

APPFOLIO INC  
Form 10-Q  
November 09, 2015  
Table of Contents

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

FORM 10-Q  
(Mark one)

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

For the quarterly period ended September 30, 2015.

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 001-37468

AppFolio, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State of incorporation or organization)

26-0359894

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

50 Castilian Drive

Goleta, California

(Address of principal executive offices)

93117

(Zip Code)

(805) 364-6093

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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. (Check one):

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Edgar Filing: APPFOLIO INC - Form 10-Q

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

As of October 25, 2015, the number of shares of the registrant's Class A common stock outstanding was 7,821,666 and the number of shares of the registrant's Class B common stock outstanding was 25,707,270.

---

Table of Contents

## TABLE OF CONTENTS

Section	Page No.
<u>Cautionary Note Regarding Forward-Looking Statements</u>	<u>1</u>
<u>Part I. Financial Information</u>	<u>2</u>
<u>Item 1. Condensed Consolidated Financial Statements (Unaudited)</u>	<u>2</u>
<u>Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014</u>	<u>2</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2015 and 2014</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive Loss for the Three and Nine Months Ended September 30, 2015 and 2014</u>	<u>4</u>
<u>Condensed Consolidated Statements of Convertible Preferred Stock and Stockholders' Equity (Deficit) for the Nine Months Ended September 30, 2015</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2015 and 2014</u>	<u>6</u>
<u>Notes to Condensed Consolidated Unaudited Financial Statements</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
<u>Item 3. Qualitative and Quantitative Disclosure about Market Risk</u>	<u>29</u>
<u>Item 4. Controls and Procedures</u>	<u>30</u>
<u>Part II. Other Information</u>	<u>32</u>
<u>Item 1. Legal Proceedings</u>	<u>32</u>
<u>Item 1A. Risk Factors</u>	<u>32</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>32</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>32</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>33</u>
<u>Item 5. Other Information</u>	<u>33</u>
<u>Item 6. Exhibits</u>	<u>33</u>
<u>Signatures</u>	
<u>Exhibit Index</u>	

---

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for the fiscal quarter ended September 30, 2015 ("Quarterly Report") includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, which statements are subject to considerable risks and uncertainties. Forward-looking statements include all statements that are not statements of historical facts contained in this Quarterly Report and can be identified by words such as "anticipates," "believes," "seeks," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "projects," "should" "would" or similar expressions and the negatives of those expressions. In particular, forward looking statements contained in this Quarterly Report relate to, among other things, our future or assumed financial condition, results of operations, business forecasts and plans, strategic plans and objectives, product development plans, and capital needs and financing plans. We caution you that the foregoing list may not include all of the forward-looking statements made in this Quarterly Report.

Forward-looking statements represent our management's current beliefs and assumptions based on information currently available. Forward-looking statements involve numerous known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. We discuss these risks and uncertainties in greater detail in the section entitled "Risk Factors" in Part II, Item 1A of this Quarterly Report, as well as in our other filings with the Securities and Exchange Commission ("SEC"). You should read this Quarterly Report, and the other documents that we have filed with the SEC, with the understanding that our actual future results may be materially different from the results expressed or implied by these forward-looking statements.

Moreover, we operate in an evolving environment. New risks and uncertainties emerge from time to time and it is not possible for our management to predict all risks and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual future results to be materially different from those expressed or implied by any forward-looking statements.

Except as required by applicable law or the rules of the NASDAQ Stock Market, we assume no obligation to update any forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

We qualify all of our forward-looking statements by these cautionary statements.

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements

## APPFOLIO, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except par values)

	September 30, 2015	December 31, 2014
Assets		
Current assets		
Cash and cash equivalents	\$11,758	\$5,412
Investment securities—current	28,151	—
Accounts receivable, net	2,238	1,191
Prepaid expenses and other current assets	2,571	1,204
Total current assets	44,718	7,807
Investment securities—noncurrent	23,704	—
Property and equipment, net	4,115	2,623
Capitalized software, net	8,916	5,509
Goodwill	6,737	4,998
Intangible assets, net	4,922	3,615
Other assets	1,079	882
Total assets	\$94,191	\$25,434
Liabilities, Convertible Preferred Stock and Stockholders' Equity (Deficit)		
Current liabilities		
Accounts payable	\$2,403	\$2,088
Accrued employee expenses	6,519	3,150
Accrued expenses	3,303	1,721
Deferred revenue	4,442	3,772
Other current liabilities	572	2,797
Total current liabilities	17,239	13,528
Deferred revenue	—	8
Other liabilities	626	199
Total liabilities	17,865	13,735
Commitments and contingencies (Note 9)		
Convertible preferred stock, Series A, B, B-1, B-2 and B-3, \$0.0001 par value, 68,027 shares authorized, issued and outstanding as of December 31, 2014. Liquidation preference of \$62,020 as of December 31, 2014.	—	63,166
Stockholders' equity (deficit):		
Preferred stock, \$0.0001 par value, 25,000 authorized and no shares issued and outstanding as of September 30, 2015	—	—
Class A common stock, \$0.0001 par value, 250,000 shares authorized as of September 30, 2015; 7,155 shares issued and outstanding as of September 30, 2015	1	—
Class B common stock, \$0.0001 par value, 50,000 and 123,000 shares authorized as of September 30, 2015 and December 31, 2014, respectively; 26,373 and 9,042 shares issued and outstanding as of September 30, 2015 and December 31, 2014, respectively;	3	1

Edgar Filing: APPFOLIO INC - Form 10-Q

Additional paid-in capital	141,115	1,546	
Accumulated other comprehensive loss	(1	) —	
Accumulated deficit	(64,792	) (53,014	)
Total stockholders' equity (deficit)	76,326	(51,467	)
Total liabilities, convertible preferred stock and stockholders' equity (deficit)	\$94,191	\$25,434	

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

2

---

Table of Contents

APPFOLIO, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (UNAUDITED)  
 (in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Revenue	\$20,305	\$13,024	\$54,578	\$34,452
Costs and operating expenses:				
Cost of revenue (exclusive of depreciation and amortization)	9,264	5,979	24,438	16,112
Sales and marketing	7,028	4,312	18,976	11,519
Research and product development	2,797	1,838	6,960	4,559
General and administrative	3,888	1,180	10,987	3,564
Depreciation and amortization	1,638	988	4,252	2,691
Total costs and operating expenses	24,615	14,297	65,613	38,445
Loss from operations	(4,310)	(1,273)	(11,035)	(3,993)
Other expense, net	(1)	(6)	(8)	(103)
Interest (expense) income, net	(426)	11	(701)	48
Loss before provision for income taxes	(4,737)	(1,268)	(11,744)	(4,048)
Provision for income taxes	23	—	34	—
Net loss	\$(4,760)	\$(1,268)	\$(11,778)	\$(4,048)
Net loss per share, basic and diluted	\$(0.14)	\$(0.14)	\$(0.68)	\$(0.46)
Weighted average common shares outstanding, basic and diluted	33,314	8,807	17,274	8,724

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

Table of Contents

APPFOLIO, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 (UNAUDITED)  
 (in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net loss	\$(4,760	) \$(1,268	) \$(11,778	) \$(4,048
Other comprehensive loss:				
Changes in unrealized losses on investment securities	(1	) —	(1	) —
Comprehensive loss	\$(4,761	) \$(1,268	) \$(11,779	) \$(4,048

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.



Table of Contents

APPFOLIO, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CONVERTIBLE  
 PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)  
 (UNAUDITED)  
 (in thousands)

	Convertible		Common Stock		Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated	
	Preferred Shares	Stock Amount	Class A Shares	Class A Amount	Class B Shares	Class B Amount			Deficit	Total
Balance at December 31, 2014	68,027	\$63,166	—	\$—	9,042	\$1	\$1,546	\$—	\$(53,014)	\$(51,467)
Exercise of stock options	—	—	—	—	299	—	328	—	—	328
Stock-based compensation	—	—	—	—	—	—	719	—	—	719
Conversion of convertible preferred stock in connection with initial public offering	(68,027)	(63,166)	—	—	17,007	2	63,164	—	—	63,166
Issuance of common stock in connection with initial public offering, net of offering costs	—	—	7,130	1	—	—	75,358	—	—	75,359
Issuance of restricted stock	—	—	25	—	25	—	—	—	—	—
Unrealized loss on investment securities	—	—	—	—	—	—	—	(1)	—	(1)
Net loss	—	—	—	—	—	—	—	—	(11,778)	(11,778)
Balance at September 30, 2015	—	—	7,155	\$1	26,373	\$3	\$141,115	\$(1)	\$(64,792)	\$76,326

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

Table of Contents

APPFOLIO, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (UNAUDITED)  
 (in thousands)

	Nine Months Ended September 30,	
	2015	2014
Cash from operating activities		
Net loss	\$(11,778	) \$(4,048
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,252	2,691
Purchased investment premium, net of amortization	(380	) —
Amortization of deferred financing costs	441	—
Loss on disposal of property and equipment	7	66
Stock-based compensation	623	158
Change in fair value of contingent consideration	—	(56
Loss on equity-method investment	—	) 19
Changes in operating assets and liabilities, net of business acquisition:		
Accounts receivable	(936	) (588
Prepaid expenses and other current assets	(1,345	) (548
Other assets	(120	) 4
Accounts payable	167	1,033
Accrued employee expenses	3,110	1,054
Accrued expenses	1,234	653
Deferred revenue	662	575
Other liabilities	289	270
Net cash (used in) provided by operating activities	(3,774	) 1,283
Cash from investing activities		
Purchases of property and equipment	(2,234	) (1,634
Additions to capitalized software	(5,373	) (3,253
Purchases of investment securities	(60,426	) —
Sales of investment securities	4,000	—
Maturities of investment securities	4,950	—
Cash paid in business acquisition, net of cash acquired	(4,039	) —
Purchases of intangible assets	(16	) (18
Net cash used in investing activities	(63,138	) (4,905
Cash from financing activities		
Proceeds from stock option exercises	328	155
Proceeds from issuance of restricted stock	141	—
Proceeds from issuance of options	208	—
Principal payments under capital lease obligations	(22	) (20
Proceeds from initial public offering, net of underwriting discounts and commissions	79,570	—
Payments of initial public offering costs	(3,999	) —
Payment of contingent consideration	(2,429	) —
Proceeds from issuance of debt	10,000	—
Principal payments on debt	(10,000	) —
Payment of debt issuance costs	(539	) —
Net cash provided by financing activities	73,258	135
Net cash increase (decrease) in cash and cash equivalents	6,346	(3,487

Edgar Filing: APPFOLIO INC - Form 10-Q

Cash and cash equivalents		
Beginning of period	5,412	11,269
End of period	\$11,758	\$7,782

Noncash investing and financing activities

Purchases of property and equipment included in accounts payable and accrued expenses	\$297	\$96
Additions of capitalized software included in accrued employee expenses	427	246
Stock-based compensation capitalized for software development	112	35
Deferred IPO costs included in accrued expenses	212	—
Conversion of convertible preferred stock into common stock in connection with initial public offering	63,166	—

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

Table of Contents

APPFOLIO, INC.

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

1. Nature of Business

Overview

AppFolio, Inc. (“we” or “AppFolio”) provides industry-specific, cloud-based software solutions for small and medium-sized businesses (“SMBs”) in the property management and legal industries. Our platform is designed to be the system of record to automate essential business processes and the system of engagement to enhance business interactions between our customers and their clients and vendors. Our mobile-optimized software solutions have a user-friendly interface across multiple devices, enabling our customers to work at any time and from anywhere. Our property management software provides small and medium-sized property managers with an end-to-end solution to their business needs, enabling them to manage properties quickly and easily in a single, integrated environment. Our legal software provides solo practitioners and small law firms with a streamlined practice and case management solution, allowing them to manage their practices and case load within a flexible system. We also offer optional, but often mission-critical, Value+ services, such as our professionally designed websites and electronic payment services, which are seamlessly built into our core solutions.

Acquisition of RentLinx

On April 1, 2015, we completed the acquisition of all of the membership interests of RentLinx, LLC (“RentLinx”), a San Diego, California-based company focused on a software platform that allows customers to advertise rental houses and apartments online. We acquired RentLinx to expand the Value+ services offered to our property manager customers, giving them the ability to better spend, track and optimize their marketing investments. For additional information regarding this acquisition, refer to Note 3, Acquisition of RentLinx.

Reverse Stock Split

On June 4, 2015, we effected a one-for-four reverse split of our common stock and a proportional adjustment to the conversion ratio of our convertible preferred stock. The par value and the number of authorized shares of our common stock and convertible preferred stock were not adjusted as a result of the reverse split. All share, per share and related information presented in these Condensed Consolidated Financial Statements and accompanying notes has been retroactively adjusted, where applicable, to reflect the impact of the reverse stock split, including an adjustment to the preferred stock conversion ratio.

Initial Public Offering

On June 30, 2015, we completed an initial public offering (“IPO”) of our Class A common stock. In connection with the offering, we sold 6,200,000 shares of common stock at \$12.00 per share for aggregate net proceeds of \$65.1 million after underwriting discounts and commissions and offering expenses. Upon the closing of the offering, all shares of our convertible preferred stock and common stock held prior to the offering were converted into shares of Class B common stock.

On July 8, 2015, in connection with the exercise of an overallotment option granted to the underwriters, we sold 930,000 additional shares of our Class A common stock to the underwriters at the public offering price of \$12.00 per share, resulting in an additional \$10.4 million in net proceeds, after deducting underwriting discounts and commissions. As a result, the aggregate net proceeds to us from the sale of shares in the IPO were approximately \$75.4 million.

For additional information regarding the conversion of our preferred stock in connection with the IPO, refer to Note 10, Convertible Preferred Stock and Stockholders' Equity (Deficit).

2. Summary of Significant Accounting Policies

Basis of Presentation and Significant Accounting Policies

The accompanying Condensed Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. Certain information and disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted. Accordingly, these Condensed Consolidated Financial Statements should be read in conjunction with our consolidated financial statements and the related notes included in our prospectus filed with the SEC on June 26, 2015 pursuant to Rule 424(b) of the Securities Act of 1933, as amended (the “Prospectus”).

The accompanying Condensed Consolidated Financial Statements are unaudited. Our unaudited interim Condensed Consolidated Financial Statements have been prepared on a basis consistent with

7

---

Table of Contents

that used to prepare our audited annual consolidated financial statements and include, in the opinion of management, all adjustments, consisting of normal and recurring items, necessary for the fair statement of the Condensed Consolidated Financial Statements. The operating results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results expected for the full year ending December 31, 2015.

Investment Securities

During the third quarter of 2015, we began investing a portion of the net proceeds from the IPO in investment securities. Our investment securities currently consist of corporate bonds, U.S. government agency securities (referred to as "Agency Securities") and certificates of deposit. We classify investment securities as available-for-sale at the time of purchase and reevaluate such classification as of each balance sheet date. All investments are recorded at estimated fair value. Unrealized gains and losses for available-for-sale securities are included in accumulated other comprehensive income (loss), a component of stockholders' equity. We classify our investments as current when the period of time between the reporting date and the contractual maturity is twelve months or less and as noncurrent when the period of time between the reporting date and the contractual maturity is more than twelve months.

We evaluate our investments to assess whether those with unrealized loss positions are other than temporarily impaired. We consider impairments to be other than temporary if they are related to deterioration in credit risk or if it is likely we will sell the securities before the recovery of their cost basis. Declines in value judged to be other than temporary are determined based on the specific identification method and are reported in other income (expense), net in the Condensed Consolidated Statements of Operations.

For additional information regarding the investment securities, refer to Note 4, Investment Securities and Fair Value Measurements.

Changes in Accounting Policies

Except as described herein, there have been no significant changes in our accounting policies from those disclosed in our annual consolidated financial statements and the related notes included in the Prospectus.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. On an ongoing basis, management evaluates its estimates based on historical data and experience, as well as various other factors that management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources.

Net Loss per Share

The following table presents a reconciliation of our weighted average number of shares used to compute net loss per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Weighted average shares outstanding	33,456	9,026	17,426	8,985
Less: Weighted average unvested restricted shares subject to repurchase	142	219	152	261
Weighted average number of shares used to compute basic and diluted net loss per share	33,314	8,807	17,274	8,724

Because we reported net losses for all periods presented, all potentially dilutive common stock equivalents are antidilutive for those periods and have been excluded from the calculation of net loss per share.

Table of Contents

The following table presents the number of anti-dilutive shares excluded from the calculation of diluted net loss per share as of September 30, 2015 and 2014 (in thousands):

	September 30,	
	2015	2014
Options to purchase common stock	1,187	707
Conversion of convertible preferred stock	—	17,007
Unvested restricted stock awards	137	208
Unvested restricted stock units	12	—
Contingent restricted stock units (1)	33	—
Total shares excluded from net loss per share attributable to common stockholders	1,369	17,922

(1) The reported shares are based on a fixed price restricted stock unit (“RSU”) commitment for which the number of shares has not been determined at the grant date. The shares disclosed in the table above are based on the closing price of our stock at September 30, 2015 divided by the future fixed price commitment to issue shares in the future. For additional information regarding the RSUs granted refer to Note 11, Stock-Based Compensation.

Recent Accounting Pronouncements

Under the Jumpstart our Business Startups Act (the “JOBS Act”), we meet the definition of an emerging growth company. We have irrevocably elected to opt out of the extended transition period for complying with new or revised accounting standards pursuant to Section 107(b) of the JOBS Act.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 is effective on January 1, 2018. Early adoption is permitted as of January 1, 2017. The standard permits the use of either a retrospective or cumulative effect transition method. We have not determined which transition method we will adopt, nor have we determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

In April 2015, the FASB issued ASU No. 2015-03, Interest— Imputation of Interest—Simplifying the Presentation of Debt Issuance Costs (“ASU 2015-03”), which requires an entity to record debt issuance costs in the balance sheet as a direct deduction of a recognized debt liability. ASU 2015-03 is effective for accounting periods beginning after December 15, 2015; however, early adoption is permitted. During the nine months ended September 30, 2015, we elected to adopt this guidance. The impact of the early adoption of this guidance was to record \$0.4 million of third-party debt financing costs as a reduction in the outstanding amount of our prior term loan from Wells Fargo Bank, N.A. (“Wells Fargo”) in March 2015. The adoption of this guidance did not impact prior period financial statements as we had no debt outstanding. For additional information regarding the prior term loan with Wells Fargo, refer to Note 8, Long-term Debt.

In May 2015, the FASB issued ASU 2015-09, Financial Services-Insurance (Topic 944): Disclosures about Short-Duration Contracts (“ASU 2015-09”), requires insurance entities to disclose for annual reporting periods information about the liability for unpaid claims and claim adjustment expenses. ASU 2015-09 is effective for public business entities for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. Early adoption is permitted. Management is assessing this guidance's impact to our disclosures within our financial statements as the guidance is disclosure related.

In August 2015, the FASB issued ASU 2015-15, Interest - Imputation of Interest (Subtopic 835-30) - Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line of Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting) (“ASU 2015-15”), which simplifies the presentation of debt issuance costs for line of credit arrangements since ASU 2015-03 did not address line of credit arrangements. ASU 2015-15 provides an update to ASU 2015-03 and allows for the debt issuance costs for line of credit arrangements to be classified as an asset. At September 30, 2015, we had an asset of \$0.1 million remaining on our balance sheet for debt issuance costs associated with our line of credit with Wells Fargo. Management has determined that this guidance has no impact to our financial statements since our debt issuance costs are currently classified as an asset.





Table of Contents

In September 2015, the FASB issued Accounting Standard Update (“ASU”) No. 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments (“ASU 2015-16”). The amendments in ASU 2015-16 require that an acquirer recognize adjustments to estimated amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments require that the acquirer record, in the same period’s financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date. Management will consider applying this guidance should we have a measurement-period adjustment for the acquisition that occurred in April 2015.

### 3. Acquisition of RentLinx

On April 1, 2015, we completed the acquisition of all of the membership interests of RentLinx. We paid the sellers \$4.1 million, of which \$0.5 million was placed into escrow to cover potential indemnification claims relating to breaches of representations, warranties and covenants. We also agreed to pay an additional amount of approximately \$1.1 million to certain individuals subject to their continued employment with us, which was recorded as an expense over the service period and paid in October 2015. All transaction costs were expensed in the period incurred and were approximately \$0.3 million.

We acquired RentLinx to expand the Value+ services offered to our property manager customers, providing them the ability to better spend, track and optimize their marketing investments. The goodwill related to our RentLinx acquisition is attributable to synergies expected from the acquisition and assembled workforce. The goodwill is deductible for income tax purposes.

The following table summarizes the purchase price allocation (in thousands):

	Amount	Estimated Useful Life
Net current assets	\$114	
Intangible assets:		
Developed technology	810	6 years
Partner relationships	680	3 years
Customer and website relationships	560	5 years
Other intangible assets	170	3 years
Goodwill	1,739	Indefinite
Purchase consideration, paid in cash	\$4,073	

We are not providing pro forma and current period financial information for this acquisition as they are not material to our Condensed Consolidated Financial Statements.

Table of Contents

## 4. Investment Securities and Fair Value Measurements

## Investment Securities

Investment securities classified as available-for-sale consist of the following at September 30, 2015 (in thousands):

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	\$34,872	\$15	\$(18)	) \$34,869
Agency securities	11,008	1	(1)	) 11,008
Certificates of deposit	\$5,976	\$2	\$—	\$5,978
Total available-for-sale investment securities	\$51,856	\$18	\$(19)	) \$51,855

We did not have investment securities at December 31, 2014. We had certain investment securities in an unrealized loss position at September 30, 2015, and we have held these securities for less than three months. These unrealized loss positions are considered temporary and there were no impairments considered "other-than-temporary" as it is more likely than not we will hold the securities until maturity or a recovery of the cost basis.

At September 30, 2015, the contractual maturities of our investments did not exceed 36 months. The fair values of available-for-sale investments, by remaining contractual maturity, are as follows (in thousands):

	September 30, 2015	
	Amortized Cost	Estimated Fair Value
Due in 1 year or less	\$28,149	\$28,151
Due after 1 year through 3 years	23,707	23,704
Total available-for-sale investment securities	\$51,856	\$51,855

During the three and nine months ended September 30, 2015, we had \$4.0 million of investment securities that were called and we recognized a \$2,000 loss on sale.

Table of Contents

## Fair Value Measurements

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2015 and December 31, 2014 by level within the fair value hierarchy. Financial assets and financial liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands):

	September 30, 2015			Total Fair Value
	Level 1	Level 2	Level 3	
Cash equivalents:				
Money market accounts	\$6,668	\$—	\$—	\$6,668
Mutual funds	126	—	—	126
Available-for-sale - investment securities:				
Corporate bonds	—	34,869	—	34,869
Agency securities	—	11,008	—	11,008
Certificates of deposit	5,978	—	—	5,978
Total Assets	\$12,772	\$45,877	\$—	\$58,649
	December 31, 2014			
	Level 1	Level 2	Level 3	Total Fair Value
Cash equivalents:				
Money market accounts	\$3,696	\$—	\$—	\$3,696
Total Assets	\$3,696	\$—	\$—	\$3,696
Contingent consideration	\$—	\$—	\$2,429	\$2,429
Total Liabilities	\$—	\$—	\$2,429	\$2,429

## Cash and Cash Equivalents

As of September 30, 2015 and December 31, 2014, cash and cash equivalents include cash invested in money market accounts and mutual funds. Market prices are based on market prices for identical assets.

## Available-for-Sale - Investment Securities

The fair value of our investment securities is based on pricing determined using inputs other than quoted prices that are observable either directly or indirectly such as yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures.

## Contingent Consideration

Contingent consideration payable in connection with acquisitions is measured at fair value each period and is based on significant inputs not observable in the market, which represents a Level 3 measurement within the fair value hierarchy. The valuation of contingent consideration uses assumptions we believe would be made by a market participant. We assess these estimates on an on-going basis as additional data impacting the assumptions becomes available. Changes in the fair value of contingent consideration related to updated assumptions and estimates are recognized within general and administrative expense in the Condensed Consolidated Statements of Operations. We determined the fair value of the contingent consideration using the probability weighted discounted cash flow method. The significant inputs used in the fair value measurement of contingent consideration are the probability of achieving revenue thresholds and determining discount rates.

Table of Contents

The following table summarizes the changes in contingent consideration liability (in thousands):

	Three Months Ended		Nine Months Ended		
	September 30,		September 30,		
	2015	2014	2015	2014	
Fair value, at beginning of period	\$—	\$2,407	\$2,429	\$2,403	
Change in fair value recorded in general and administrative expenses	—	(60	) —	(56	)
Payment of contingent consideration	\$—	\$—	\$(2,429	) —	
Fair value, at end of period	\$—	\$2,347	\$—	\$2,347	

The contingent consideration liability was recorded in other current liabilities on the accompanying Condensed Consolidated Balance Sheets as of December 31, 2014. On May 6, 2015, we paid the final earn-out payment in the amount of \$2.4 million.

There were no changes to our valuation techniques used to measure asset and liability fair values on a recurring basis during the nine months ended September 30, 2015.

The carrying amounts of cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities approximate fair value because of the short maturity of these items. The carrying value of our SecureDocs' note receivable approximates its fair value based on a discounted cash flow analysis and is a level 3 measurement. Certain assets, including goodwill and intangible assets, are also subject to measurement at fair value on a non-recurring basis if they are deemed to be impaired as a result of an impairment review. For the three and nine months ended September 30, 2015, no impairments were identified on those assets required to be measured at fair value on a non-recurring basis.

## 5. Property and Equipment

Property and equipment consists of the following as of September 30, 2015 and December 31, 2014 (in thousands):

	September 30,	December 31,	
	2015	2014	
Data center and computer equipment	\$3,768	\$2,871	
Furniture and fixtures	1,697	1,158	
Office equipment	456	215	
Leasehold improvements	868	333	
Construction in process	164	—	
Gross property and equipment	6,953	4,577	
Less: Accumulated depreciation	(2,838	) (1,954	)
Total property and equipment, net	\$4,115	\$2,623	

Depreciation expense for property and equipment totaled \$0.4 million and \$0.3 million for the three months ended September 30, 2015 and 2014, respectively, and \$1.0 million and \$0.6 million for the nine months ended September 30, 2015 and 2014, respectively.

As of September 30, 2015 and December 31, 2014, capital leases are included in property and equipment with a cost basis of \$82,000. Accumulated depreciation on property and equipment under capital leases as of September 30, 2015 and December 31, 2014 was \$41,000 and \$21,000, respectively.

Table of Contents

## 6. Internal-Use Software Development Costs

Internal-use software development costs were as follows (in thousands):

	September 30, 2015	December 31, 2014
Internal use software development costs, gross	\$19,674	\$13,931
Less: Accumulated amortization	(10,758	) (8,422
Internal use software development costs, net	\$8,916	\$5,509

Capitalized software development costs were \$2.4 million and \$1.4 million for the three months ended September 30, 2015 and 2014, respectively, and \$5.8 million and \$3.4 million for the nine months ended September 30, 2015 and 2014, respectively. Amortization expense with respect to software development costs totaled \$0.9 million and \$0.5 million for the three months ended September 30, 2015 and 2014, respectively and \$2.3 million and \$1.4 million for the nine months ended September 30, 2015 and 2014, respectively.

## 7. Goodwill and Intangible Assets

Goodwill activity for the nine months ended September 30, 2015 is as follows (in thousands):

Goodwill as of December 31, 2014	\$4,998
Addition:	
Acquisition of RentLinx	1,739
Goodwill as of September 30, 2015	\$6,737

Intangible assets consisted of the following as of September 30, 2015 and December 31, 2014 (in thousands, except years):

	September 30, 2015			Weighted Average Useful Life in Years
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	
Customer relationships	\$790	\$(194	) \$596	5.0
Technology	4,810	(2,068	) 2,742	6.0
Trademarks	930	(262	) 668	9.0
Partner relationships	680	(113	) 567	3.0
Non-compete agreements	40	(7	) 33	3.0
Domain names	287	(195	) 92	5.0
Patents	340	(116	) 224	5.0
	\$7,877	\$(2,955	) \$4,922	5.9
	December 31, 2014			
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life in Years
Customer relationships	\$230	\$(104	) \$126	5.0
Technology	4,000	(1,500	) 2,500	6.0
Trademarks	800	(180	) 620	10.0
Domain names	287	(161	) 126	5.0
Patents	324	(81	) 243	5.0
	\$5,641	\$(2,026	) \$3,615	6.4



Table of Contents

Amortization expense for the three months ended September 30, 2015 and 2014 was \$0.4 million and \$0.2 million, respectively and \$0.9 million and \$0.7 million for the nine months ended September 30, 2015 and 2014, respectively. A summary of the activity within our intangible assets since December 31, 2014 is as follows (in thousands):

Intangible assets, net at December 31, 2014	\$3,615	
Additions from the acquisition of RentLinx (Note 3):	2,220	
Other additions	16	
Amortization	(929	)
Intangible assets, net at September 30, 2015	\$4,922	

## 8. Long-term Debt

## Credit Facility

On March 16, 2015, we entered into a credit facility (the “Credit Facility”) comprised of a \$10.0 million term loan (the “Term Loan”), and a \$2.5 million revolving line of credit (the “Revolving Facility”) with Wells Fargo. In March 2015 we borrowed \$10.0 million under the Term Loan.

On July 16, 2015, we made an optional prepayment in full of the Term Loan and we became obligated to pay the related \$0.2 million prepayment premium. Wells Fargo agreed with us that the prepayment premium would not be payable until the earlier of September 1, 2015 (which was subsequently extended to October 9, 2015) and the date we terminated the Revolving Facility in full (the earliest of those dates being referred to as the “Due Date”). Wells Fargo further agreed with us that if we entered into an amended revolving credit facility with them by October 9, 2015, and we agreed to pay them a closing fee of at least \$0.1 million in connection with the new credit facility before the Due Date, they would waive the \$0.2 million prepayment premium.

As of September 30, 2015, there was no outstanding balance under the Term Loan and Revolving Facility.

On October 9, 2015, we entered into Amendment Number One to Credit Agreement, which amended the terms of that certain Credit Agreement, dated March 16, 2015, entered into by and among us, Wells Fargo, as administrative agent, and the lenders that are parties thereto (as amended, the “Credit Agreement”).

Under the terms of the Credit Agreement, the lenders made available to us a \$25.0 million revolving line of credit (the “New Revolving Facility”). Subject to customary terms and conditions, we can seek to increase the principal amount of indebtedness available under the Credit Agreement by up to \$10.0 million, in the form of revolving commitments or term loan debt, although the lenders are under no obligation to make additional amounts available to us. Borrowings under the Revolving Facility are subject to the satisfaction of customary conditions.

Borrowings under the New Revolving Facility bear interest at a fluctuating rate per annum equal to, at our option, (i) a base rate equal to the highest of (a) the federal funds rate plus 1/2 of 1%, (b) the London Interbank Offered Rate (“LIBOR”) for a one-month interest period plus 1% and (c) the rate of interest in effect for such day as publicly announced from time to time by Wells Fargo as its prime rate, in each case plus an applicable margin of 1.5%, or (ii) LIBOR for the applicable interest period plus an applicable margin of 2.5%. Interest is due and payable monthly. We are also required to pay a commitment fee equal to 0.25% per annum of the unused portion of the New Revolving Facility if revolver usage is above \$10.0 million, or 0.375% per annum of the unused portion of the New Revolving Facility if revolver usage is less than or equal to \$10.0 million.

The New Revolving Facility matures on October 9, 2020. However, we can make payments on, and cancel in full, the New Revolving Facility at any time without premium or penalty.

The Credit Agreement contains customary affirmative, negative and financial covenants. The affirmative covenants require us to, among other things, disclose financial and other information to the lenders, maintain its business and properties, and maintain adequate insurance. The negative covenants restrict us from, among other things, incurring additional indebtedness, prepaying certain types of indebtedness, encumbering or disposing of its assets, making fundamental changes to its corporate structure, and making certain dividends and distributions. The financial covenants require us to maintain liquidity of not less than

## Table of Contents

\$12.5 million and, to the extent liquidity is determined to be below \$25.0 million, to comply with a maximum senior leverage ratio.

### Debt Financing Costs

Debt financing costs are deferred and amortized, using the effective interest method for costs related to the Term Loan and the straight-line method for costs related to the Revolving Facility. We incurred fees to Wells Fargo attributable to the Term Loan of \$0.3 million and other third-party debt financing costs of \$0.1 million, which were recorded as a reduction of the carrying amount of the Term Loan. Amortization of such costs is included in interest expense. When the Term Loan was repaid prior to the maturity date, the unamortized debt financing costs of \$0.4 million were expensed as interest expense. The allocated unamortized debt financing costs for the Revolving Facility of \$0.1 million were recorded as an asset at September 30, 2015.

## 9. Commitments and Contingencies

### Lease Obligations

As of September 30, 2015, we had operating lease obligations of approximately \$6.9 million through 2022. We recorded rent expense of \$0.3 million for the three months ended September 30, 2015 and 2014, respectively, and \$0.9 million and \$0.8 million for the nine months ended September 30, 2015 and 2014, respectively.

In September 2015, we signed a new lease for 24,479 square feet that will replace our existing office in Richardson, Texas. The aggregate annual payments under the new lease will be approximately \$0.4 million and are subject to annual increases over the lease term, which expires in March 2022, approximately.

In October 2015, we signed an amendment to our existing lease at 90 Castilian Drive in Santa Barbara, California which increased the square footage leased by 7,855 square feet. The aggregate annual payments under the lease increased our annual commitments by approximately \$150,000, and are subject to annual increases over the term of the lease. The amendment does not change any other material provisions of the lease, including the term of the lease, which expires in November 2020.

### Insurance

We have a wholly owned subsidiary, Terra Mar Insurance Company, Inc. ("Terra Mar"), which was established to provide our customers with the option to purchase tenant liability insurance. If our customers choose to use our insurance services, they are issued an insurance policy underwritten by our third-party service provider. The policy has a limit of \$100,000 per incident for each insured residence. We have entered into a reinsurance agreement with our third-party service provider and, as a result, we assume a 100% quota share of the tenant liability insurance provided to our customers through our third-party service provider. Included in cost of revenue we accrue for reported claims and an estimate of losses incurred but not reported by our property manager customers, as we bear the risk related to claims. Our liability for reported claims and incurred but not reported claims as of September 30, 2015 and December 31, 2014 was \$0.4 million and \$0.3 million, respectively, and is included in other current liabilities on the Condensed Consolidated Balance Sheets.

Included in other current assets as of September 30, 2015 and December 31, 2014 are \$0.9 million and \$0.6 million, respectively, of deposits held with a third party related to requirements to maintain collateral for our insurance services.

### Litigation

From time to time, we may become subject to legal proceedings, claims and litigation arising in the ordinary course of business. We are not currently a party to any legal proceedings, nor are we aware of any pending or threatened litigation, that would have a material adverse effect on our business, operating results, cash flows or financial condition should such litigation be resolved unfavorably.

In December 2014, we provided notice to a third-party service provider to terminate our agreement so we could transition services to a new third-party partner. In February 2015, the third-party service provider filed an injunction preventing us from transferring the service to the new third-party partner. No monetary claims were made and, at the time of issuance of our December 31, 2014 consolidated financial statements, we determined the incurrence of a material loss was not probable or reasonably possible and that an estimate of an amount of loss or a range of possible



losses could not reliably be made. In May 2015, primarily to expedite the transition of services to the new third-party partner, we agreed to pay the third-party service provider \$0.6 million, which we recorded in general and administrative expenses for the nine months ended September 30, 2015.

Table of Contents

In May 2015, we paid the final earn-out payment relating to the acquisition of MyCase, Inc. of \$2.4 million. On May 26, 2015, we received a letter from counsel for a former shareholder of MyCase alleging that we failed to make commercially reasonable efforts to cause the maximum earn-out of \$6.6 million to be earned. This amount represents the maximum earn-out that could potentially have been earned by all former MyCase shareholders. The former shareholder also stated that he intends to pursue punitive damages. We believe the allegations are without merit and we plan to vigorously defend against them. Based on information currently available, we have determined that the amount of any possible loss or range of possible loss is not reasonably estimable and we have therefore not established a reserve or a range of possible loss.

**Indemnification**

In the ordinary course of business, we may provide indemnification of varying scope and terms to customers, investors, directors and officers with respect to certain matters, including, but not limited to, losses arising out of our breach of any applicable agreements, services to be provided by us, or intellectual property infringement claims made by third parties. These indemnification provisions may survive termination of the underlying agreement and the maximum potential amount of future payments we could be required to make under these indemnification provisions may not be subject to maximum loss clauses. The maximum potential amount of future payments we could be required to make under these indemnification provisions is indeterminable. We have never paid a material claim, nor have we been sued in connection with these indemnification arrangements. As of September 30, 2015 and December 31, 2014, we had not accrued a liability for these indemnification arrangements because we have determined that the likelihood of incurring a payment obligation, if any, in connection with these indemnification arrangements is not probable or reasonably possible and the amount or range of amounts of any such liability is not reasonably estimable.

**10. Convertible Preferred Stock and Stockholders' Equity (Deficit)**

On June 30, 2015, we completed an IPO of our Class A common stock. Upon the closing of the IPO, all shares of our convertible preferred stock and common stock held prior to the IPO were converted into Class B common stock.

Upon the effectiveness of the Amended and Restated Certificate of Incorporation of the Company on June 25, 2015, the number of shares of capital stock that is authorized to be issued was increased to 325,000,000 shares, of which 250,000,000 shares are Class A common stock, 50,000,000 shares are Class B common stock and 25,000,000 are undesignated preferred stock. The Class A common stock, Class B common stock and preferred stock have a par value of \$0.0001 per share.

**11. Stock-Based Compensation****Stock Options**

A summary of our stock option activity for the nine months ended September 30, 2015 is as follows (number of shares in thousands):

	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life in Years
Options outstanding as of December 31, 2014	1,217	\$3.12	8.2
Options granted	339	9.13	
Options exercised	(299)	) 1.79	
Options cancelled/forfeited	(70)	) 4.97	
Options outstanding as of September 30, 2015	1,187	\$5.06	8.4

The fair value of stock options granted is estimated on the date of grant using the Black-Scholes option-pricing model. Our stock-based compensation expense for stock options for the three months ended September 30, 2015 and 2014 was \$184,000 and \$34,000, respectively, and for the nine months ended September 30, 2015 and 2014 was \$453,000 and \$89,000, respectively.



Table of Contents

The following table summarizes information relating to our stock options granted during the three and nine months ended September 30, 2015 and 2014:

	Three Months Ended		Nine Months Ended		
	September 30,		September 30,		
	2015	2014	2015	2014	
Stock options granted (in thousands)	62	48	339	166	
Weighted average exercise price per share	\$16.37	\$4.16	\$9.13	\$3.53	
Weighted average Black-Scholes model assumptions:					
Risk-free interest rate	1.71	% 1.89	% 1.57	% 1.90	%
Expected term (in years)	6.1	6.0	6.2	6.0	
Expected volatility	44	% 50	% 47	% 49	%
Expected dividend yield	—	—	—	—	

As of September 30, 2015, the total remaining stock-based compensation expense for unvested stock options was \$2.7 million, which is expected to be recognized over a weighted average period of 3.6 years.

**Restricted Stock**

A summary of activity in connection with our restricted stock awards for the nine months ended September 30, 2015 is as follows (number of shares in thousands):

	Number of Shares	Weighted- Average Grant Date Fair Value per Share
Unvested as of December 31, 2014	173	\$1.64
Granted	50	8.78
Vested	(86	) 1.53
Forfeited	—	—
Unvested as of September 30, 2015	137	\$4.31

We have the right to repurchase any unvested restricted stock granted. Restricted stock vests over a four-year period for employees and over a one-year period for non-employee directors. For the three months ended September 30, 2015 and 2014, we recognized stock-based compensation expense for restricted stock awards of \$123,000 and \$36,000, respectively, and for the nine months ended September 30, 2015 and 2014 of \$266,000 and \$104,000, respectively. As of September 30, 2015, the total remaining stock-based compensation expense for unvested restricted stock with a repurchasing right was \$0.5 million, which is expected to be recognized over a weighted average period of 1.7 years.

**Restricted Stock Units**

In September 2015, we granted restricted stock units ("RSUs") with a fixed monetary amount of \$750,000 that vest in equal tranches over four annual periods. On the first day of each vesting period, the number of shares to be issued in respect of the RSUs is determined by dividing the value of the portion of the RSUs that vest in that tranche (\$188,000) by the closing price of our Class A common stock on the vesting date. The shares underlying this grant are not issued and outstanding until the applicable vesting date.

We recognized stock-based compensation expense for these RSUs of \$16,000 for the three and nine months ended September 30, 2015. As of September 30, 2015, the total remaining stock-based compensation expense for these RSUs was \$0.7 million, which is expected to be recognized over a weighted average period of 3.9 years.

Table of Contents

## 12. Income Taxes

Our effective tax rate differs from the U.S. Federal statutory rate of 34% primarily because our losses have been offset by a valuation allowance due to uncertainty as to the realization of those losses.

For the nine months ended September 30, 2015, we recorded income tax expense of \$34,000 associated with our payments of state minimum taxes and the amortization of tax deductible goodwill that is not an available source of income to realize the deferred tax asset.

## 13. Revenue and Other Information

Our chief operating decision maker reviews separate revenue information for our core solutions, Value+ and other service offerings as a measure of growth in the number of our customers and growth in the adoption and utilization of our core solutions and Value+ services by new and existing customers. The following table presents our revenue categories for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Core solutions	\$8,330	\$5,849	\$23,161	\$15,998
Value+ services	10,783	6,586	27,895	16,581
Other	1,192	589	3,522	1,873
Total revenues	\$20,305	\$13,024	\$54,578	\$34,452

Value+ services presented in the table above include subscriptions to website hosting services and contact center services. Other services included above are for one-time services related to on-boarding our core solutions, website design services and revenue related to RentLinx online marketing services.

Our revenue is generated primarily from U.S. customers. All of our property and equipment is located in the United States.

## 14. Subsequent Events

On October 5, 2015, we signed an amendment to our existing lease at 90 Castilian Drive in Santa Barbara, California to exercise a portion of our expansion rights under our existing lease, which increased the square footage leased by 7,855 square feet. For additional information regarding the lease amendment, refer to Note 9, Commitments and Contingencies.

On October 9, 2015, we entered into an amendment to our Credit Agreement with Wells Fargo, pursuant to which the lenders made available to us a revolving credit facility in the amount of \$25.0 million. For additional information regarding the Credit Agreement, refer to Note 8, Long-term Debt

Table of Contents

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

The following discussion and analysis of our financial condition and results of operations should be read together with our Condensed Consolidated Financial Statements and the related notes included elsewhere in this Quarterly Report. This discussion and analysis contains forward-looking statements that are based on our current expectations and reflect our plans, estimates and anticipated future financial performance. These statements involve numerous risks and uncertainties. Our actual results may differ materially from those expressed or implied by these forward-looking statements as a result of many factors, including those set forth in the section entitled "Risk Factors" in Part II, Item 1A of this Quarterly Report.

Overview

We provide industry-specific, cloud-based software solutions for small and medium-sized businesses or SMBs in the property management and legal industries. Our platform is designed to be the system of record to automate essential business processes and the system of engagement to enhance business interactions between our customers and their clients and vendors. Our mobile-optimized software solutions have a user-friendly interface across multiple devices, enabling our customers to work at any time and from anywhere. Our property management software provides small and medium-sized property managers with an end-to-end solution to their business needs, enabling them to manage properties quickly and easily in a single, integrated environment. Our legal software provides solo practitioners and small law firms with a streamlined practice and case management solution, allowing them to manage their practices and case load seamlessly within a flexible system. We also offer optional, but often mission-critical, Value+ services, such as our professionally designed websites and electronic payment services, which are seamlessly built into our core solutions.

We were formed in 2006 with a vision to revolutionize the way that SMBs grow and compete. We launched our first product, APM, a property management solution, in 2008. Recognizing that our customers would benefit from additional mission-critical services that they can purchase as needed, we launched our first Value+ service in 2009 by offering website design and hosting services to our property manager customers. Our websites give our customers a professional online presence and serve as the hub for our system of engagement. In 2010, we commenced the roll out of our electronic payments platform with the introduction of ACH payment processing and, in 2011, we launched resident screening as additional Value+ services. In 2012, we introduced our tenant liability insurance program as a further Value+ service. Also in 2012, after completing our market validation process, we decided to enter the legal market. We expedited our time-to-market by acquiring MyCase Inc. or MyCase, a legal practice and case management solution, and we leveraged our AppFolio Business System, including our experience gained in the property management vertical, to advance our software solution in the legal vertical. In 2013, we extended our website design and hosting services to our law firm customers and expanded our electronic payments platform by allowing residents to pay rent by Electronic Cash Payment and credit or debit card. In 2014, we launched an additional Value+ service for our property manager customers with our contact center to resolve or route incoming maintenance requests. In April 2015, we expanded the services offered to our property manager customers, giving them the ability to better spend, track and optimize their marketing investments through our acquisition of RentLinx, a software platform that allows customers to advertise rental houses and apartments online. Through our disciplined market validation approach and ongoing investment in product development, we continuously update our software solutions through new and innovative core functionality and Value+ services, as well as assess opportunities in adjacent markets and new verticals.

We have focused on growing our revenue by increasing the size of our customer base, retaining customers and increasing the adoption and utilization of our Value+ services by new and existing customers. We have achieved significant customer growth in a relatively short period of time. We define our customer base as the number of customers subscribing to our core solutions, exclusive of free trials, as identified by a unique customer identification code. Customers acquired through the RentLinx acquisition are included in our customer count only if they have a subscription to our core solution.

Customer count is summarized in the table below:

As of September 30,

Edgar Filing: APPFOLIO INC - Form 10-Q

	2015	2014	% Change	
Property manager	7,561	5,331	42	%
Law firm	5,566	3,203	74	%

We have invested in growth in a disciplined manner across our organization. As a result, our costs and operating expenses have increased significantly in absolute dollars primarily due to our significant growth in employees and personnel-related costs. For example, we increased our employee headcount from 347 employees as of September 30, 2014 to 556 employees as of

## Table of Contents

September 30, 2015, representing a period-over-period increase of 60%. We intend to continue to invest across our organization. These investments to grow our business will continue to increase our costs and operating expenses on an absolute basis. Many of these investments will occur in advance of our realization of revenue or any other benefit and will make it difficult to determine if we are allocating our resources efficiently. We expect cost of revenue, research and product development expense, sales and marketing expense, and general and administrative expense to decrease as a percentage of revenue over the long term as revenue increases and we gain additional operating leverage in our business. As a result of this increased operating leverage, we expect our operating margins will improve over the long term.

To date, we have experienced rapid revenue growth due to our investments in research and product development, sales and marketing, customer service and support, and infrastructure. During the periods presented, we have derived more than 90% of our revenue from our property management solution, as it has been available for a longer period of time, is more established within its vertical with a larger customer base, and currently offers a greater number of Value+ services.

We have managed, and plan to continue to manage, our business towards the achievement of long-term growth that we believe will positively impact long-term stockholder value, and not towards the realization of short-term financial or business metrics, or short-term stockholder value.

### Key Components of Results of Operations

#### Revenue

We charge our customers on a subscription basis for our core solutions and many of our Value+ services. Our subscription fees are designed to scale to the size of our customers' businesses. We recognize subscription revenue ratably over the terms of the subscription agreements, which range from one month to one year. We generally invoice our customers for subscription services in monthly, quarterly or annual installments, typically in advance of the subscription period. As a result, we do not have significant deferred revenue because our invoicing is generally for periods less than one year. Revenue from subscription services is impacted by the change in the number and type of our customers, the size and needs of our customers' businesses, our customer renewal rates, and the level of adoption of our Value+ subscription services by new and existing customers.

We also charge our customers usage-based fees for using certain Value+ services, although fees for electronic payment processing are generally paid by the clients of our customers. Usage-based fees are charged on a flat fee per transaction basis with no minimum usage commitments. We recognize revenue for usage-based services in the period the service is rendered. We generally invoice our customers for usage-based services on a monthly basis for services rendered in the preceding month. Revenue from usage-based services is impacted by the change in the number and type of our customers, the size and needs of our customers' businesses, and the level of adoption and utilization of our Value+ usage-based services by new and existing customers.

We also offer our customers assistance with on-boarding our core solutions, as well as website design services. These services are generally purchased as part of a subscription agreement, and are typically performed within the first several months of the arrangement. We recognize revenue for these other services upon completion of the related service. We generally invoice our customers for other services in advance of the services being completed.

In April 2015, we acquired RentLinx which primarily generates revenue by providing online services that allow customers to advertise rental houses and apartments. Revenue related to RentLinx is currently being recorded under other services. In the future, we expect to offer these services as Value+ services to our customer base at which time we will classify this revenue as Value+.

#### Costs and Operating Expenses

Cost of Revenue. Cost of revenue consists of personnel-related costs (including salaries, incentive-based compensation, benefits, and stock-based compensation) for our employees focused on customer service and the support of our operations, platform infrastructure costs (such as data center operations and hosting-related costs), fees paid to third-party service providers, payment processing fees, and allocated shared costs. We typically allocate shared costs across our organization based on headcount within the applicable part of our organization. Cost of revenue excludes amortization of capitalized software development costs and acquired technology. We intend to continue to invest in customer service and support, and the expansion of our technology infrastructure, as we grow the number of



our customers and roll out additional Value+ services.

**Sales and Marketing.** Sales and marketing expense consists of personnel-related costs (including salaries, sales commissions, incentive-based compensation, benefits, and stock-based compensation) for our employees focused on sales and marketing, costs

21

---

Table of Contents

associated with sales and marketing activities, and allocated shared costs. Marketing activities include advertising, online lead generation, lead nurturing, customer and industry events, industry-related content creation and collateral creation. Sales commissions and other incremental costs to acquire customers and grow adoption and utilization of our Value+ services by new and existing customers are expensed as incurred. We focus our sales and marketing efforts on generating awareness of our software solutions, creating sales leads, establishing and promoting our brands, and cultivating an educated community of successful and vocal customers. We intend to continue to invest in sales and marketing to increase the size of our customer base and increase the adoption and utilization of Value+ services by our new and existing customers.

**Research and Product Development.** Research and product development expense consists of personnel-related costs (including salaries, incentive-based compensation, benefits, and stock-based compensation) for our employees focused on research and product development, fees for third-party development resources, and allocated shared costs. Our research and product development efforts are focused on enhancing the ease of use and functionality of our existing software solutions by adding new core functionality, Value+ services and other improvements, as well as developing new products. We capitalize the portion of our software development costs that meets the criteria for capitalization. Amortization of software development costs is included in depreciation and amortization expense. We intend to continue to invest in research and product development as we continue to introduce new core functionality, roll out new Value+ services, develop new products, and expand into adjacent markets and new verticals.

**General and Administrative.** General and administrative expense consists of personnel-related costs (including salaries, incentive-based compensation, benefits, and stock-based compensation) for employees in our executive, finance, information technology, or IT, human resources and administrative organizations. In addition, general and administrative expense includes fees for third-party professional services (including consulting, legal and audit services), other corporate expenses, and allocated shared costs. We intend to incur incremental costs associated with supporting the growth of our business, both in terms of increased headcount and to meet the increased reporting requirements and compliance obligations associated with our transition to, and operation as, a public company. Such costs will include increases in our finance, IT, human resources and administrative personnel, additional consulting, legal and audit fees, insurance costs, board of directors' compensation, the cost of achieving and maintaining compliance with Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, and other costs associated with being a public company.

**Depreciation and Amortization.** Depreciation and amortization expense includes depreciation of property and equipment, amortization of capitalized software development costs and amortization of intangible assets. We depreciate or amortize property and equipment, software development costs and intangible assets over their expected useful lives on a straight-line basis, which approximates the pattern in which the economic benefits of the assets are consumed. Accounting guidance for internal-use software costs requires that we capitalize and then amortize qualifying internal-use software costs, rather than expense costs as incurred, which has the impact of shifting these expenses to a future period and reducing the impact of these costs on our financial results in the current period. As we continue to invest in our research and product development organization and the development or acquisition of new technology, we expect to have increased capitalized software development costs and incremental amortization.

Table of Contents

## Results of Operations

The following table sets forth our results of operations for the periods presented in dollars (in thousands) and as a percentage of revenue:

	Three Months Ended September 30, 2015				2014				Nine Months Ended September 30, 2015				2014			
	Amount	%		%	Amount	%		%	Amount	%		%	Amount	%		%
Consolidated Statements of Operations Data:																
Revenue	\$20,305	100	%	\$13,024	100	%	\$54,578	100	%	\$34,452	100	%				
Costs and operating expenses:																
Cost of revenue (exclusive of depreciation and amortization) <sup>(1)</sup>	9,264	46		5,979	46		24,438	45		16,112	47					
Sales and marketing <sup>(1)</sup>	7,028	35		4,312	33		18,976	35		11,519	33					
Research and product development <sup>(1)</sup>	2,797	14		1,838	14		6,960	13		4,559	13					
General and administrative <sup>(1)</sup>	3,888	19		1,180	9		10,987	20		3,564	10					
Depreciation and amortization	1,638	8		988	8		4,252	8		2,691	8					
Total costs and operating expenses	24,615	121		14,297	110		65,613	120		38,445	112					
Operating loss	(4,310)	(21)	)	(1,273)	(10)	)	(11,035)	(20)	)	(3,993)	(12)	)				
Other income (expense), net	(1)	—		(6)	—		(8)	—		(103)	—					
Interest income (expense), net	(426)	(2)	)	11	—		(701)	(1)	)	48	—					
Loss before income taxes	(4,737)	(23)	)	(1,268)	(10)	)	(11,744)	(22)	)	(4,048)	(12)	)				
Provision for income taxes	23	—		—	—		34	—		—	—					
Net loss	\$(4,760)	(23)	)%	\$(1,268)	(10)	)%	\$(11,778)	(22)	)%	\$(4,048)	(12)	)%				

<sup>(1)</sup> Includes stock-based compensation expense as follows (in thousands):

	Three Months Ended September 30, 2015		2014		Nine Months Ended September 30, 2015		2014	
Costs and operating expenses:								
Cost of revenue (exclusive of depreciation and amortization)	\$35		\$17		\$86		\$49	
Sales and marketing	33		12		84		32	
Research and product development	10		3		22		17	
General and administrative	200		26		431		60	
Total stock-based compensation expense	\$278		\$58		\$623		\$158	



Table of Contents

## Comparison of the Three and Nine Months Ended September 30, 2015 and 2014

## Revenue

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2015	2014	Change Amount	%	2015	2014	Change Amount	%
	(dollars in thousands)							

Revenue	\$20,305	\$13,024	\$7,281	56	%	\$54,578	\$34,452	\$20,126	58	%
---------	----------	----------	---------	----	---	----------	----------	----------	----	---

Revenue increased \$7.3 million, or 56%, for the three months ended September 30, 2015 compared to the three months ended September 30, 2014, reflecting mainly increased revenue from our property manager customers. The overall increase was primarily the result of an increase in revenue from Value+ services from \$6.6 million to \$10.8 million, or 64%, mainly driven by increased usage of our electronic payments platform, screening services and tenant liability insurance programs by a larger customer base. The increase was also the result of an increase in revenue from our core solutions from \$5.8 million to \$8.3 million, or 42%, driven by growth in the number of our customers and strong customer renewal rates. The increase of \$0.6 million, or 102%, in other revenue from \$0.6 million to \$1.2 million was primarily a result of incremental revenue from the acquisition of RentLinx, which contributed \$0.4 million during the period and an increase in revenue from website design services related to the increase in new customers.

Revenue increased \$20.1 million, or 58%, for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014, reflecting mainly increased revenue from our property manager customers. The overall increase was primarily a result of an increase in revenue from Value+ services from \$16.6 million to \$27.9 million, or 68%, mainly driven by increased usage of our electronic payments platform, screening services and tenant liability insurance programs by a larger customer base. The increase was also the result of an increase in revenue from our core solutions of \$7.2 million, or 45%, driven by growth in the number of our customers and strong customer renewal rates. The increase of \$1.6 million, or 88%, in other revenue from \$1.9 million to \$3.5 million was primarily the result of an increase in fees for website design fees and data migration fees from the increase in new customers and incremental revenue gained from the acquisition of RentLinx.

## Cost of Revenue (Exclusive of Depreciation and Amortization)

	Three Months Ended September 30,				Nine Months Ended September 30,					
	2015	2014	Change Amount	%	2015	2014	Change Amount	%		
	(dollars in thousands)									
Cost of revenue (exclusive of depreciation and amortization)	\$9,264	\$5,979	\$3,285	55	%	\$24,438	\$16,112	\$8,326	52	%

Cost of revenue (exclusive of depreciation and amortization) increased \$3.3 million, or 55%, for the three months ended September 30, 2015 compared to the three months ended September 30, 2014. The increase was primarily the result of an increase in third-party costs of \$1.5 million incurred to support the delivery of our software solutions, an increase in personnel-related costs of \$1.3 million, and an increase in allocated and other costs of \$0.5 million. The increase in third-party costs primarily relates to increased expenditures associated with increased adoption and utilization of certain Value+ services by our new and existing customers as evidenced by the 64% increase in revenue from Value+ services for the three-month period described above. The increase in personnel-related costs was primarily due to a substantial increase in headcount within our customer service and support organization to support the increased usage of Value+ services. The increase in allocated and other costs primarily relates to an increase in overhead costs, such as facility and IT costs, as we continued to expand our operations to support our growth. Cost of revenue (exclusive of depreciation and amortization) increased \$8.3 million, or 52%, for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014. The increase was primarily a

result of an increase in third-party costs of \$4.2 million incurred to support the delivery of our software solutions, an increase in personnel-related costs of \$3.1 million, and an increase in allocated and other costs of \$1.0 million. The increase in third-party costs primarily relates to increased expenditures associated with increased adoption and utilization of certain Value+ services by our new and existing customers as evidenced by the 68% increase in revenue from Value+ services for the nine-month period described above. The increase in personnel-related costs and allocated and other costs for the nine months ended September 30, 2015 occurred for the same reasons described in the quarterly discussion above.

Table of Contents

## Sales and Marketing

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2015	2014	Change			2015	2014	Change		
			Amount	%				Amount	%	
	(dollars in thousands)									
Sales and marketing	\$7,028	\$4,312	\$2,716	63	%	\$18,976	\$11,519	\$7,457	65	%

Sales and marketing expense increased \$2.7 million, or 63%, for the three months ended September 30, 2015 compared to the three months ended September 30, 2014. The increase was primarily the result of an increase in personnel-related costs of \$1.7 million, an increase in marketing program costs of \$0.7 million, and an increase in other operating costs of \$0.3 million. The increase in personnel-related costs was primarily due to an increase in headcount within our sales and marketing organization, an increase in sales commissions due to our revenue growth, and other incentive-based compensation. The increase in marketing program costs was primarily due to an expansion of online lead generation marketing programs to acquire new customers and marketing programs designed to expand adoption and utilization of our Value+ services by new and existing customers. The increase in other operating costs primarily relates to an increase in overhead costs, such as facility and IT costs, as we continued to expand our operations to support our growth.

Sales and marketing expense increased \$7.5 million, or 65%, for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014. The increase was primarily the result of an increase in personnel-related costs of \$4.7 million, an increase in marketing program costs of \$1.9 million primarily associated with online advertising, and an increase in other operating costs of \$0.9 million. The increase in personnel-related costs, marketing program costs and other operating costs for the nine months ended September 30, 2015 occurred for the same reasons described in the quarterly discussion above.

## Research and Product Development

	Three Months Ended September 30,					Nine Months Ended September 30,				
	2015	2014	Change			2015	2014	Change		
			Amount	%				Amount	%	
	(dollars in thousands)									
Research and product development	\$2,797	\$1,838	\$959	52	%	\$6,960	\$4,559	\$2,401	53	%

Research and product development expense increased \$1.0 million, or 52%, for the three months ended September 30, 2015 compared to the three months ended September 30, 2014. The increase was primarily the result of an increase in personnel-related costs net of capitalized software development costs, of \$0.6 million and an increase in other operating costs of \$0.4 million. The increase in personnel-related and other operating costs was primarily due to an increase in headcount within our research and product development organization.

Research and product development expense increased \$2.4 million, or 53%, for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014. The increase was primarily the result of an increase in personnel-related costs net of capitalized software development costs, of \$1.7 million and an increase in other operating costs of \$0.7 million. The increase in personnel-related and other operating costs for the nine months ended September 30, 2015 occurred for the same reasons described in the quarterly discussion above.

Table of Contents

## General and Administrative

	Three Months Ended		Change			Nine Months Ended		Change		
	September 30, 2015	2014	Amount	%		September 30, 2015	2014	Amount	%	
	(dollars in thousands)									
General and administrative	\$3,888	\$1,180	\$2,708	229	%	\$10,987	\$3,564	\$7,423	208	%

General and administrative expense increased \$2.7 million, or 229%, for the three months ended September 30, 2015 compared to the three months ended September 30, 2014. The increase was primarily the result of an increase in personnel-related costs of \$1.7 million, increased legal, accounting and insurance fees related to being a publicly traded company of \$0.6 million, and an increase in other costs of \$0.5 million. The increase in personnel-related costs was primarily due to a substantial increase in headcount within our finance, IT and administrative organizations and \$0.5 million related to incremental compensation we agreed to pay to certain RentLinx personnel subject to their continued employment with us. The increase in other operating costs primarily relates to an increase in overhead costs, such as facility and IT costs, as we continued to expand our operations to support our growth.

General and administrative expense increased \$7.4 million, or 208%, for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014. The increase was primarily the result of an increase in personnel-related costs of \$3.7 million and other operating expenses of \$3.7 million. The increase in personnel-related costs was primarily due to a substantial increase in headcount within our finance, IT and administrative organizations and \$1.1 million related to incremental compensation we agreed to pay to certain RentLinx personnel subject to their continued employment with us. The increase in other operating expenses was mostly attributable to an increase in professional fees in connection with our IPO of \$1.8 million, a payment to a third-party service provider to expedite our transition to a new third-party partner of \$0.6 million, legal fees of \$0.3 million associated with our acquisition of RentLinx, and an increase in overhead costs, such as facility and IT costs, as we continued to expand our operations to support our growth.

## Depreciation and Amortization

	Three Months Ended		Change			Nine Months Ended		Change		
	September 30, 2015	2014	Amount	%		September 30, 2015	2014	Amount	%	
	(dollars in thousands)									
Depreciation and amortization	\$1,638	\$988	\$650	66	%	\$4,252	\$2,691	\$1,561	58	%

Depreciation and amortization expense increased \$0.7 million, or 66%, for the three months ended September 30, 2015 compared to the three months ended September 30, 2014. The increase was primarily due to increased amortization expense of \$0.4 million associated with higher capitalized software development balances, increased amortization of intangible assets of \$0.1 million from the acquisition of RentLinx and increased depreciation expense of \$0.1 million related to capital purchases.

Depreciation and amortization expense increased \$1.6 million, or 58%, for the nine months ended September 30, 2015 compared to the nine months ended September 30, 2014. The increase was primarily due to increased amortization expense of \$1.0 million associated with higher capitalized software development balances, increased depreciation expense of \$0.3 million related to capital purchases and increased amortization of intangible assets of \$0.3 million from the acquisition of RentLinx.

## Interest Income (expense), net

	Three Months		Change			Nine Months		Change		
	Ended September 30, 2015	2014	Amount	%		Ended September 30, 2015	2014	Amount	%	
	(dollars in thousands)									



Edgar Filing: APPFOLIO INC - Form 10-Q

Interest income (expense) \$(426 ) \$11 \$(437 ) (3,973 )% \$(701 ) \$48 \$(749 ) (1,560 )%

26

---

## Table of Contents

Interest expense increased by \$0.4 million and \$0.7 million for the three and nine months ended September 30, 2015, respectively compared to the three and nine months ended September 30, 2014. The increase is primarily attributable to the interest expense recognized from the write-off of deferred financing costs associated with the repayment of the Term Loan. The interest expense was offset by \$0.1 million of interest income from our investment securities, cash and notes receivable.

### Liquidity and Capital Resources

#### Cash and Cash Equivalents

As of September 30, 2015, our principal sources of liquidity were cash and cash equivalents and investment securities, which had an aggregate balance of \$63.6 million. Historically, we have financed our operations primarily through private placements of equity securities in the form of convertible preferred stock, proceeds from borrowings under the Credit Facility, and cash generated from our operations.

In June 2015, we completed our IPO, resulting in net proceeds of \$65.1 million. In July 2015, we sold additional shares to the underwriters, upon their exercise in full of the option we granted them in connection with the IPO resulting in an additional \$10.4 million in net proceeds. As a result, the aggregate net proceeds to us from the sale of shares in the IPO were approximately \$75.4 million. This increase in net proceeds resulted in a commensurate increase in our working capital balance as of the closing date. During the third quarter of 2015, we used a portion of the net proceeds to purchase \$52.0 million of investment securities, which mature at various times over the next three years.

#### Working Capital

As of September 30, 2015, we had working capital of \$27.5 million, compared to a working capital deficit of \$5.7 million as of December 31, 2014. The increase in our working capital was primarily due to an increase in our cash balance and an increase in the current portion of investment securities, each as a result of the net proceeds of the IPO, offset by increases in our accrued employee expenses, accrued expenses and deferred revenue from the continued growth of our business.

#### Credit Facility

As of September 30, 2015, we had no outstanding balance under the under the Term Loan or the Revolving Facility. On October 9, 2015, we entered into Amendment Number One to Credit Agreement, which amended the terms of that certain Credit Agreement, dated March 16, 2015, entered into by and among us, Wells Fargo, as administrative agent, and the lenders that are parties thereto (as amended, the "Credit Agreement").

Under the terms of the Credit Agreement, the lenders have made available to us a \$25.0 million revolving line of credit (the "New Revolving Facility"). Subject to customary terms and conditions, we can seek to increase the principal amount of indebtedness available under the Credit Agreement by up to \$10.0 million, in the form of revolving commitments or term loan debt, although the lenders are under no obligation to make additional amounts available to us. Borrowings under the New Revolving Facility are subject to the satisfaction of customary conditions. At the date of this filing, there was no outstanding balance under the New Revolving Facility.

#### Liquidity Requirements

We believe that our existing cash and cash equivalents, and our investment securities, together with available borrowings under the New Revolving Facility, will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months.

#### Capital Requirements

Our future capital requirements will depend on many factors, including the continued market acceptance of our software solutions, the change in the number of our customers, the adoption and utilization of our Value+ services by new and existing customers, the timing and extent of the introduction of new core functionality and Value+ services in our existing markets and verticals, the timing and extent of our expansion into adjacent markets or new verticals and

the timing and extent of our investments across our organization. In addition, we may in the future enter into arrangements to acquire or invest in complementary businesses, services, technologies or intellectual property rights, although we have no present plans with respect to any acquisitions or investments.

Table of Contents

We may be required to seek additional equity or debt financing in order to meet these future capital requirements. If we are unable to raise additional capital when desired, or on terms that are acceptable to us, our business, operating results and financial condition could be adversely affected.

## Cash Flows

The following table summarizes our cash flows for the periods indicated:

	Nine Months Ended September 30,	
	2015	2014
Net cash (used in) provided by operating activities	\$(3,774	) \$1,283
Net cash used in investing activities	(63,138	) (4,905
Net cash provided by financing activities	73,258	135
Net cash increase (decrease) in cash and cash equivalents	\$6,346	\$(3,487
Cash (Used in) Provided by Operating Activities		

Our primary source of operating cash inflows is cash collected from our customers in connection with their use of our core solutions and Value+ services. Our primary uses of cash from operating activities are for personnel-related expenditures and third-party costs incurred to support the delivery of our software solutions.

For the nine months ended September 30, 2015, cash used in operating activities was \$3.8 million resulting from our net loss of \$11.8 million, adjusted by non-cash charges of \$4.9 million and a net increase in our operating assets and liabilities of \$3.1 million. The net increase in our operating assets and liabilities was primarily the result of an increase of \$4.3 million of depreciation and amortization of our property and equipment and capitalized software and \$3.1 million in accrued employee expenses related to an overall increase in personnel-related costs.

For the nine months ended September 30, 2014, cash provided by operating activities was \$1.3 million resulting from our net loss of \$4.0 million adjusted by non-cash charges of \$2.9 million and a net increase in our operating assets and liabilities of \$2.5 million. The net increase in our operating assets and liabilities was primarily the result of an increase of \$2.7 million of depreciation and amortization of our property and equipment and capitalized software, a \$1.0 million increase in accounts payable due to an increase in expenditures associated with the overall growth of our business, and \$1.0 million in accrued employee expenses.

## Cash Used in Investing Activities

Cash used in and provided by investing activities is generally comprised of purchases, maturities and sales of investment securities, additions to capitalized software development, cash paid for business acquisitions and purchases and dispositions of capital expenditures.

For the nine months ended September 30, 2015, investing activities used \$63.1 million in cash primarily as a result of \$60.4 million of investment securities purchased offset by \$9.0 million of sales and maturities of investment securities. In addition, we had capitalized software development costs of \$5.4 million, used \$4.0 million for the acquisition of RentLinx and had an increase in capital expenditures of \$2.2 million to purchase property and equipment.

For the nine months ended September 30, 2014, investing activities used \$4.9 million in cash primarily as a result of an increase in capitalized software development costs of \$3.3 million, and an increase in capital expenditures of \$1.6 million to purchase property and equipment.

## Table of Contents

### Cash Provided by Financing Activities

Cash provided by and used by financing activities is mostly attributed to the net proceeds from the IPO and includes issuance and payments of debt and the receipt of cash from the exercise of stock options and the issuance of restricted stock.

For the nine months ended September 30, 2015, financing activities provided \$73.3 million in cash primarily as a result of net proceeds from the IPO in the amount of \$75.4 million, offset by a \$2.4 million earnout payment relating to our acquisition of MyCase.

For the nine months ended September 30, 2014, financing activities provided \$0.1 million in cash primarily as a result of proceeds from the exercise of stock options.

### Contractual Obligations and Other Commitments

In October 2015, we signed an amendment to our existing lease at 90 Castilian Drive in Santa Barbara, California to exercise a portion of our expansion rights under our existing lease, which increased the square footage leased by 7,855 square feet. For additional information regarding the amendment to our lease, refer to Note 9, Commitments and Contingencies in the Notes to Condensed Consolidated Financial Statements.

In October 2015, we entered into an amendment to our Credit Agreement with Wells Fargo, pursuant to which the lenders made available to us a revolving credit facility in the amount of \$25.0 million. For additional information regarding the Credit Agreement, refer to Note 8, Long-term Debt.

In July 2015, we made an optional prepayment in full of the Term Loan. For additional information regarding the term loan, refer to Note 8, Long-term Debt in the Notes to Condensed Consolidated Financial Statements.

### Off-Balance Sheet Arrangements

As of September 30, 2015, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that have been established for the purpose of facilitating off-balance sheet arrangements or for other purposes.

### Critical Accounting Policies

As disclosed in our Prospectus, our financial statements and the related notes are prepared in accordance with GAAP. The preparation of our Condensed Consolidated Financial Statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and operating expenses, provision for income taxes and related disclosures.

During the third quarter of 2015, we began purchasing investment securities. As of September 30, 2015 we held \$51.9 million in investment securities. Accordingly, we determined that our accounting policy for investment securities is a critical accounting policy and is as follows:

### Investment Securities

During the third quarter of 2015, we began investing a portion of the net proceeds from the IPO in investment securities. Our investment securities currently consist of corporate bonds, U.S. government agency securities (referred to as "Agency Securities") and certificates of deposit. We classify investment securities as available-for-sale at the time of purchase and reevaluate such classification as of each balance sheet date. All investments are recorded at estimated fair value. Unrealized gains and losses for available-for-sale securities are included in accumulated other comprehensive income (loss), a component of stockholders' equity. We classify our investments as current when the period of time between the reporting date and the contractual maturity is twelve months or less and as noncurrent when the period of time between the reporting date and the contractual maturity is more than twelve months.

We evaluate our investments to assess whether those with unrealized loss positions are other than temporarily impaired. We consider impairments to be other than temporary if they are related to deterioration in credit risk or if it is likely we will sell the securities before the recovery of their cost basis. Declines in value judged to be other than temporary are determined based on

29

---

## Table of Contents

the specific identification method and are reported in other income (expense), net in the Condensed Consolidated Statements of Operations.

For additional information regarding the investment securities, refer to Note 4, Investment Securities and Fair Value Measurements.

### Recent Accounting Pronouncements

For information regarding recent accounting pronouncements, refer to Note 2, Summary of Significant Accounting Policies within our Condensed Consolidated Financial Statements.

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

#### Interest Rate Risk

We had cash and cash equivalents of \$11.8 million as of September 30, 2015, consisting of bank deposits and money market funds. At September 2015, we held \$51.9 million of investment securities which are comprised of fixed rate debt securities and certificates of deposit. We did not purchase these investments for trading or speculative purposes and have not used any derivative financial instruments to manage our interest rate risk exposure. We have not been exposed to, nor do we anticipate being exposed to, material risks due to changes in interest rates. A hypothetical 1% change in interest rates during any of the periods presented would not have had a material impact on our Condensed Consolidated Financial Statements.

On October 9, 2015, we entered into the Credit Agreement, pursuant to which the lenders made available to us a \$25.0 million revolving line of credit. The New Revolving Facility bears interest at a fluctuating rate as described therein.

There are no amounts currently outstanding under the New Revolving Facility.

#### Inflation Risk and Foreign Currency Risk

We have not been exposed to, nor do we anticipate being exposed to, material risks due to changes in inflation rates or foreign currency rates.

As of September 30, 2015, there were no other material changes in the market risks described in the section of the Prospectus entitled "Quantitative and Qualitative Disclosure of Market Risk."

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of our disclosure controls and procedures, as of the end of the period covered by this Quarterly Report. Disclosure controls and procedures refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognizes that no evaluation of controls can provide absolute assurance that all control issues within a company have been detected. In addition, the design of disclosure controls and procedures must reflect the fact that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs. Accordingly, our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of our disclosure control system are met.

As disclosed in the section entitled "Risk Factors" in Part II, Item 1A of this Quarterly Report, we previously concluded that we have material weaknesses in our internal control over financial reporting resulting from our failure to design

or maintain an effective control environment with sufficient personnel with an appropriate level of accounting and financial reporting expertise with respect to the accounting for non-routine, complex transactions, which contributed to a material weakness in our accounting policies and procedures designed to address the accounting for unusual or complex transactions. Because of the material weaknesses in our internal control over financial reporting, our principal executive officer and principal financial officer concluded that our

30

---



Table of Contents

disclosure controls and procedures were not effective as of the end of the period covered by this Quarterly Report at the reasonable assurance level. However, our management, including our principal executive officer and principal financial officer, has concluded that, notwithstanding the identified material weaknesses in our internal control over financial reporting, the Condensed Consolidated Financial Statements in this Quarterly Report fairly present, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with U.S. GAAP.

Management's Remediation Efforts

We continued our efforts to remediate the identified material weaknesses in our internal control over financial reporting, including by:

Hiring additional personnel in our accounting and finance department with extensive knowledge in accounting and financial reporting, a majority of which are Certified Public Accountants ("CPA") with experience addressing unusual, complex and non-routine transactions.

Adding additional members to our Board of Directors with extensive experience overseeing publicly traded companies and reviewing SEC filings, including a new Audit Committee Chairman who qualifies as an "audit committee financial expert" under SEC rules.

Organizing and implementing a Disclosure Committee to review the Company's transactions each quarter with key management and operational personnel, including reviewing and discussing unusual, complex and non-routine transactions.

Pursuing ongoing efforts to improve, design and implement processes to enhance our internal control over financial reporting.

Our remediation efforts are subject to ongoing senior management review, as well as Audit Committee oversight. We will not be able to conclude whether the steps we are taking will fully remediate these material weaknesses until we have completed our remediation efforts and subsequent evaluation of their effectiveness. Following this evaluation, we may conclude that additional measures are required to be implemented, which may necessitate the expenditure of additional resources.

Changes in Internal Control over Financial Reporting

As discussed above, during the period covered by this Quarterly Report, management continued to implement measures to remediate the previously identified material weaknesses in our internal control over financial reporting. Except for the remediation efforts described above, there was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various legal proceedings and claims arising in the ordinary course of our business. Although the results of legal proceedings and claims cannot be predicted with certainty, we currently believe that the final outcome of these ordinary course matters will not, individually or in the aggregate, have a material adverse effect on our business, operating results, financial condition or cash flows. However, regardless of the outcome, litigation can have an adverse impact on us because of legal costs, diversion of management time and resources, and other factors.

Item 1A. Risk Factors

An investment in our Class A common stock involves risks. Before making an investment decision, you should carefully consider all of the information in this Quarterly Report, including in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Condensed Consolidated Financial Statements and related notes. In addition, you should carefully consider the risks and uncertainties described in the section entitled “Risk Factors” in our Quarterly Report for the fiscal quarter ended June 30, 2015, which was filed with the SEC on August 6, 2015, as well as in our other public filings with the SEC. If any of the identified risks are realized, our business, financial condition, operating results and prospects could be materially and adversely affected. In that case, the trading price of our Class A common stock may decline, and you could lose all or part of your investment. In addition, other risks of which we are currently unaware, or which we do not currently view as material, could have a material adverse effect on our business, financial condition, operating results and prospects.

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

Unregistered Sales of Equity Securities

None.

Use of Proceeds

On June 30, 2015, we closed our initial public offering of 6,200,000 shares of our Class A common stock, at a price to the public of \$12.00 per share (the “IPO”). The offer and sale of all of the shares in the IPO were registered under the Securities Act pursuant to a Registration Statement on Form S-1 (File No. 333-204262), which was declared effective by the SEC on June 25, 2015 (the “Registration Statement”). The aggregate offering price for shares sold in the IPO was approximately \$74.4 million. We raised approximately \$65.1 million in net proceeds from the offering, after deducting underwriting discounts and commissions of \$5.2 million and other offering expenses of approximately \$4.1 million.

On July 8, 2015, in connection with the exercise of an overallotment option granted to the underwriters, we sold 930,000 additional shares of our Class A common stock to the underwriters at the public offering price of \$12.00 per share, resulting in an additional \$10.4 million in net proceeds to us, after deducting underwriting discounts and commissions of \$0.8 million. As a result, the aggregate net proceeds to us from the sale of shares in the IPO were approximately \$75.4 million.

There has been no material change in the planned use of net proceeds from the IPO as described in the Prospectus. The amounts and timing of our actual uses of net proceeds will vary depending on numerous factors, including the factors described in the section entitled “Risk Factors” in Part II, Item 1A of this Quarterly Report.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Item 3. Defaults Upon Senior Securities

None.

32

---

Table of Contents

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

See the Exhibit Index immediately following the signature page of this Quarterly Report, which is incorporated herein by reference.

Table of Contents

SIGNATURES

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

AppFolio, Inc.

Date: November 9, 2015

By: /s/ Ida Kane  
Ida Kane  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer)

---

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description of Document
3.1	Amended and Restated Certificate of Incorporation of the registrant as currently in effect (incorporated herein by reference to Exhibit 3.1 to our Current Report on Form 10-Q filed on August 6, 2015).
3.2	Amended and Restated Bylaws of the registrant as currently in effect (incorporated herein by reference to Exhibit 3.2 to our Current Report on Form 10-Q filed on August 6, 2015).
10.1	Amendment Number One to Credit Agreement, by and among registrant, Wells Fargo Bank, N.A., as administrative agent, and the lenders that are parties thereto, dated October 9, 2015.
10.2	First Amendment to Lease, by and between the registrant and Nassau Land Company, L.P., dated October 5, 2015.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

\* The certifications attached as Exhibit 32.1 accompany this Quarterly Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed “filed” by the registrant for purposes of Section 18 of the Exchange Act.