers and device manufacturers and to generate and grow mobile revenue, our operating and financial results will be adversely impacted. We are dependent on the interoperability of our products and services with mobile operating systems we do not control and we may not be successful in maintaining relationships with the key participants in the mobile industry that control such mobile operating systems. The manufacturer or access provider might promote a competitor's or its own products and services, impair users' access to our services by blocking access through their devices, make it hard for users to readily discover, install, update or access our products on their devices, or charge us for delivery of ads, or limit our ability to deliver ads or measure their effectiveness. If distributors impair access to or refuse to distribute our services or apps, or charge for or limit our ability to deliver ads or measure the effectiveness of our ads, then our user engagement and revenue could decline.

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***If we do not manage our operating expenses effectively, our profitability could fail to improve and could decline.***

We have implemented cost reduction initiatives to reduce our operating expenses, including reducing our headcount, closing offices and exiting certain products and verticals. However, we may not realize the cost savings expected from these initiatives or the revenue impact from our exit of certain regions and products may be greater than we expect. We plan to seek to operate efficiently and to manage our costs effectively. However, we are also investing in areas we believe will grow revenue and our operating expenses might increase as a result of these investments. If our operating expenses increase at a greater pace than our revenue grows, or if we fail to manage costs effectively, our profitability could fail to improve and could decline.

***Risks and uncertainties associated with the pending Sale transaction with Verizon may adversely affect our business, financial performance and stock price.***

There is no assurance that the Sale transaction will be consummated in a timely manner or at all. In addition, the anticipated benefits of the Sale transaction may not be realized. Potential risks and uncertainties related to the Sale transaction include, among others:

- the inability to consummate the transaction in a timely manner or at all, due to the inability to obtain or delays in obtaining the approval of our stockholders, the necessary regulatory approvals, or satisfaction of other conditions to the closing of the Sale;
- the existence or occurrence of any event, change or other circumstance that could give rise to the termination of the Stock Purchase Agreement, which, in addition to other adverse consequences, could result in the Company incurring substantial fees, including, in certain circumstances, the payment of a termination fee to Verizon under the Stock Purchase Agreement;
- risks that Verizon may assert, or threaten to assert, rights or claims with respect to the Stock Purchase Agreement as a result of facts relating to the Security Incident and may seek to terminate the Stock Purchase Agreement or renegotiate the terms of the Sale transaction on that basis;
- potential adverse effects on our relationships with our existing and potential advertisers, suppliers, customers, vendors, distributors, landlords, licensors, licensees, joint venture partners and other business partners;
- the implementation of the Sale transaction will require significant time, attention and resources of our senior management and others within the Company, potentially diverting their attention from the conduct of our business;
- risks related to our ability to retain or recruit key talent;
- costs, fees, expenses and charges related to or triggered by the Sale transaction;
- the net proceeds that the Company will receive from Verizon is subject to uncertainties as a result of the purchase price adjustments in the Stock Purchase Agreement;
- restrictions on the conduct of our business, including the ability to make certain acquisitions and divestitures, enter into certain contracts, and incur certain indebtedness and expenditures until the earlier of the completion of the Sale transaction or the termination of the Stock Purchase Agreement;
- potential adverse effects on our business, properties or operations caused by us implementing the transactions or foregoing opportunities that we might otherwise pursue absent the pending Sale transaction;
- the initiation or outcome of any legal proceedings or regulatory proceedings that may be instituted against us and our directors and/or officers relating to the transactions; and
- following the closing of the Sale, the Company will be required to register and be regulated as an investment company under the Investment Company Act of 1940, which will result in, among other things, the Company having to comply with the regulations thereunder, certain stockholders may be prohibited from holding or acquiring shares of the Company, the Company likely being removed from the Standard and Poor's 500 Index and other indices which could have an adverse impact the Company's share price following the Sale.

All of these risks and uncertainties could potentially have an adverse impact on our business and financial performance, and could cause our stock price to decline.

***The investigation into the Security Incident is ongoing and we are still in the process of determining all of the facts and assessing the full extent of its impact and the impact of related government investigations and civil litigation on our results of operations, which could be material.***

The Security Incident involved the theft of certain user account information for at least 500 million user accounts. The investigation of the Security Incident is ongoing, and we are still in the process of assessing the financial and other effects of the Security Incident. We may identify additional information that was accessed or stolen, or develop a clearer understanding of the Security Incident, evidence of such compromise in 2014 or related issues, and other developments related to the Security Incident could occur, which could have an adverse impact on our business, results of operations, financial results, and reputation. For example, our forensic experts are currently investigating certain evidence and activity that indicates an intruder, believed to be the same state-sponsored actor responsible for the Security Incident, created cookies that could have enabled such intruder to bypass the need for a password to access certain users' accounts or account information. As a result of the Security Incident, we are facing at least 23 putative consumer class action lawsuits and other lawsuits and claims may be asserted by or on behalf of users, partners, shareholders, or others seeking damages or other related relief, allegedly arising out of the Security Incident. We are also facing investigations

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by a number of federal, state, and foreign governmental officials and agencies. These claims and investigations may adversely affect how we operate our business, divert the attention of management from the operation of the business, and result in additional costs and potential fines. In addition, the governmental agencies investigating the Security Incident may seek to impose injunctive relief, consent decrees, or other civil or criminal penalties which could, among other things, materially increase our data security costs, and affect how we operate our systems and collect and use customer and user information.

***Our security measures may be breached as they were in the Security Incident and user data accessed, which may cause users and customers to curtail or stop using our products and services, and may cause us to incur significant legal and financial exposure.***

Our products and services involve the storage and transmission of Yahoo's users' and customers' personal and proprietary information in our facilities and on our equipment, networks, and corporate systems. Yahoo is routinely targeted by outside third parties, including technically sophisticated and well-resourced state-sponsored actors, attempting to access or steal our user and customer data or otherwise compromise user accounts. We believe such a state-sponsored actor was responsible for the theft involved in the Security Incident. Security breaches or other unauthorized access or actions expose us to a risk of theft of user data, regulatory actions, litigation, investigations, remediation costs, damage to our reputation and brand, loss of user and partner confidence in the security of our products and services and resulting fees, costs, and expenses, loss of revenue, damage to our reputation, and potential liability. Outside parties may attempt to fraudulently induce employees, users, partners, or customers to disclose sensitive information or take other actions to gain access to our data or our users' or customers' data. In addition, hardware, software, or applications we procure from third parties may contain defects in design or manufacture or other problems that could unexpectedly compromise network and data security. In addition, our or our partners' implementation of software may contain security vulnerabilities or may not be implemented properly due to human error or limitations in our systems. Additionally, some third parties, such as our distribution partners, service providers, vendors, and app developers, may receive or store information provided by us or by our users through applications that are integrated with Yahoo properties and services. If these third parties fail to adopt or adhere to adequate data security practices, or in the event of a breach of their networks, our data or our users' data may be improperly accessed, used, or disclosed. Security breaches or other unauthorized access (such as the Security Incident) have resulted in, and may in the future result in, a combination of significant legal and financial exposure, increased remediation and other costs, damage to our reputation, and a loss of confidence in the security of our products, services, and networks that could have a significantly adverse effect on our business. We take steps to prevent unauthorized access to our corporate systems, however, because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently or may be disguised or difficult to detect, or designed to remain dormant until a triggering event, we may be unable to anticipate these techniques or implement adequate preventative measures. Breaches of our security measures, such as the Security Incident, or perceived breaches, have caused and may in the future cause, the market perception of the effectiveness of our security measures to be harmed and cause us to lose users and customers.

***Changes in regulations or user concerns regarding privacy and protection of user data, or any failure to comply with such laws, could adversely affect our business.***

Federal, state, and international laws and regulations govern the collection, use, retention, disclosure, sharing and security of data that we receive from and about our users. The use of consumer data by online service providers and advertising networks is a topic of active interest among federal, state, and international regulatory bodies, and the regulatory environment is unsettled. Many states have passed laws requiring notification to users where there is a security breach for personal data, such as California's Information Practices Act. We face similar risks in international markets where our products, services and apps are offered. Any failure, or perceived failure, by us to comply with or make effective modifications to our policies, or to comply with any applicable federal, state, or international privacy, data-retention or data-protection-related laws, regulations, orders or industry self-regulatory principles could result in proceedings or actions against us by governmental entities or others, a loss of user confidence, damage to the Yahoo brands, and a loss of users, advertising partners, or Affiliates, any of which could potentially have an adverse effect on our business.

In addition, various federal, state and foreign legislative or regulatory bodies may enact new or additional laws and regulations concerning privacy, data retention, data transfer and data protection issues, including laws or regulations mandating disclosure to domestic or international law enforcement bodies, which could adversely impact our business, our brand or our reputation with users. For example, some countries are considering or have enacted laws mandating that user data regarding users in their country be maintained in their country. Having to maintain local data centers in individual countries could increase our operating costs significantly. In addition, there currently is a data protection regulation pending implementation by the member states of the European Union by May 2018 that includes operational and compliance requirements that are different than those currently in place and that also includes significant penalties for non-compliance.

The European Court of Justice invalidated the European Commission's 2000 Safe Harbor Decision that we had previously relied on for data transfers between the European Union and United States. The model contractual clauses and other mechanisms that we currently rely on to address European Union data protection requirements for transfers of data are subject to uncertainty and legal challenges. The European Union and United States recently agreed to the Privacy Shield Framework, an alternative mechanism to comply with European Union data protection requirements. We are not currently relying on the Privacy Shield Framework. Challenges to our existing data transfer mechanisms, and any future legal challenges to data transfer mechanisms that we may adopt, could cause us to incur additional costs, require us to change business practices in a manner adverse to our business, or affect the manner in which we provide our services.

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The interpretation and application of privacy, data protection, data transfer and data retention laws and regulations are often uncertain and in flux in the United States and internationally. These laws may be interpreted and applied inconsistently from country to country and inconsistently with our current policies and practices, complicating long-range business planning decisions. If privacy, data protection, data transfer or data retention laws are interpreted and applied in a manner that is inconsistent with our current policies and practices we may be fined or ordered to change our business practices in a manner that adversely impacts our operating results. Complying with these varying international requirements could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business and operating results.

### ***Risks associated with our Search Agreement with Microsoft may adversely affect our business and operating results.***

Under our Search Agreement with Microsoft, Microsoft was the exclusive provider of algorithmic and paid search services for Yahoo Properties and Affiliate sites on personal computers and the non-exclusive provider of such services on mobile devices. As of April 15, 2015, Microsoft became the non-exclusive provider of such services on all devices. Commencing on May 1, 2015, the Company is required to request paid search results from Microsoft for 51 percent of its search queries originating from personal computers accessing Yahoo Properties and its Affiliate sites (the "Volume Commitment") and will display only Microsoft's paid search results on such search result pages. Approximately 39 percent, 36 percent and 35 percent of our revenue for the three and nine months ended September 30, 2016 and the year ended December 31, 2015, respectively, were attributable to the Microsoft Search Agreement (or approximately 24 percent and 26 percent for the three and nine months ended September 30, 2016, respectively, after excluding the impact of the change in revenue presentation related to the implementation of the Eleventh Amendment to the Microsoft Search Agreement during the second quarter of 2016). Our business and operating results would be adversely affected by a significant decline in or loss of this revenue if we are not able to successfully replace this revenue with revenue from search results displayed through our Yahoo Gemini platform or our Services Agreement with Google.

As a result of the Volume Commitment, we continue to be dependent on Microsoft continuing to invest and innovate to maintain and improve its algorithmic and paid search services and to be competitive with other search providers. If Microsoft fails to do this, our revenue and profitability could decline and our ability to maintain and expand our relationships with Affiliates for search and paid search advertising could be negatively impacted. Further, our competitors may continue to increase revenue, profitability, and market share at a higher rate than we do.

The term of the Microsoft Search Agreement is 10 years from its commencement date, February 23, 2010, subject to earlier termination as provided in the Microsoft Search Agreement. On or after October 1, 2015, either the Company or Microsoft may terminate the Microsoft Search Agreement by delivering a written notice of termination to the other party. The Microsoft Search Agreement will remain in effect for four months from the date of a termination notice to provide for a transition period. If Microsoft terminated the Microsoft Search Agreement and the Company was unable to rely on its own services or the Services Agreement with Google, the termination could have an adverse impact on our business, revenue and operating results.

### ***Risks associated with our Services Agreement with Google may adversely affect our business and operating results.***

Under our Services Agreement with Google, Google will provide us with search advertisements through Google's AdSense for Search service, web algorithmic search services through Google's Websearch Service, and image search services. We entered into the Services Agreement with Google in the fourth quarter of 2015. We expect that our revenues under the Services Agreement with Google will increase in 2016. In addition, if Microsoft were to terminate its Search Agreement with us, we would be required to rely on the Services Agreement and our Yahoo Gemini platform to replace the search revenue we currently receive under the Microsoft Search Agreement.

We are dependent on Google continuing to invest and innovate to maintain and improve its algorithmic and paid search services and to be competitive with other search providers. If Google fails to do this, our revenue and profitability could decline. Further, Google has a number of termination rights under the Services Agreement. If Google terminated the Services Agreement and we were unable to rely on our Yahoo Gemini platform or the Microsoft Search Agreement, the termination could have an adverse impact on our business, revenue and operating results.

### ***If we are unable to provide innovative search experiences and other products and services that differentiate our services and generate significant traffic to our websites, our business could be harmed, causing our revenue to decline.***

Internet search is characterized by rapidly changing technology, significant competition, evolving industry standards, and frequent product and service enhancements. Although we have agreements with Microsoft and Google to use their paid search platforms, we still need to continue to invest in our Yahoo Gemini search platform and to innovate to improve our users' search experience (especially on mobile) to continue to differentiate our services and attract, retain, and expand our user base and paid search advertiser base. We also generate revenue through other online products, services and apps, and continue to innovate the products, services and apps in our portfolio. The research and development of new, technologically advanced products is a complex process that requires significant levels of innovation and investment, as well as accurate anticipation of technology, market and consumer trends.

If we are unable to provide innovative search experiences and other products and services which differentiate our services, gain user acceptance and generate significant traffic to our websites, or if we are unable to effectively monetize the traffic from such products and services, our business could be harmed, causing our revenue to decline.

***Our business depends on a strong brand, and failing to maintain or enhance the Yahoo brands in a cost-effective manner could harm our operating results.***

Maintaining and enhancing our brands is an important aspect of our efforts to attract and expand our user, advertiser, and Affiliate base. We believe that the importance of brand recognition will increase due to the relatively low barriers to entry in certain portions of the Internet market. Maintaining and enhancing our brands will depend largely on our ability to provide high-quality, innovative products, and services, which we might not do successfully. We have spent and expect to spend considerable money and resources on the establishment and maintenance of our brands, as well as advertising, marketing, and other brand-building efforts to preserve and enhance consumer awareness of our brands. Our brands may be negatively impacted by a number of factors such as service outages, product malfunctions, data protection and security issues, exploitation of our trademarks by others without permission, and poor presentation or integration of our search marketing offerings by Affiliates on their sites or in their software and services.

Further, while we attempt to ensure that the quality of our brands is maintained by our licensees, our licensees might take actions that could impair the value of our brands, our proprietary rights, or the reputation of our products and media properties. If we are unable to maintain or enhance our brands in a cost-effective manner, or if we incur excessive expenses in these efforts, our business, operating results and financial condition could be harmed.

***If we are unable to attract, sustain, and renew distribution arrangements on favorable terms, our revenue may decline.***

We enter into distribution arrangements with third parties to promote or supply our services to their users. For example:

- We maintain search and display advertising relationships with Affiliate sites, which integrate our advertising offerings into their websites.
- We enter into distribution alliances with Internet service providers (including providers of cable and broadband Internet access) and software distributors to promote our services to their users.
- We enter into agreements with mobile phone, tablet, television, and other device manufacturers, electronics companies and carriers to promote our software and services on their devices.

In some markets, we depend on a limited number of distribution arrangements for a significant percentage of our user activity. A failure by our distributors to attract or retain their user bases would negatively impact our user activity and, in turn, reduce our revenue. For mobile app distribution, we depend on a limited number of distributors, primarily the developers of the operating systems or device manufacturers. If we are unable to reach agreements with these distributors for distribution of our mobile apps or they refuse to distribute or block our mobile apps, our operating results will be harmed. In the future, as new methods for accessing the Internet and our services become available, including through alternative devices, we may need to enter into amended distribution agreements with existing access providers, distributors, and manufacturers to cover the new devices and new arrangements. We face a risk that existing and potential new access providers, distributors, and manufacturers may decide not to offer distribution of our services on reasonable terms, or at all.

Distribution agreements often involve revenue sharing. Competition to enter into distribution arrangements has caused and may in the future cause our traffic acquisition costs to increase. In some cases, we guarantee distributors a minimum level of revenue and, as a result, run a risk that the distributors' performance (in terms of ad impressions, toolbar installations, etc.) might not be sufficient to otherwise earn their minimum payments, in which case our payments could exceed the revenue that we receive. In other cases, we agree that if the distributor does not realize specified minimum revenue we will adjust the distributor's revenue-share percentage or provide make-whole arrangements.

Some of our distribution agreements are not exclusive, have a short term, are terminable at will, or are subject to early termination provisions. The loss of distributors, increased distribution costs, or the renewal of distribution agreements on significantly less favorable terms may cause our revenue to decline.

***If we are unable to license, acquire, create or aggregate compelling content and services at reasonable cost, or receive compelling content, the number of users of our services may not grow as anticipated, or may decline, or users' level of engagement with our services may decline, all of which could harm our operating results.***

Our future success depends in part on our ability to aggregate compelling content and deliver that content through our online properties. We license from third parties much of the content and services on our online properties, such as news, stock quotes, weather, sports, video, and photos. In addition, our users also contribute content to us. We believe that users will increasingly demand high-quality content and services. We may need to make substantial payments to third parties from whom we license or acquire such content or services. Our ability to maintain and build relationships with such third-party providers is critical to our success. In addition, as users increasingly access the Internet via mobile and other alternative devices, we may need to enter into amended agreements with existing third-party providers to cover new devices. We may be unable to enter into new, or preserve existing, relationships with the third-parties whose content or services we seek to obtain. In addition, as competition for compelling content increases both domestically and internationally, our third-party providers may increase the prices at which they offer their content and services to us, stop offering their content or services to us, or offer their content and services on terms that are not agreeable to us. An increase in the prices charged to us by third-party providers could harm our operating results and financial condition. Further, because many of our licenses for our content and services with third parties are non-exclusive, other media providers may be able to offer similar or identical content.

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This increases the importance of our ability to deliver compelling editorial content and personalization of this content for users in order to differentiate Yahoo from other businesses. If we are unable to license or acquire compelling content at reasonable cost, if other companies distribute content or services that are similar to or the same as that provided by us, or if we do not receive compelling content from our users, the number of users of our services may not grow as anticipated, or may decline, users' level of engagement with our services may decline, clicks on our ads may decrease, or advertisers may reduce future purchases of our ads, all or any of which could harm our operating results.

### ***Interruptions, delays, or failures in the provision of our services could damage our reputation and harm our operating results.***

Delays or disruptions to our service, or the loss or compromise of data, could result from a variety of causes, including the following:

- Our operations are susceptible to outages and interruptions due to fire, flood, earthquake, tsunami, other natural disasters, power loss, equipment or telecommunications failures, cyber attacks, terrorist attacks, political or social unrest, and other events over which we have little or no control. We do not have multiple site capacity for all of our services and some of our systems are not fully redundant in the event of delays or disruptions to service, so some data or systems may not be fully recoverable after such events.
- The systems through which we provide our products and services are highly technical, complex, and interdependent. Design errors might exist in these systems, or might be introduced when we make modifications, which might cause service malfunctions or require services to be taken offline while corrective responses are developed.
- Despite our implementation of network security measures, our servers are vulnerable to computer viruses, malware, worms, hacking, physical and electronic break-ins, router disruption, sabotage or espionage, and other disruptions from unauthorized access and tampering, as well as coordinated denial-of-service attacks. We may not be in a position to promptly address attacks or to implement adequate preventative measures if we are unable to immediately detect such attacks. Such events could result in large expenditures to investigate or remediate, to recover data, to repair or replace networks or information systems, including changes to security measures, to deploy additional personnel, to defend litigation or to protect against similar future events, and may cause damage to our reputation or loss of revenue.
- We rely on third-party providers over which we have little or no control for our principal Internet connections and co-location of a significant portion of our data servers, as well as for our payment processing capabilities and key components or features of certain of our products and services. Any disruption of the services they provide us or any failure of these third-party providers to handle higher volumes of use could, in turn, cause delays or disruptions in our services and loss of revenue. In addition, if our agreements with these third-party providers are terminated for any reason, we might not have a readily available alternative.

Prolonged delays or disruptions to our service could result in a loss of users, damage to our brands, legal costs or liability, and harm to our operating results.

### ***Technologies, tools, software, and applications could block our advertisements, impair our ability to deliver interest-based advertising, or shift the location in which advertising appears, which could harm our operating results.***

Technologies, tools, software, and applications (including new and enhanced browsers) have been developed and are likely to continue to be developed that can block or allow users to opt out of display, search, and interest-based advertising and content, delete or block the cookies used to deliver such advertising, or shift the location in which advertising appears on pages so that our advertisements do not show up in the most monetizable places on our pages or are obscured. Most of our revenue is derived from fees paid by advertisers in connection with the display of graphical and non-graphical advertisements or clicks on search advertisements on web pages. As a result, the adoption of such technologies, tools, software, and applications could reduce the number of search and display advertisements that we are able to deliver and/or our ability to deliver interest-based advertising and this, in turn, could reduce our advertising revenue and operating results.

### ***If we are unable to recruit, hire, motivate, and retain key personnel, we may not be able to execute our business plan.***

Our business is dependent on our ability to recruit, hire, motivate, and retain talented, highly skilled personnel. Achieving this objective may be difficult due to many factors, including the pending Sale transaction with Verizon; the intense competition for such highly skilled personnel in the San Francisco Bay Area and other metropolitan areas where our offices are located; competitors' hiring practices; the effectiveness of our compensation and retention programs; and fluctuations in global economic and industry conditions. If we do not succeed in retaining and motivating our existing key employees, and in attracting new key personnel, we may be unable to meet our business plan and as a result, our revenue and profitability may decline.

### ***We are regularly involved in claims, suits, government investigations, and other proceedings that may result in adverse outcomes.***

We are regularly involved in claims, suits, government investigations, and proceedings arising from the ordinary course of our business, including actions with respect to intellectual property claims, privacy, consumer protection, information security, data protection or law enforcement matters, tax matters, labor and employment claims, commercial claims, as well as actions involving content generated by our users, stockholder derivative actions, purported class action and class action lawsuits, and other matters. Such claims, suits, government investigations, and proceedings are inherently uncertain and their results cannot be predicted with certainty. Regardless of the outcome, such legal proceedings can have an adverse impact on us because of legal costs, diversion of management and other personnel, and other factors. In addition, it is possible that a resolution of one or more such proceedings could result in reputational

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harm, liability, penalties, or sanctions, as well as judgments, consent decrees, or orders preventing us from offering certain features, functionalities, products, or services, or requiring a change in our business practices, products or technologies, which could in the future materially and adversely affect our business, operating results, and financial condition. See Note 12—"Commitments and Contingencies" in the Notes to our condensed consolidated financial statements.

***Our intellectual property rights are valuable, and any failure or inability to sufficiently protect them could harm our business and our operating results.***

We create, own, and maintain a wide array of copyrights, patents, trademarks, trade dress, trade secrets, rights to domain names and other intellectual property assets which we believe are collectively among our most valuable assets. We seek to protect our intellectual property assets through patent, copyright, trade secret, trademark, and other laws of the U.S. and other countries of the world, and through contractual provisions. However, the efforts we have taken to protect our intellectual property and proprietary rights might not be sufficient or effective at stopping unauthorized use of those rights. Protection of the distinctive elements of Yahoo might not always be available under copyright law or trademark law, or we might not discover or determine the full extent of any unauthorized use of our copyrights and trademarks in order to protect our rights. In addition, effective trademark, patent, copyright, and trade secret protection might not be available or cost-effective in every country in which our products and media properties are distributed or made available through the Internet. Changes in patent law, such as changes in the law regarding patentable subject matter, could also impact our ability to obtain patent protection for our innovations. In particular, recent amendments to the U.S. patent law may affect our ability to protect our innovations and defend against claims of patent infringement. Further, given the costs of obtaining patent protection, we might choose not to protect (or not to protect in some jurisdictions) certain innovations that later turn out to be important. There is also a risk that the scope of protection under our patents may not be sufficient in some cases or that existing patents may be deemed invalid or unenforceable. To help maintain our trade secrets, we have entered into confidentiality agreements with most of our employees and contractors, and confidentiality agreements with many of the parties with whom we conduct business, in order to limit access to and disclosure of our proprietary information. If these confidentiality agreements are breached it could compromise our trade secrets and cause us to lose any competitive advantage provided by those trade secrets.

If we are unable to protect our proprietary rights from unauthorized use, the value of our intellectual property assets may be reduced. In addition, protecting our intellectual property and other proprietary rights is expensive and time consuming. Any increase in the unauthorized use of our intellectual property could make it more expensive to do business and consequently harm our operating results.

***We are, and may in the future be, subject to intellectual property infringement or other third-party claims, which are costly to defend, could result in significant damage awards, and could limit our ability to provide certain content or use certain technologies in the future.***

Internet, technology, media, and patent holding companies often possess a significant number of patents. Further, many of these companies and other parties are actively developing or purchasing search, indexing, e-commerce, and other Internet-related technologies, as well as a variety of online business models and methods.

We believe that these parties will continue to take steps such as seeking patent protection to protect these technologies. In addition, patent holding companies may continue to seek to monetize patents they have purchased or otherwise obtained. As a result, disputes regarding the ownership of technologies and rights associated with online businesses are likely to continue to arise in the future. From time to time, parties assert patent infringement claims against us. Currently, we are engaged in a number of lawsuits regarding patent issues and have been notified of a number of other potential disputes.

In addition to patent claims, third parties have asserted, and are likely in the future to assert, claims against us alleging infringement of copyrights, trademark rights, trade secret rights or other proprietary rights, or alleging unfair competition, violation of federal or state statutes or other claims, including alleged violation of international statutory and common law. In addition, third parties have made, and may continue to make, infringement and other claims against us over the display of content or search results triggered by search terms.

As we develop new technologies, products and services, we may become increasingly subject to intellectual property infringement and other claims, including those that may arise under international laws. In the event that there is a determination that we have infringed third-party proprietary rights such as patents, copyrights, trademark rights, trade secret rights, or other third-party rights such as publicity and privacy rights, we could incur substantial monetary liability, or be required to enter into costly royalty or licensing agreements or be prevented from using such rights, which could require us to change our business practices in the future, hinder us from offering certain features, functionalities, products or services, require us to develop non-infringing products or technologies, and limit our ability to compete effectively. We may also incur substantial expenses in defending against third-party claims regardless of the merit of such claims. In addition, many of our agreements with our customers or Affiliates require us to indemnify them for some types of third-party intellectual property infringement claims, which could increase our costs in defending such claims and our damages. Furthermore, such customers and Affiliates may discontinue the use of our products, services, and technologies either as a result of injunctions or otherwise. The occurrence of any of these results could harm our brands or have an adverse effect on our business, financial position, operating results, and cash flows.

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### ***We may be required to record a significant charge to earnings if our goodwill, intangible assets, investments in equity interests, or other investments become impaired.***

We have previously recorded charges to earnings when our goodwill, intangible assets, investments in equity interests, including investments held by any equity method investee, and other investments became impaired. For example, we recorded a \$4.461 billion non-cash goodwill impairment charge during the fourth quarter of 2015 and a non-cash goodwill impairment charge of \$395 million and a non-cash intangible assets impairment charge of \$87 million during the second quarter of 2016. We are required under generally accepted accounting principles to test goodwill for impairment at least annually and to review our intangible assets, investments in equity interests (including investments held by any equity method investee), and our other investments, for impairment when events or changes in circumstance indicate the carrying value may not be recoverable. Factors that could lead to impairment of goodwill, intangible assets (including goodwill or assets acquired via acquisitions) and other investments include significant adverse changes in the business climate and actual or projected operating results (affecting our company as a whole or affecting any particular reporting unit) and declines in the financial condition of our business. Factors that could lead to impairment of investments in equity interests include a prolonged period of decline in the stock price or operating performance of, or an announcement of adverse changes or events by, the companies in which we invested or the investments held by those companies. Factors that could lead to an impairment of U.S. government securities, which constitute a significant portion of our current assets, include any downgrade of U.S. government debt or concern about the creditworthiness of the U.S. government. We may be required in the future to record additional charges to earnings if our goodwill, intangible assets, investments in equity interests, including investments held by any equity method investee, or other investments become impaired. Any such charge would adversely impact our financial results .

### ***Fluctuations in foreign currency exchange rates may adversely affect our operating results and financial condition.***

Revenue generated and expenses incurred by our international subsidiaries and any equity method investee are often denominated in the currencies of the local countries. As a result, our consolidated U.S. dollar financial statements are subject to fluctuations due to changes in exchange rates as the financial results of our international subsidiaries and any equity method investee are translated from local currencies into U.S. dollars. Our financial results are also subject to changes in exchange rates that impact the settlement of transactions in non-local currencies. The carrying values of our equity investments in any equity investee are also subject to fluctuations in the exchange rates of foreign currencies.

We use derivative instruments, such as foreign currency forward contracts and options, to partially offset certain exposures to fluctuations in foreign currency exchange rates. The use of such instruments may not offset any, or more than a portion, of the adverse financial effects of unfavorable movements in foreign currency exchange rates. Any losses on these instruments that we experience may adversely impact our financial results, cash flows and financial condition. Further, we hedge a portion of our net investment in Yahoo Japan Corporation (“Yahoo Japan”) with currency forward contracts. If the Japanese yen has appreciated at maturity beyond the contract execution rate, we would be required to settle the contract by making a cash payment which could be material and could adversely impact our cash flows and financial condition. See Part I, Item 3—“Quantitative and Qualitative Disclosures About Market Risk” of this Quarterly Report.

### ***Acquisitions and strategic investments could result in adverse impacts on our operations and in unanticipated liabilities.***

We have acquired, and have made strategic investments in, a number of companies (including through joint ventures). Such acquisitions and strategic investments to date were accompanied by a number of risks, including:

- the difficulty of integrating the operations, personnel, systems, and controls of acquired companies as a result of cultural, regulatory, systems, and operational differences;
- the potential disruption of our ongoing business and distraction of management;
- the incurrence of additional operating losses and operating expenses of the businesses we acquired or in which we invested;
- the difficulty of integrating acquired technology and rights into our services and unanticipated expenses related to such integration;
- the failure to successfully further develop an acquired business or technology and any resulting impairment of amounts currently capitalized as intangible assets;
- the failure of strategic investments to perform as expected or to meet financial projections;
- the potential for patent and trademark infringement and data privacy and security claims against the acquired companies, or companies in which we have invested;
- litigation or other claims in connection with acquisitions, acquired companies, or companies in which we have invested;
- the impairment or loss of relationships with customers and partners of the companies we acquired or in which we invested or with our customers and partners as a result of the integration of acquired operations;
- the impairment of relationships with, or failure to retain, employees of acquired companies or our existing employees as a result of integration of new personnel;
- our lack of, or limitations on our, control over the operations of our joint venture companies;
- in the case of foreign acquisitions and investments, the impact of particular economic, tax, currency, political, legal and regulatory risks associated with specific countries; and
- the impact of known potential liabilities or liabilities that may be unknown, including as a result of inadequate internal controls, associated with the companies we acquired or in which we invested.

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Our failure to be successful in addressing these risks or other problems encountered in connection with our acquisitions and strategic investments could cause us to fail to realize the anticipated benefits of such acquisitions or investments, incur unanticipated liabilities, and harm our business generally.

***A variety of new and existing U.S. and foreign government laws and regulations could subject us to claims, judgments, monetary liabilities and other remedies, and to limitations on our business practices.***

We are subject to numerous U.S. and foreign laws and regulations covering a wide variety of subject matters. New laws and regulations, changes in existing laws and regulations or the interpretation of them, our introduction of new products or forms of advertising (such as native advertising), or an extension of our business into new areas, could increase our future compliance costs, make our products and services less attractive to our users, or cause us to change or limit our business practices. We may incur substantial expenses to comply with laws and regulations or defend against a claim that we have not complied with them. Further, any failure on our part to comply with any relevant laws or regulations may subject us to significant civil or criminal liabilities, penalties, and negative publicity.

The application of existing domestic and international laws and regulations to us relating to issues such as user privacy and data protection, data transfer, security, defamation, pricing, advertising, taxation, gambling, sweepstakes, promotions, billing, real estate, fantasy sports, consumer protection, accessibility, content regulation, quality of services, law enforcement demands, telecommunications, mobile, television, and intellectual property ownership and infringement in many instances is unclear or unsettled. Further, the application to us or our subsidiaries of existing laws regulating or requiring licenses for certain businesses of our advertisers can be unclear. For example, paid fantasy sports contests are an area of current regulatory uncertainty, with various government authorities having taken positions that some types of contests are unlawful and/or subject to licensing requirements. U.S. export control laws and regulations also impose requirements and restrictions on exports to certain nations and persons and on our business. Internationally, we may also be subject to laws regulating our activities in foreign countries and to foreign laws and regulations that are inconsistent from country to country.

The Digital Millennium Copyright Act (“DMCA”) is intended, in part, to limit the liability of eligible online service providers for caching, hosting, listing or linking to, third-party websites or user content that include materials that give rise to copyright infringement. Portions of the Communications Decency Act (“CDA”) are intended to provide statutory protections to online service providers who distribute third-party content. We rely on the protections provided by both the DMCA and the CDA in conducting our business, and may be adversely impacted by future legislation and future judicial decisions altering these safe harbors or if international jurisdictions refuse to apply similar protections.

Various U.S. and international laws restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from minors. These laws currently impose restrictions and requirements on our business, and future federal, state or international laws and legislative efforts designed to protect children on the Internet may impose additional requirements on us.

***Our international operations expose us to additional risks that could harm our business, operating results, and financial condition.***

In addition to uncertainty about our ability to continue to generate revenue from our foreign operations, there are additional risks inherent in doing business internationally (including through our international joint ventures), including:

- tariffs, trade barriers, customs classifications and changes in trade regulations;
- difficulties in developing, staffing, and simultaneously managing a large number of varying foreign operations as a result of distance, language, and cultural differences;
- stringent local labor laws and regulations;
- longer payment cycles;
- credit risk and higher levels of payment fraud;
- profit repatriation restrictions and foreign currency exchange restrictions;
- political or social unrest, economic instability, repression, or human rights issues;
- geopolitical events, including natural disasters, acts of war and terrorism;
- import or export regulations;
- compliance with U.S. laws such as the Foreign Corrupt Practices Act, and local laws prohibiting bribery and corrupt payments to government officials;
- antitrust and competition regulations;

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- potentially adverse tax developments;
- seasonal volatility in business activity and local economic conditions;
- economic uncertainties relating to volatility in emerging markets and global economic uncertainty;
- laws, regulations, licensing requirements, and business practices that favor local competitors or prohibit foreign ownership or investments;
- different, uncertain or more stringent user protection, content, data protection, privacy, intellectual property and other laws; and
- risks related to other government regulation (including the potential for actions restricting access to our products), required compliance with local laws or lack of legal precedent.

The recent advisory referendum on the United Kingdom's membership in the European Union, and any resulting changes to UK or EU policies, may, among other things, adversely affect business activity and economic conditions, cause unfavorable exchange rate fluctuations, create uncertainty regarding international data protection and transfer, government requests for information, advertising regulations, and tax rates, and affect our ability to recruit and retain employees.

We are subject to numerous and sometimes conflicting U.S. and foreign laws and regulations which increase our cost of doing business. Violations of these complex laws and regulations that apply to our international operations could result in damage awards, fines, criminal actions, sanctions, or penalties against us, our officers or our employees, prohibitions on the conduct of our business and our ability to offer products and services, and damage to our reputation. Although we have implemented policies and procedures designed to promote compliance with these laws, there can be no assurance that our employees, contractors, or agents will not violate our policies. These risks inherent in our international operations and expansion increase our costs of doing business internationally and could result in harm to our business, operating results, and financial condition.

### ***We may be subject to legal liability associated with providing online services or content.***

We host and provide a wide variety of services and technology products that enable and encourage individuals and businesses to exchange information; upload or otherwise generate photos, videos, text, and other content; advertise products and services; conduct business; and engage in various online activities both domestically and internationally. The law relating to the liability of providers of online services and products for activities of their users is currently unsettled both within the United States and internationally. As a publisher and producer of original content, we may be subject to claims such as copyright, libel, defamation or improper use of publicity rights, as well as other infringement claims such as plagiarism. Claims have been threatened and brought against us for defamation, negligence, breaches of contract, plagiarism, copyright and trademark infringement, unfair competition, unlawful activity, tort, including personal injury, fraud, or other theories based on the nature and content of information which we publish or to which we provide links or that may be posted online or generated by us or by third parties, including our users. In addition, we have been and may again in the future be subject to domestic or international actions alleging that certain content we have generated or third-party content that we have made available within our services violates laws in domestic and international jurisdictions. We arrange for the distribution of third-party advertisements to third-party publishers and advertising networks, and we offer third-party products, services, or content, such as stock quotes and trading information, under the Yahoo brand or via distribution on Yahoo Properties. We may be subject to claims concerning these products, services, or content by virtue of our involvement in marketing, branding, broadcasting, or providing access to them, even if we do not ourselves host, operate, provide, or provide access to these products, services, or content. While our agreements with respect to these products, services, and content may provide that we will be indemnified against such liabilities, the ability to receive such indemnification may be disputed, could result in substantial costs to enforce or defend, and depends on the financial resources of the other party to the agreement, and any amounts received might not be adequate to cover our liabilities or the costs associated with defense of such proceedings. Defense of any such actions could be costly and involve significant time and attention of our management and other resources, may result in monetary liabilities or penalties, and may require us to change our business in an adverse manner.

It is also possible that if any information provided directly by us contains errors or is otherwise wrongfully provided to users, third parties could make claims against us. For example, we offer web-based e-mail services, which expose us to potential risks, such as liabilities or claims, by our users and third parties, resulting from unsolicited e-mail, lost or misdirected messages, illegal or fraudulent use of e-mail, alleged violations of policies, property interests, or privacy protections, including civil or criminal laws, or interruptions or delays in e-mail service. We may also face purported consumer class actions or state actions relating to our online services, including our fee-based services (particularly in connection with any decision to discontinue a fee-based service). In addition, our customers, third parties, or government entities may assert claims or actions against us if our online services or technologies are used to spread or facilitate malicious or harmful code or applications.

Investigating and defending these types of claims are expensive, even if the claims are without merit or do not ultimately result in liability, and could subject us to significant monetary liability or cause a change in business practices that could negatively impact our ability to compete.

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***Certain of our metrics are subject to inherent challenges in measurement, and real or perceived inaccuracies in such metrics may harm our reputation and negatively affect our business.***

We present key metrics such as unique users, number of Ads Sold, number of Paid Clicks, Search click-driven revenue, Price-per-Click and Price-per-Ad that are calculated using internal company data. We periodically review, refine and update our methodologies for monitoring, gathering, and calculating these metrics.

While our metrics are based on what we believe to be reasonable measurements and methodologies, there are inherent challenges in deriving our metrics across large online and mobile populations around the world. In addition, our user metrics may differ from estimates published by third parties or from similar metrics of our competitors due to differences in methodology. Furthermore, over time we may revise or cease reporting certain metrics that we no longer believe are useful or meaningful measures of our performance and add new metrics which we believe are better measurements of performance.

If advertisers or publishers do not perceive our metrics to be accurate, or if we discover material inaccuracies in our metrics, it could negatively affect our reputation, business and financial results.

***Any failure to scale and adapt our existing technology architecture to manage expansion of user-facing services and to respond to rapid technological change could adversely affect our business.***

As some of the most visited sites on the Internet, Yahoo Properties deliver a significant number of products, services, page views, and advertising impressions to users around the world. We expect our products and services to continue to expand and change significantly and rapidly in the future to accommodate new technologies, new devices, new Internet advertising solutions, and new means of content delivery.

In addition, widespread adoption of new Internet, networking or telecommunications technologies, or other technological or platform changes, could require substantial expenditures to modify or adapt our services or infrastructure. The technology architectures and platforms utilized for our services are highly complex and may not provide satisfactory security features or support in the future, as usage increases and products and services expand, change, and become more complex. In the future, we may make additional changes to our existing, or move to completely new, architectures, platforms and systems, such as the changes we have made in response to the increased use of mobile devices such as tablets and smartphones. Such changes may be technologically challenging to develop and implement, may take time to test and deploy, may cause us to incur substantial costs or data loss, and may cause changes, delays or interruptions in service. These changes, delays, or interruptions in our service may cause our users, Affiliates and other advertising platform participants to become dissatisfied with our service or to move to competing providers or seek remedial actions or compensation. Further, to the extent that demands for our services increase, we will need to expand our infrastructure, including the capacity of our hardware servers and the sophistication of our software. This expansion is likely to be expensive and complex and require additional technical expertise. As we acquire users who rely upon us for a wide variety of services, it becomes more technologically complex and costly to retrieve, store, and integrate data that will enable us to track each user's preferences. Any difficulties experienced in adapting our architectures, platforms and infrastructure to accommodate increased traffic, to store user data, and track user preferences, together with the associated costs and potential loss of traffic, could harm our operating results, cash flows from operations, and financial condition.

***We rely on third parties to provide the technologies necessary to deliver content, advertising, and services to our users, and any change in the licensing terms, costs, availability, or acceptance of these formats and technologies could adversely affect our business.***

We rely on third parties to provide the technologies that we use to deliver the majority of the content, advertising, and services to our users. There can be no assurance that these providers will continue to license their technologies or intellectual property to us on reasonable terms, or at all. Providers may change the fees they charge users or otherwise change their business model in a manner that slows the widespread acceptance of their technologies. In order for our services to be successful, there must be a large base of users of the technologies necessary to deliver our content, advertising, and services. We have limited or no control over the availability or acceptance of those technologies, and any change in the licensing terms, costs, availability, or user acceptance of these technologies could adversely affect our business.

***Our business depends on continued and unimpeded access to the Internet by us and our users. Internet access providers may be able to block, degrade, or charge for access to certain of our products and services, which could lead to additional expenses and the loss of users and advertisers.***

Our products and services depend on the ability of our users to access the Internet, and certain of our products require significant bandwidth to work effectively. Currently, this access is provided by companies that have significant market power in the broadband and internet access marketplace, including incumbent telephone companies, cable companies, mobile communications companies, and government-owned service providers. Some of these providers may take, or have stated that they may take, measures that could degrade, disrupt, or increase the cost of user access to certain of our products by restricting or prohibiting the use of their infrastructure to support or facilitate our offerings, or by charging increased fees to us or our users to provide our offerings. Such interference could result in a loss of existing users and advertisers, and increased costs, and could impair our ability to attract new users and advertisers, thereby harming our revenues and growth. The adoption of any laws or regulations that limit access to the Internet by blocking, degrading or charging access fees to us or our users for certain services could decrease the demand for, or the usage of, our products, services and apps, increase our cost of doing business and adversely affect our operating results.

***Any failure to manage changes to our business could adversely affect our operating results.***

If we are unable to effectively manage a large and geographically dispersed group of employees, our business may be adversely affected. Our business relies on data systems, billing systems, and financial reporting and control systems, among others. All of these systems have become increasingly complex in the recent past due to the growing complexity of our business, acquisitions of new businesses with different systems, and increased regulation over controls and procedures. To manage our business in a cost-effective manner, we will need to continue to upgrade and improve our data systems, billing systems, and other operational and financial systems, procedures, and controls. In some cases, we are outsourcing administrative functions to lower-cost providers. These upgrades, improvements and outsourcing changes will require a dedication of resources and in some cases are likely to be complex. If we are unable to adapt our systems and put adequate controls in place in a timely manner, our business may be adversely affected. In particular, sustained failures of our billing systems to accommodate increasing numbers of transactions, to accurately bill users and advertisers, or to accurately compensate Affiliates could adversely affect the viability of our business model.

***We have dedicated resources to provide a variety of premium enhancements to our products, services and apps, which might not prove to be successful in generating significant revenue for us.***

We offer fee-based enhancements for many of our free services. The development cycles for these technologies are long and generally require investment by us. We have invested and will continue to invest in premium products, services and apps. Some of these premium products, services and apps might not generate anticipated revenue or might not meet anticipated user adoption rates. We have previously discontinued some non-profitable premium services and may discontinue others. General economic conditions as well as the rapidly evolving competitive landscape may affect users' willingness to pay for such premium services. If we cannot generate revenue from our premium services that are greater than the cost of providing such services, our operating results could be harmed.

***We may have exposure to additional tax liabilities which could negatively impact our income tax provision, net income, and cash flow.***

We are subject to income taxes and other taxes in both the United States and the foreign jurisdictions in which we currently operate or have historically operated. The determination of our worldwide provision for income taxes and current and deferred tax assets and liabilities requires judgment and estimation. Our income taxes could be adversely affected by earnings being lower than anticipated in jurisdictions that have lower statutory tax rates and higher than anticipated in jurisdictions that have higher statutory tax rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, or accounting principles.

In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. As a U.S. multinational corporation, we are subject to changing tax laws both within and outside of the United States. We cannot predict the form or timing of potential legislative changes, but any newly enacted tax law could have a material adverse impact on our tax expense and cash flow. For example, several jurisdictions have sought to increase revenues by imposing new taxes on internet advertising or increasing general business taxes. In addition, the Organization for Economic Co-operation and Development ("OECD"), which represents a coalition of member countries, is supporting changes to numerous long-standing tax principles through its base erosion and profit shifting (BEPS) project, which is focused on a number of issues, including the shifting of profits between affiliated entities in different tax jurisdictions. To the extent any of these proposals are enacted into legislation by OECD member countries, or if other international, consensus-based tax policies and principles are amended or implemented, they could adversely affect the amount of tax we pay and thereby our financial position and results of operations.

We earn a material amount of our income from outside the United States. As of September 30, 2016, we had undistributed foreign earnings of approximately \$3.1 billion, related to our equity method investment in Yahoo Japan. While we do not currently anticipate repatriating these earnings, any repatriation of funds in foreign jurisdictions to the United States could result in higher effective tax rates for us and subject us to significant additional U.S. income tax liabilities.

We are subject to regular review and audit by both domestic and foreign tax authorities as well as subject to the prospective and retrospective effects of changing tax regulations and legislation. Although we believe our tax estimates are reasonable, the ultimate tax outcome may materially differ from the tax amounts recorded in our consolidated financial statements and may materially affect our income tax provision, net income, or cash flows in the period or periods for which such determination and settlement is made.

***Proprietary document formats may limit the effectiveness of our search technology by preventing our technology from accessing the content of documents in such formats, which could limit the effectiveness of our products and services.***

A large amount of information on the Internet is provided in proprietary document formats. These proprietary document formats may limit the effectiveness of search technology by preventing the technology from accessing the content of such documents. The providers of the software applications used to create these documents could engineer the document format to prevent or interfere with the process of indexing the document contents with search technology. This would mean that the document contents would not be included in search results even if the contents were directly relevant to a search. The software providers may also seek to require us to pay them royalties in exchange for giving us the ability to search documents in their format. If the search platform technology we employ is unable to index proprietary format web documents as effectively as our competitors' technology, usage of our search services might decline, which could cause our revenue to fall.

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### ***Adverse macroeconomic conditions could cause decreases or delays in spending by our advertisers and could harm our ability to generate revenue and our results of operations.***

Advertising expenditures tend to be cyclical, reflecting overall economic conditions and budgeting and buying patterns. Since we derive most of our revenue from advertising, adverse macroeconomic conditions have caused, and future adverse macroeconomic conditions could cause, decreases or delays in advertising spending and negatively impact our advertising revenue and short-term ability to grow our revenue. Further, any decreased collectability of accounts receivable or early termination of agreements, whether resulting from customer bankruptcies or otherwise due to adverse macroeconomic conditions, could negatively impact our results of operations.

### ***Our stock price has been volatile historically and may continue to be volatile regardless of our operating performance.***

The trading price of our common stock has been and may continue to be subject to broad fluctuations. During the three months ended September 30, 2016, the closing sale price of our common stock on the NASDAQ Global Select Market ranged from \$37.50 to \$44.71 per share and the closing sale price on October 28, 2016 was \$41.78 per share. Our stock price may fluctuate in response to a number of events and factors, such as variations in quarterly operating results or announcements of technological innovations, significant transactions, or new features, products or services by us or our competitors; changes in financial estimates and recommendations by securities analysts; the operating and stock price performance of, or other developments involving, other companies that investors may deem comparable to us; trends in our industry; general economic conditions; and the operating performance and market valuation of Alibaba Group Holding Limited (“Alibaba Group”) and Yahoo Japan in which we have investments. Following the closing of the Sale transaction with Verizon, our stock price will be further materially impacted by the operating performance and market valuation of Alibaba Group and Yahoo Japan. The equity valuation of our investment in Yahoo Japan may be impacted due to fluctuations in foreign currency exchange rates. We present our investment in Alibaba Group on our consolidated balance sheet as an available-for-sale marketable security. Consequently, the carrying value of this investment on our consolidated balance sheet will vary over time and fluctuations in its valuation may cause our stock price to fluctuate.

In addition, the stock market in general, and the market prices for companies in our industry, have experienced volatility that often has been unrelated to operating performance. These broad market and industry fluctuations may adversely affect the price of our stock, regardless of our operating performance. A decrease in the market price of our common stock would likely adversely impact the trading price of the 0.00% Convertible Senior Notes due 2018 that we issued in November 2013 (the “Notes”). Volatility or a lack of positive performance in our stock price may also adversely affect our ability to retain key employees who have been granted stock options or other stock-based awards. A sustained decline in our stock price and market capitalization could lead to an impairment charge to our long-lived assets.

### ***Delaware statutes and certain provisions in our charter documents could make it more difficult for a third-party to acquire us.***

Our Board has the authority to issue up to 10 million shares of preferred stock and to determine the price, rights, preferences, privileges and restrictions, including voting rights, of those shares without any further vote or action by the stockholders. The rights of the holders of our common stock may be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock may have the effect of delaying, deterring or preventing a change in control of Yahoo without further action by the stockholders and may adversely affect the voting and other rights of the holders of our common stock.

Some provisions of our charter documents, including provisions eliminating the ability of stockholders to take action by written consent and limiting the ability of stockholders to raise matters at a meeting of stockholders without giving advance notice, may have the effect of delaying or preventing changes in control or changes in our management, which could have an adverse effect on the market price of our stock and the value of the \$1.4375 billion aggregate principal amount of the Notes we issued in November 2013. In addition, our charter documents do not permit cumulative voting, which may make it more difficult for a third-party to gain control of our Board. Further, we are subject to the anti-takeover provisions of Section 203 of the Delaware General Corporation Law, which will prohibit us from engaging in a “business combination” with an “interested stockholder” for a period of three years after the date of the transaction in which the person became an interested stockholder, even if such combination is favored by a majority of stockholders, unless the business combination is approved in a prescribed manner. The application of Section 203 also could have the effect of delaying or preventing a change in control of us.

Any of these provisions could, under certain circumstances, depress the market price of our common stock and the Notes.

## **Risks Relating to the Notes**

### ***The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and operating results.***

In the event the conditional conversion feature of the Notes is triggered, holders of Notes will be entitled to convert the Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes, unless we elect to satisfy our

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conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

***We may not have the ability to raise the funds necessary to settle conversions of the Notes in cash or to repurchase the Notes upon a fundamental change, and our future debt may contain limitations on our ability to pay cash upon conversion or repurchase of the Notes.***

Holders of the Notes will have the right to require us to repurchase all or a portion of their Notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid special interest, if any. We may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefore, or pay cash with respect to Notes being converted if we elect not to issue shares, which could harm our reputation and affect the trading price of our common stock.

***The note hedge and warrant transactions may affect the value of the Notes and our common stock.***

In connection with the pricing of the Notes, we entered into note hedge transactions with the option counterparties. The note hedge transactions are generally expected to reduce the potential dilution upon conversion of the Notes and/or offset any cash payments we are required to make in excess of the principal amount of converted Notes, as the case may be. We also entered into warrant transactions with the option counterparties. However, the warrant transactions could separately have a dilutive effect to the extent that the market price per share of our common stock exceeds the applicable strike price of the warrants. The initial strike price of the warrants was \$71.24. Counterparties to the warrants may make adjustments to certain terms of the warrants upon the occurrence of specified events, including the announcement of the Stock Purchase Agreement, if the event results in a material change to the trading price of our common stock or the value of the warrants. To date, two counterparties have given us notices of adjustment to their warrant exercise prices.

In connection with establishing their initial hedge of the note hedge and warrant transactions, the option counterparties or their respective affiliates have purchased shares of our common stock and/or entered into various derivative transactions with respect to our common stock concurrently with or shortly after the pricing of the Notes. In addition, the option counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions prior to the maturity of the Notes (and are likely to do so during any observation period related to a conversion of Notes or following any repurchase of Notes by us on any fundamental repurchase date or otherwise). This activity could cause or avoid an increase or a decrease in the market price of our common stock or the Notes.

***Any adverse change in the rating of the Notes or the Company may cause their trading price to decline.***

While we did not solicit a credit rating on the Company or on the Notes, one rating service has rated both the Notes and the Company. If that rating service announces its intention to put the Company or the Notes on credit watch or lowers its rating on the Company or the Notes below any rating initially assigned to the Company or the Notes, the trading price of the Notes could decline.

***The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.***

In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification ("ASC") 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the Notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component would be treated as debt discount for purposes of accounting for the debt component of the Notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the Notes to their face amount over the term of the Notes. We will report lower net income in our financial results because ASC 470-20 will require interest to include the current period's amortization of the debt discount, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the Notes.

In addition, under certain circumstances, convertible debt instruments (such as the Notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the Notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the Notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the Notes, then our diluted earnings per share would be adversely affected.

## **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

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## **Item 3. Defaults Upon Senior Securities**

None.

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## **Item 4. Mine Safety Disclosures**

Not applicable.

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## **Item 5. Other Information**

None.

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## **Item 6. Exhibits**

The exhibits listed in the Index to Exhibits (following the signatures page of this Report) are filed with, or incorporated by reference in, this Report.

**SIGNATURES**

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

YAHOO! INC.

Dated: November 9, 2016

By: \_\_\_\_\_ /s/ M ARISSA A. M AYER  
**Marissa A. Mayer**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

Dated: November 9, 2016

By: \_\_\_\_\_ /s/ K EN G OLDMAN  
**Ken Goldman**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

**Yahoo! Inc.**  
**Index to Exhibits**

Exhibit Number	Description
2.5§	Stock Purchase Agreement, dated July 23, 2016, by and between the Registrant and Verizon Communications Inc. (previously filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed July 25, 2016 and incorporated herein by reference).
2.6§	Reorganization Agreement, dated July 23, 2016, by and between the Registrant and Yahoo Holdings, Inc. (previously filed as Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed July 25, 2016 and incorporated herein by reference).
3.1(A)	Amended and Restated Certificate of Incorporation of the Registrant (previously filed as Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q filed July 28, 2000 and incorporated herein by reference).
3.1(B)	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Registrant (previously filed as Exhibit 4.8 to the Registrant's Quarterly Report on Form 10-Q filed May 4, 2001 and incorporated herein by reference).
3.2	Amended and Restated Bylaws of Yahoo! Inc. (previously filed as Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed March 30, 2016 and incorporated herein by reference).
10.2(M)+*	Form of Restricted Stock Unit Award Agreement, including Notice of Grant (for certain grants made after the Registrant's entry into the Stock Purchase Agreement with Verizon), under the Yahoo! Inc. Stock Plan.
31.1*	Certificate of Chief Executive Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 9, 2016.
31.2*	Certificate of Chief Financial Officer Pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated November 9, 2016.
32**	Certificate of Chief Executive Officer and Chief Financial Officer Pursuant to Securities Exchange Act Rules 13a-14(b) and 15d-14(b) and 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 9, 2016.
101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels
101.PRE*	XBRL Taxonomy Extension Presentation

\* Filed herewith.

\*\* Furnished herewith.

+ Indicates a management contract or compensatory plan or arrangement.

§ Certain schedules and attachments have been omitted in accordance with Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule and attachment will be furnished supplementally to the SEC upon request.



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- **you consent to the collection, use and transfer, in electronic or other form, of your personal data as described in the Governing Documents for the purpose of implementing, administering and managing your participation in the Plan.**

This Notice of Restricted Stock Unit Grant shall be construed and determined in accordance with the laws of the U.S. State of Delaware (without giving effect to the conflict of laws principles thereof) and shall be deemed to have been executed and delivered by the parties hereto as of the Date of Grant.

GRANTEE:

YAHOO! INC.

[Click here to accept](#)



\_\_\_\_\_  
Signature

By:

\_\_\_\_\_  
Marissa A. Mayer

\_\_\_\_\_  
[grantee name]

Title:

\_\_\_\_\_  
Chief Executive Officer

Name

Supplemental Documents:

[U.S. Prospectus](#)  
[Insider Trading Policy](#)

NOTE: This award is excluded from the Yahoo! Inc. Change in Control Employee Severance Plans (the "CIC Plans") and will not be eligible for accelerated vesting under the CIC Plans nor under any other pre-existing plan, policy, or agreement, except as expressly provided in section 2(g) below.

**YAHOO! INC. STOCK PLAN**  
**RESTRICTED STOCK UNIT AWARD AGREEMENT**  
**FOR U.S. EMPLOYEES**  
**(Transaction Form)**

**Section 1. Grant of Restricted Stock Unit Award**

- (a) *Grant of Restricted Stock Units ("RSUs").* Yahoo! Inc., a Delaware corporation (the "Company"), hereby grants to the grantee (the "Grantee") named in the Notice of Restricted Stock Unit Grant (the "Notice of Grant") the total number of RSUs set forth in the Notice of Grant, on the terms and conditions set forth in this Restricted Stock Unit Award Agreement for U.S. Employees (this "Agreement") and as otherwise provided in the Yahoo! Inc. Stock Plan, as amended (the "Award").
- (b) *Incorporation of Plan; Capitalized Terms.* The provisions of the Yahoo! Inc. Stock Plan, as amended (the "Plan") are hereby incorporated herein by reference. Except as otherwise expressly set forth herein, this Agreement shall be construed in accordance with the provisions of the Plan and any capitalized terms not otherwise defined in this Agreement shall have the definitions set forth in the Plan. The Administrator shall have final authority to interpret and construe the Plan and this Agreement and to make any and all determinations thereunder, and its decision shall be binding and conclusive upon the Grantee and his/her legal representative in respect of any questions arising under the Plan or this Agreement.

**Section 2. Terms and Conditions of Award**

The grant of RSUs provided in Section 1(a) shall be subject to the following terms, conditions and restrictions:

- (a) *Limitations on Rights Associated with RSUs.* The RSUs are bookkeeping entries only. The Grantee shall have no rights as a stockholder of the Company, no dividend rights and no voting rights with respect to the RSUs.
- (b) *Restrictions.* The RSUs and any interest therein, may not be sold, assigned, transferred, pledged, hypothecated or otherwise disposed of, except by will or the laws of descent and distribution. Any attempt to dispose of any RSUs in contravention of the above restriction shall be null and void and without effect.
- (c) *Lapse of Restrictions .* Subject to Sections 2(e) through 2(g) below, on each vesting date specified in the vesting schedule set forth in the Notice of Grant (the "Vesting Schedule"), the number of RSUs set forth opposite such vesting date shall vest and become non-forfeitable.

(d) *Timing and Manner of Payment of RSUs.*

- (i) In the event that the Notice of Grant specifies that the manner of payment by the Company shall be stock, as soon as practicable after (and in no case more than seventy-four days after) the date any RSUs subject to the Award become non-forfeitable (the “Payment Date”), such RSUs shall be paid by the Company delivering to the Grantee a number of Shares equal to the number of RSUs that become non-forfeitable upon that Payment Date (rounded down to the nearest whole share). The Company shall issue the Shares either (A) in certificate form or (B) in book entry form, registered in the name of the Grantee. Delivery of any certificates will be made to the Grantee’s last address reflected on the books of the Company and its Subsidiaries unless the Company is otherwise instructed in writing. The Grantee shall not be required to pay any cash consideration for the RSUs or for any Shares received pursuant to the Award. Neither the Grantee nor any of the Grantee’s successors, heirs, assigns or personal representatives shall have any further rights or interests in any RSUs that are so paid. Notwithstanding the foregoing, the Company shall have no obligation to issue Shares in payment of the RSUs unless such issuance and such payment shall comply with all relevant provisions of law and the requirements of any Stock Exchange.
- (ii) In the event that the Notice of Grant specifies that the manner of payment by the Company shall be cash, as soon as practicable after (and in no case more than seventy-four days after) the Payment Date, such RSUs shall be paid in a lump sum cash payment equal in the aggregate to the Fair Market Value of a Share on the Payment Date multiplied by the number of such RSUs that become non-forfeitable upon that Payment Date. The Grantee shall not be required to pay any cash consideration for the RSUs or for any cash received pursuant to the Award. Neither the Grantee nor any of the Grantee’s successors, heirs, assigns or personal representatives shall have any further rights or interests in any RSUs that are so paid.
- (iii) In the event that the Notice of Grant specifies that the manner of payment by the Company shall be cash or stock at the Company’s election, as soon as practicable after (and in no case more than seventy-four days after) the Payment Date, such RSUs shall be paid, at the Company’s option, (A) in a lump sum cash payment equal in the aggregate to the Fair Market Value of a Share on the Payment Date multiplied by the number of such RSUs that become non-forfeitable upon that Payment Date or (B) by the Company delivering to the Grantee a number of Shares equal to the number of RSUs that become non-forfeitable upon that Payment Date (rounded down to the nearest whole share). If the RSUs are paid in Shares, the Company shall issue the Shares either (1) in certificate form or (2) in book entry form, registered in the name of the Grantee. Delivery of any certificates will be made to the Grantee’s last address reflected on the books of the Company and its Subsidiaries unless the Company is otherwise instructed in writing. The Grantee shall not be required to pay any cash consideration for the RSUs or for any Shares or cash received pursuant to the Award. Neither the

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Grantee nor any of the Grantee's successors, heirs, assigns or personal representatives shall have any further rights or interests in any RSUs that are so paid. Notwithstanding anything herein to the contrary, the Company shall have no obligation to issue Shares in payment of the RSUs unless such issuance and such payment shall comply with all relevant provisions of law and the requirements of any Stock Exchange.

- (e) *Termination of Employment Generally; Leaves of Absence.* The following provisions shall apply in the event of the termination of the Grantee's employment or service with the Company, Parent or any Subsidiary, or should the Grantee take a leave of absence from employment with the Company, Parent or any Subsidiary:
- (i) *General.* Except as expressly provided below in Section 2(g) (regarding certain terminations following a Change in Control), in the event of the termination of the Grantee's employment or service with the Company, Parent or any Subsidiary for any reason prior to the lapsing of the restrictions in accordance with Section 2(c) hereof with respect to any of the RSUs granted hereunder, such portion of the RSUs held by the Grantee shall be automatically forfeited by the Grantee as of the date of termination. (The date of any such termination of the Grantee's employment or service is referred to in this Agreement as the "Termination Date.") Neither the Grantee nor any of the Grantee's successors, heirs, assigns or personal representatives shall have any rights or interests in any RSUs that are forfeited pursuant to any provision of this Agreement.
  - (ii) *Previously Adopted Yahoo Severance Plans and Policies Do Not Apply to This Award.* This Award of RSUs shall *not* be subject to the acceleration of vesting provisions of any Yahoo! Inc. Amended and Restated Change in Control Employee Severance Plan or of any other plan, policy, or agreement in effect on the date of grant specified in the Notice of Grant (the "Date of Grant") (such as, to the extent applicable and without limitation, the Yahoo! Inc. Employee Severance Plan for Vice Presidents and Employees, any Key Employee Income Protection Benefits letter, any executive severance agreement letter, or any other agreement between the Grantee and the Company or any Subsidiary, or any amendment to any of the foregoing). This Award *shall* be subject to acceleration under Section 2(g) below, to the extent applicable in accordance with the terms thereof.
  - (iii) *Leaves of Absence.* Unless otherwise expressly provided in a Company leave of absence vesting policy approved by the Administrator or otherwise by the Administrator, and subject to compliance with all applicable laws relating to the Grantee's employment by the Company, Parent or Subsidiary (as applicable), in the event the Grantee takes an authorized leave of absence from the Company, Parent or Subsidiary (as applicable), each vesting date specified in the Vesting Schedule that has not occurred as of the commencement of such leave of absence shall be tolled for the number of calendar days in the period that the Grantee is on such leave of absence, beginning with the commencement date of such leave of absence, but not beyond the maximum term of this Award as provided in the Plan (and any RSUs that have not vested and become non-forfeitable when such

maximum term is reached shall be automatically forfeited by the Grantee). (For example, if the scheduled vesting date is January 1, 2017 and, prior to that date the Grantee commences a leave of absence spanning 365 calendar days, the vesting date shall (unless otherwise expressly provided in a Company leave of absence policy approved by the Administrator or otherwise by the Administrator) be tolled for 365 days and shall become January 1, 2018.)

- (f) *Corporate Transactions.* The following provisions shall apply to the corporate transactions described below:
- (i) In the event of a proposed dissolution or liquidation of the Company, the Award will terminate and be forfeited immediately prior to the consummation of such proposed transaction, unless otherwise provided by the Administrator.
  - (ii) In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, the Award shall be assumed or substituted with an equivalent award by such successor corporation, parent or subsidiary of such successor corporation; provided that the Administrator may determine, in the exercise of its sole discretion in connection with a transaction that constitutes a permissible distribution event under Section 409A(a)(2)(A)(v) of the Code, that in lieu of such assumption or substitution, the Award shall be vested and non-forfeitable and any conditions or restrictions on the Award shall lapse, as to all or any part of the Award, including RSUs as to which the Award would not otherwise be non-forfeitable.
- (g) *Certain Terminations of Employment within 12 Months after a Change in Control.* The following provisions shall apply in the event of certain terminations of employment within 12 months after a Change in Control (as defined below) and prior to the date the RSUs have either become vested and non-forfeitable or have been forfeited pursuant to this Agreement:
- (i) *Termination of Employment After First Vesting Event.* In the event that the Grantee's Termination Date occurs on or after the date of the first vesting event specified in the Vesting Schedule (as adjusted pursuant to Section (2)(e)(iii), if applicable) (the "Initial Vesting Date"), then this Award shall *not* be subject to any acceleration under this Section 2(g).
  - (ii) *Termination of Employment Before First Vesting Event.* In the event that, (A) during the period of 12 months following the Change in Control, the Grantee's employment is terminated by the Company, Parent or any Subsidiary without Cause or by the Grantee for Good Reason (as such terms are defined below), and (B) the Termination Date is before the Initial Vesting Date, and (C) the Grantee complies with the release and other requirements described in Section 2(j) below, then the number of RSUs subject to the Award (to the extent then outstanding and not vested) that shall become fully vested and non-forfeitable as of the later of the Termination Date or the date such release

becomes final and irrevocable shall be equal to the product obtained by multiplying the number of RSUs scheduled to vest on the Initial Vesting Date (as adjusted pursuant to Section 2(f)(ii), if applicable), by a fraction, (x) the numerator of which is the number of months that have elapsed from the vesting commencement date set forth in the Notice of Grant (the "Vesting Commencement Date") through the Termination Date, rounded down to the nearest whole month, and (y) the denominator of which is the number of months from the Vesting Commencement Date through the Initial Vesting Date, rounded down to the nearest whole month (with both the numerator and the denominator calculated exclusive of the period of any leave of absence for which a vesting schedule adjustment occurred under Section 2(e)(iii)). Any RSUs that vest pursuant to this clause (ii) shall be paid as soon as practicable after (and in no case more than seventy-four days after) the Termination Date (provided, that if the period for the Grantee to consider and revoke such release spans two different calendar years, payment of such RSUs will be made within such prescribed time period, but in the second of those two years).

- (iii) For purposes of this Agreement, "Change in Control" shall mean the first of the following events to occur after the Date of Grant:
- (A) any person or group of persons (as defined in Section 13(d) and 14(d) of the Exchange Act) together with its Affiliates (as defined below), but excluding (1) the Company or any of its subsidiaries, (2) any employee benefit plans of the Company or (3) a corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company (individually a "Person" and collectively, "Persons"), is or becomes, directly or indirectly, the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act) of securities of the Company representing 40% or more of the combined voting power of the Company's then outstanding securities (not including in the securities beneficially owned by such Person any securities acquired directly from the Company or its Affiliates);
  - (B) the consummation of a merger or consolidation of the Company or any direct or indirect subsidiary of the Company with any other corporation or entity regardless of which entity is the survivor, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or being converted into voting securities of the surviving entity) more than 50% of the combined voting power of the voting securities of the Company, such surviving entity or any parent thereof outstanding immediately after such merger or consolidation; or
  - (C) the stockholders of the Company approve a plan of complete liquidation or winding-up of the Company; or

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- (D) the consummation of a sale or disposition (whether directly or by merger or other business combination) of all or substantially all of the assets of the Company to a Person or Persons in one or a series of related transactions; provided, however, that, for purposes of this paragraph (D), the assets of the Company shall not include the Company's direct and indirect equity interests in Alibaba Group Holding Limited and Yahoo Japan Corporation.
- (iv) For purposes of this Agreement, "Cause" and "Good Reason" shall be as defined in the Amended and Restated Yahoo! Inc. Change in Control Employee Severance Plan, as amended, that is applicable to the Grantee. For purposes of such definitions, the term "Company" shall include a Parent or any Subsidiary of the Company.
- (v) For purposes of this Agreement, "Affiliate" means, with respect to any individual or entity, any other individual or entity who, directly or indirectly through one or more intermediaries, controls, is controlled by or is under common control with, such individual or entity.
- (h) *Income Taxes.* Except as provided in the next three sentences, the Company shall withhold and/or reacquire a number of Shares issued in payment of (or otherwise issuable in payment of, as the case may be) the RSUs having a Fair Market Value equal to the taxes that the Company determines it or the Grantee's employer is required to withhold under applicable tax laws with respect to the RSUs (with such withholding obligation determined based on any applicable minimum statutory withholding rates) ("Net Share Settlement"). In the event that the Company cannot (under applicable legal, regulatory, listing or other requirements, or otherwise) satisfy such tax withholding obligation in such method or in the event that the RSUs are paid in cash (as opposed to Shares), the Company may satisfy such withholding by any one or a combination of the following methods: (i) by requiring the Grantee to pay such amount in cash or check; (ii) by reducing the amount of any cash otherwise payable to the Grantee with respect to the RSUs; (iii) by deducting such amount out of any other compensation otherwise payable to the Grantee; and/or (iv) by allowing the Grantee to surrender shares of Common Stock of the Company which (A) in the case of shares initially acquired from the Company (upon exercise of a stock option or otherwise), have been owned by the Grantee for such period (if any) as may be required to avoid a charge to the Company's earnings, and (B) have a Fair Market Value on the date of surrender equal to the amount required to be withheld. For these purposes, the Fair Market Value of the Shares to be withheld or repurchased, as applicable, shall be determined on the date that the amount of tax to be withheld is to be determined. Notwithstanding the foregoing, if the Grantee has been designated by the Company's Board of Directors as an "executive officer" (as such term is defined in Rule 3b-7 under the Securities Exchange Act of 1934, as amended) the Administrator may (but is under no obligation to) allow the Grantee, during such times and under such terms as the Administrator may provide, to elect in advance whether tax withholding obligations in connection with any payment of the RSUs in Shares will be satisfied (1) by Net Share Settlement, or (2) by the Grantee making a payment in cash to the Company (such election (2), a "Cash Election"); and if the Grantee has a Cash

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Election in effect on the Date of Grant as to other Company RSU awards, such election shall also apply to this Award, unless and until such election is modified in accordance with its terms.

- (i) *No Advice Regarding Award*. The Company is not providing any tax, legal or financial advice, nor is the Company making any recommendations regarding the Grantee's participation in the Plan, or the Grantee's acquisition or sale of the underlying Shares. The Grantee is hereby advised to consult with his or her own personal tax, legal and financial advisors regarding his or her participation in the Plan before taking any action related to the Plan.
- (j) *Conditions of Accelerated Vesting; Exclusive Remedy*. The accelerated vesting provisions specified in Section 2(g) above are conditioned on (i) the Grantee's signing a full release of any and all claims against the Company in a release form acceptable to the Company (within the period specified in it by the Company, which in no event shall be more than fifty days following the Grantee's Termination Date) and the Grantee's not revoking such release pursuant to any revocation rights afforded by applicable law, and (ii) the Grantee's compliance with the Grantee's obligations under his or her Employee Confidentiality and Assignment of Inventions Agreement, or similar agreement. The Grantee agrees that such accelerated vesting benefits specified in this Agreement (and any applicable severance benefits provided under a written agreement with the Company then in effect in accordance with its terms) will constitute the exclusive and sole remedy for any termination of the Grantee's employment and the Grantee covenants not to assert or pursue any other remedies, at law or in equity, with respect to the Grantee's termination and/or employment.

### **Section 3. Miscellaneous**

- (a) *Notices*. Any and all notices, designations, consents, offers, acceptances and any other communications provided for herein shall be given in writing and shall be delivered either personally or by registered or certified mail, postage prepaid, which shall be addressed, in the case of the Company to both the Chief Financial Officer and the General Counsel of the Company at the principal office of the Company and, in the case of the Grantee, to the Grantee's address appearing on the books of the Company or to the Grantee's residence or to such other address as may be designated in writing by the Grantee. Notices may also be delivered to the Grantee, during his or her employment, through the Company's inter-office or electronic mail systems.
- (b) *No Right to Continued Employment*. The Grantee understands and agrees that the vesting of Shares pursuant to Section 2 above is earned only by continuing in the employ or service of the Company at the will of the Company (not through the act of being hired, being granted the RSUs or acquiring Shares under this Agreement). The Grantee further acknowledges and agrees that nothing in this Agreement, nor in the Plan which is incorporated in this Agreement by reference, shall confer upon the Grantee any right with respect to continuation as an employee or consultant with the Company, a Parent or any Subsidiary, nor shall it interfere with or restrict in any way the right of the Company, a Parent or any Subsidiary, which is hereby expressly reserved, to remove, terminate or discharge the Grantee at any time for any reason whatsoever, with or without Cause and with or without advance notice.

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- (c) *Bound by Plan.* By signing this Agreement, the Grantee acknowledges that he/she has received a copy of the Plan and has had an opportunity to review the Plan and agrees to be bound by all the terms and provisions of the Plan.
- (d) *Successors.* The terms of this Agreement shall be binding upon and inure to the benefit of the Company, its successors and assigns, and of the Grantee and the beneficiaries, executors, administrators, heirs and successors of the Grantee.
- (e) *Headings.* The headings of the Sections hereof are provided for convenience only and are not to serve as a basis for interpretation or construction, and shall not constitute a part, of this Agreement.
- (f) *Section 409A.* This Agreement and the Award are intended to comply with or be exempt from, as the case may be, Section 409A of the Code so as to not result in any tax, penalty or interest thereunder. This Agreement and the Award shall be construed and interpreted accordingly. Except for the Company's tax withholding rights, the Grantee shall be solely responsible for any and all tax liability with respect to the Award.
- (g) *Invalid Provision.* The invalidity or unenforceability of any particular provision hereof shall not affect the other provisions hereof, and this Agreement shall be construed in all respects as if such invalid or unenforceable provision had been omitted.
- (h) *Governing Law/Choice of Venue.*
- (i) This Agreement and the rights of the Grantee hereunder shall be construed and determined in accordance with the laws of the State of Delaware (without giving effect to the conflict of laws principles thereof), as provided in the Plan.
  - (ii) For the purposes of litigating any dispute that arises directly or indirectly from the relationship of the parties evidenced by the Award or this Agreement, the parties hereby submit and consent to the exclusive jurisdiction of the State of California where this grant is made and/or to be performed and agree that such litigation shall be conducted only in the courts of Santa Clara County, California, or the federal court of the United States for the Northern District of California, and no other courts.
- (i) *Imposition of Other Requirements.* If the Grantee relocates to another country after the Date of Grant, the Company reserves the right to impose other requirements on the Grantee's participation in the Plan, to the extent the Company determines it is necessary or advisable in order to comply with local law or facilitate the administration of the Plan, and to require the Grantee to sign any additional agreements or undertakings that may be necessary to accomplish the foregoing.

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- (j) *Insider Trading Restrictions/Market Abuse Laws* . The Grantee acknowledges that he or she is subject to the Company’s Insider Trading Policy and may be or may become subject to the Company’s 10b5-1 Trading Plan Policy, each as amended from time to time. In addition, the Grantee understands that he or she may be subject to insider trading restrictions under securities laws, market abuse laws, and/or other similar laws, and such restrictions may affect his or her ability to acquire or sell Shares or rights to Shares. The Grantee acknowledges that it is the Grantee’s responsibility to comply with such Company policies and any additional restrictions that may apply under applicable laws with respect to the Grantee’s acquisition, holding, and any disposition of Shares or rights to Shares.
- (k) *Recoupment* . Notwithstanding any other provision herein, the recoupment or “clawback” policies adopted by the Administrator and applicable to equity awards, as such policies are in effect from time to time, shall apply to the Award and any Shares or cash that may be issued in respect of the Award.
- (l) *Entire Agreement*. This Agreement, the Notice of Grant and the Plan contain the entire agreement and understanding of the parties hereto with respect to the subject matter contained herein and therein and supersede all prior communications, representations and negotiations in respect thereto.
- (m) *Modifications*. No change, modification or waiver of any provision of this Agreement shall be valid unless the same is in writing and signed by the parties hereto.
- (n) *Counterparts* . This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.
- (o) *Signature*. This Agreement shall be deemed executed by the Company and the Grantee as of the Date of Grant upon execution by such parties (or upon the Grantee’s online acceptance) of the Notice of Grant.

**Certification of Chief Executive Officer Pursuant to  
Securities Exchange Act Rules 13a-14(a) and 15d-14(a)  
as Adopted Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Marissa A. Mayer, certify that:

1. I have reviewed this Form 10-Q of Yahoo! Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 9, 2016

By: \_\_\_\_\_ /s/ MARISSA A. MAYER  
**Marissa A. Mayer**  
**Chief Executive Officer**

**Certification of Chief Financial Officer Pursuant to  
Securities Exchange Act Rules 13a-14(a) and 15d-14(a)  
as Adopted Pursuant to  
Section 302 of the Sarbanes-Oxley Act of 2002**

I, Ken Goldman, certify that:

1. I have reviewed this Form 10-Q of Yahoo! Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 9, 2016

By: \_\_\_\_\_ /s/ KEN GOLDMAN  
**Ken Goldman**  
**Chief Financial Officer**

**Certification of Chief Executive Officer and Chief Financial Officer Pursuant to  
18 U.S.C. Section 1350,  
as Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of Yahoo! (the "Company") for the quarter ended September 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Marissa A. Mayer, as Chief Executive Officer of the Company, and Ken Goldman, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, to the best of her or his knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ MARISSA A. MAYER

**Name:** \_\_\_\_\_  
**Title:** **Marissa A. Mayer**  
**Dated:** **Chief Executive Officer**  
**November 9, 2016**

/s/ KEN GOLDMAN

**Name:** \_\_\_\_\_  
**Title:** **Ken Goldman**  
**Dated:** **Chief Financial Officer**  
**November 9, 2016**

The foregoing certification is being furnished pursuant to 18 U.S.C. Section 1350. It is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and it is not to be incorporated by reference into any filing of the Company, regardless of any general incorporation language in such filing.