2U, Inc.
Form 10-Q
August 06, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

or

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

For the transition period from to

Commission File Number: 001-36376

2U, INC.

(Exact name of registrant as specified in its charter)

Delaware	**26-2335939**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
8201 Corporate Drive, Suite 900 **Landover, MD**	**20785**
(Address of principal executive offices)	(Zip Code)

(301) 892-4350

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x	Smaller reporting company o

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

As of August 4, 2015, there were 41,592,472 shares of the registrant s common stock, par value $0.001 per share, outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and which are subject to substantial risks and uncertainties. In some cases, you can identify forward-looking statements by the words may, might, will, could, would, should, expect, intend, plan, objective, anticipate, believe, estimate, predict, project, p or the negative of these terms, or other comparable terminology intended to identify statements about the future. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from the information expressed or implied by these forward-looking statements. Although we believe that we have a reasonable basis for each forward-looking statement contained in this Quarterly Report on Form 10-Q, we caution you that these statements are based on a combination of facts and factors currently known by us and our expectations of the future, about which we cannot be certain. Forward-looking statements include statements about:

- trends in the higher education market and the market for online education, and expectations for growth in those markets;
- the acceptance, adoption and growth of online learning by colleges and universities, faculty, students, employers, accreditors and state and federal licensing bodies;
- the potential benefits of our cloud-based software-as-a-service (SaaS) technology and technology-enabled services to clients and students;
- anticipated launch dates of new client programs;
- the predictability, visibility and recurring nature of our business model;
- our ability to acquire new clients and expand programs with existing clients, including in the international, undergraduate and doctoral markets;
- our ability to continue to acquire prospective students for our clients programs;
- our ability to affect or increase student retention in our clients programs;

- our growth strategy;
- the scalability of our cloud-based SaaS technology;
- our expected expenses in future periods and their relationship to revenue;
- potential changes in regulations applicable to us or our clients; and
- the amount of time that we expect our cash balances and other available financial resources to be sufficient to fund our operations.

You should refer to the risks described in Part I, Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2014 for a discussion of important factors that may cause our actual results to differ materially from those expressed or implied by our forward-looking statements. As a result of these factors, we cannot assure you that the forward-looking statements in this Quarterly Report on Form 10-Q will prove to be accurate. Furthermore, if our forward-looking statements prove to be inaccurate, the inaccuracy may be material. In light of the significant uncertainties in these forward-looking statements, you should not regard these statements as a representation or warranty by us or any other person that we will achieve our objectives and plans in any specified timeframe, or at all. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

2U, Inc.

Condensed Consolidated Balance Sheets

(unaudited, in thousands, except share and per share amounts)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 88,224	$ 86,929
Accounts receivable, net	4,393	350
Advance to clients, current	817	
Prepaid expenses	3,215	2,709
Total current assets	96,649	89,988
Property and equipment, net	7,353	6,755
Capitalized content development costs, net	15,373	13,155
Advance to clients, non-current	1,733	1,675
Other non-current assets	1,995	1,466
Total assets	$ 123,103	$ 113,039
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 2,846	$ 2,293
Accrued expenses and other current liabilities	21,881	17,138
Deferred revenue	13,426	1,906
Refunds payable	3,077	2,431
Total current liabilities	41,230	23,768
Rebate reserve	642	639
Other non-current liabilities	612	621
Total liabilities	42,484	25,028
Commitments and contingencies (Note 5)		
Stockholders equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized, 0 shares issued and outstanding as of June 30, 2015 and December 31, 2014		
Common stock, $0.001 par value, 200,000,000 shares authorized, 41,502,290 shares issued and outstanding as of June 30, 2015; 40,735,069 shares issued and outstanding as of December 31, 2014	42	41
Additional paid-in capital	224,523	216,818
Accumulated deficit	(143,946)	(128,848)
Total stockholders equity	80,619	88,011
Total liabilities and stockholders equity	$ 123,103	$ 113,039

See accompanying notes to condensed consolidated financial statements.

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2U, Inc.

Condensed Consolidated Statements of Operations

(unaudited, in thousands, except share and per share amounts)

	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Revenue	$ 35,238	$ 24,744	$ 69,850	$ 51,076
Costs and expenses:				
Servicing and support	7,903	7,000	15,454	13,248
Technology and content development	6,466	5,818	12,600	11,492
Program marketing and sales	21,526	16,710	41,113	31,951
General and administrative	8,871	5,708	15,582	11,144
Total costs and expenses	44,766	35,236	84,749	67,835
Loss from operations	(9,528)	(10,492)	(14,899)	(16,759)
Other income (expense):				
Interest expense	(126)	(134)	(252)	(918)
Interest income	24	31	53	32
Total other income (expense)	(102)	(103)	(199)	(886)
Loss before income taxes	(9,630)	(10,595)	(15,098)	(17,645)
Income tax expense				
Net loss	(9,630)	(10,595)	(15,098)	(17,645)
Preferred stock accretion		(2)		(89)
Net loss attributable to holders of common stock	$ (9,630)	$ (10,597)	$ (15,098)	$ (17,734)
Net loss per share attributable to holders of common stock, basic and diluted	$ (0.23)	$ (0.27)	$ (0.37)	$ (0.75)
Weighted-average shares of common stock outstanding, basic and diluted	41,362,476	39,304,884	41,171,669	23,588,330

See accompanying notes to condensed consolidated financial statements.

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2U, Inc.

Condensed Consolidated Statements of Changes in Stockholders Equity

(unaudited, in thousands, except share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders Equity
Balance, December 31, 2014	40,735,069	$ 41	$ 216,818	$ (128,848)	$ 88,011
Exercise of stock options	505,156	1	2,226		2,227
Issuance of common stock in connection with settlement of restricted stock units, net of withholdings	235,498		(436)		(436)
Issuance of common stock award	26,567		750		750
Stock-based compensation expense			5,165		5,165
Net loss				(15,098)	(15,098)
Balance, June 30, 2015	41,502,290	$ 42	$ 224,523	$ (143,946)	$ 80,619

See accompanying notes to condensed consolidated financial statements.

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2U, Inc.

Condensed Consolidated Statements of Cash Flows

(unaudited, in thousands)

	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Cash flows from operating activities		
Net loss	$ (15,098)	$ (17,645)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,390	2,646
Stock-based compensation expense	5,915	3,239
Change in the fair value of the Series D redeemable convertible preferred stock warrant prior to conversion		695
Changes in operating assets and liabilities:		
Accounts receivable, net	(4,043)	1,180
Advances to clients	(875)	(569)
Prepaid expenses	(506)	(1,010)
Other assets	(555)	662
Accounts payable	553	(773)
Accrued expenses and other current liabilities	5,101	1,921
Deferred revenue	11,520	11,130
Refunds payable	646	196
Rebate reserve	3	(5)
Other liabilities	(9)	(25)
Net cash provided by operating activities	6,042	1,642
Cash flows from investing activities		
Expenditures for property and equipment	(2,040)	(1,720)
Capitalized content development cost expenditures	(4,498)	(3,476)
Other investing activities		(21)
Net cash used in investing activities	(6,538)	(5,217)
Cash flows from financing activities		
Proceeds from issuance of common stock, net of offering costs		100,302
Proceeds from exercise of stock options	2,227	1,023
Tax withholding payments in connection with net settlement of restricted stock units	(436)	
Proceeds from revolving line of credit		5,000
Payment on revolving line of credit		(5,000)
Net cash provided by financing activities	1,791	101,325
Net increase in cash and cash equivalents	1,295	97,750
Cash and cash equivalents, beginning of period	86,929	7,012
Cash and cash equivalents, end of period	$ 88,224	$ 104,762
Supplemental disclosure of non-cash investing and financing activities		
Accretion of issuance costs on redeemable convertible preferred stock	$	$ 89
Accrued capital expenditures	199	278
Deferred offering costs included in accounts payable and accrued expenses		144
Common stock granted in exchange for consulting services received		55

See accompanying notes to condensed consolidated financial statements.

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2U, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Description of the Business

2U, Inc. (the Company) was incorporated as 2Tor Inc. in the State of Delaware in April 2008 and changed its name to 2U, Inc. on October 11, 2012. Under long-term agreements, the Company provides an integrated solution comprised of cloud-based software-as-a-service (SaaS), fused with technology-enabled services (together, the Platform), that allows leading colleges and universities to deliver high quality online degree programs, extending the universities reach and distinguishing their brands. The Company s SaaS technology consists of (i) a comprehensive learning environment (Online Campus), which acts as the hub for all student and faculty academic and social interaction, and (ii) operations applications, which provide the content management, admissions application processing, customer relationship management and other functionality necessary to effectively operate the Company s clients programs. The Company also provides a suite of technology-enabled services that support the complete lifecycle of a higher education program, including attracting students, advising prospective students through the admissions application process, providing technical, success coaching and other support, facilitating accessibility to individuals with disabilities, and facilitating in-program field placements.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary and have been prepared in accordance with United States generally accepted accounting principles (U.S. GAAP). All intercompany accounts and transactions have been eliminated in consolidation.

Unaudited Condensed Consolidated Financial Information

The accompanying unaudited condensed consolidated financial statements and footnotes have been prepared in accordance with U.S. GAAP. The Company has condensed or omitted certain information and footnote disclosures normally included in financial statements presented in accordance with U.S. GAAP in the accompanying unaudited condensed consolidated financial statements. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of financial position, the results of operations, changes in stockholders equity and cash flows, and the disclosures made herein are adequate to prevent the information presented from being misleading. The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the results for the full year ending December 31, 2015 or the results for any future periods. These unaudited condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes for the year ended December 31, 2014, which are included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (the

SEC) on February 26, 2015.

Use of Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. On an ongoing basis, the Company evaluates its estimates, including those related to the useful lives of long-lived assets, fair value measurement and income taxes, among others. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable, the results of which form the basis for making judgments about the carrying value of assets and liabilities. Actual results could differ from those estimates.

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Revenue Recognition and Deferred Revenue

The Company recognizes revenue when all of the following conditions are met: (i) persuasive evidence of an arrangement exists, (ii) rendering of services is complete, (iii) fees are fixed or determinable and (iv) collection of fees is reasonably assured.

The Company primarily derives its revenue from long-term contracts that typically range from 10 to 15 years in length. Under these contracts, the Company enables access to its Platform to its clients and their faculty and students. The Company is entitled to a contractually specified percentage of net program proceeds from its clients. These net program proceeds represent gross proceeds billed by clients to students, less credit card fees and other specified charges the Company has agreed to exclude in certain of its client contracts. A refund allowance is established for the Company s share of tuition and fees ultimately uncollected by its clients. The Company also offered rebates to a group of students who enrolled in a specific client program between 2009 and 2011, which the Company will pay to the student if he or she completes the degree and certain post-graduation work requirements within a specified period of time. These rebates and refunds offset the net program proceeds recognized as revenue. Revenue is recognized ratably over the service period, which the Company defines as the first through the last day of classes for each semester in a client s program. The Company invoices its clients based on enrollment reports that are generated by its clients. In some instances, these enrollment reports are received prior to the conclusion of the drop/add period. In such cases, the Company establishes a reserve against revenue, if necessary, based on its estimate of changes in enrollments expected prior to the end of the drop/add period.

The Company generates substantially all of its revenue from multiple-deliverable contractual arrangements with its clients. Under each of these arrangements, the Company provides (i) access to Online Campus, which serves as a learning platform for its client s faculty and students and which also enables a comprehensive range of other client functions, (ii) access to operations applications which provide the content management, admissions application processing, customer relationship management, and other functionality necessary to effectively operate the Company s clients programs and (iii) technology-enabled services that support the complete lifecycle of a higher education program, including attracting students, advising prospective students through the admissions application process, providing technical, success coaching and other support, facilitating accessibility to individuals with disabilities, and facilitating in-program field placements.

In order to treat deliverables in a multiple-deliverable contractual arrangement as separate units of accounting, deliverables must have standalone value upon delivery. The technology-enabled services within the Platform are provided primarily in support of programs delivered through Online Campus, and for students of the programs delivered through Online Campus. Accordingly, the Company has determined that no individual deliverable has standalone value upon delivery and, therefore, deliverables within the Company s multiple-deliverable arrangements do not qualify for treatment as separate units of accounting. Accordingly, the Company considers all deliverables to be a single unit of accounting and recognizes revenue from the entire arrangement over the term of the service period.

Advance payments are recorded as deferred revenue until services are delivered or obligations are met, at which time revenue is recognized. Deferred revenue as of a particular balance sheet date represents the excess of amounts received as compared to amounts recognized in revenue in the consolidated statements of operations as of the end of the reporting period, and such amounts are reflected as a current liability on the Company s consolidated balance sheets.

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Concentration of Credit Risk

Financial instruments that subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. All of the Company s cash is held at financial institutions that management believes to be of high credit quality. The Company s bank accounts exceed federally insured limits at times. The Company has not experienced any losses on cash to date. To manage accounts receivable risk, the Company evaluates the creditworthiness of its clients and maintains an allowance for doubtful accounts, if needed.

Four of the Company s clients accounted for the following percentages of revenue for the periods presented below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	**2014**	**2015**	**2014**
Client A	45%	54%	48%	58%
Client B	10	16	10	16
Client C	11	14	12	14
Client D	17	8	15	6

Additionally, the Company s largest client accounted for 74% and 35% of the Company s accounts receivable balance as of June 30, 2015 and December 31, 2014, respectively. No additional clients accounted for more than 10% of the Company s accounts receivable balance as of June 30, 2015, while two additional clients accounted for more than 10% of the Company s accounts receivable balance as of December 31, 2014.

Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Computer software is included in property and equipment and consists of internally-developed software. Expenditures for major additions, construction and improvements are capitalized. Depreciation and amortization is expensed using the straight-line method over the estimated useful lives of the related assets, which range from three to five years for computer hardware and five to seven years for furniture and office equipment. Leasehold improvements are depreciated on a straight-line basis over the lesser of the remaining term of the leased facility or the estimated useful life of the improvement, which ranges from four to ten years. Useful lives of significant assets are periodically reviewed and adjusted prospectively to reflect the Company s current estimates of the respective assets expected utility. Repair and maintenance costs are expensed as incurred.

The Company capitalizes certain costs associated with internally-developed software, primarily consisting of direct labor associated with creating the software. Software development projects generally include three stages: the preliminary project stage (all costs are expensed as incurred), the application development stage (certain costs are capitalized and certain costs are expensed as incurred) and the post-implementation/operation stage (all costs are expensed as incurred). Costs capitalized in the application development stage include costs of designing the application, coding, integrating the Company s and the university s networks and systems, and the testing of the software. Capitalization of costs requires judgment in determining when a project has reached the application development stage and the period over which the Company expects to benefit from the use of that software. Once the software is placed in service, these costs are depreciated on the straight-line method over the estimated useful life of the software, which is generally three years.

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Capitalized Content Development Costs

The Company works with each client s faculty members to develop and maintain educational content that is delivered to their students through Online Campus. The online content developed jointly by the Company and its clients consists of subjects chosen and taught by clients faculty members and incorporates references and examples designed to remain relevant over extended periods of time. Online delivery of the content, combined with live, face-to-face instruction, provides the Company with rapid user feedback that it uses to make ongoing corrections, modifications and improvements to the course content. The Company s clients retain all intellectual property rights to the developed content, although the Company retains the rights to the content packaging and delivery mechanisms. Much of the Company s new content development uses proven delivery platforms and is therefore primarily subject-specific in nature. As a result, a significant portion of content development costs qualify for capitalization due to the focus of the Company s development efforts on the unique subject matter of the content. Similar to on-campus programs offered by the Company s clients, the online degree programs enabled by the Company offer numerous courses for each degree. The Company therefore capitalizes its development costs on a course-by-course basis. As students must matriculate into a client program in order to take a course, revenues and identifiable cash flows are also measured at the client program level.

The Company develops content on a course-by-course basis in conjunction with the faculty for each client program. The clients and their faculty generally provide course outlines in the form of the curriculum, required textbooks, case studies and other reading materials, as well as presentations that are typically used in the on-campus setting. The Company is then responsible for, and incurs all of the expenses related to, the conversion of the materials provided by each client into a format suitable for delivery through Online Campus.

The content development costs that qualify for capitalization are third-party direct costs, such as videography, editing and other services associated with creating digital content. Additionally, the Company capitalizes internal payroll and payroll-related costs incurred to create and produce videos and other digital content utilized in the clients programs for delivery via Online Campus. Capitalization ends when content has been fully developed by both the Company and the client, at which time amortization of the capitalized content development costs begins. The capitalized costs are recorded on a course-by-course basis and included in capitalized content costs on the consolidated balance sheets. These costs are amortized using the straight-line method over the estimated useful life of the respective capitalized content program, which is generally five years. The estimated useful life corresponds with the Company s planned curriculum refresh rate. This refresh rate is consistent with expected curriculum refresh rates as cited by program faculty members for similar on-campus programs. It is reasonably possible that developed content could be refreshed before the estimated useful lives are complete or be expensed immediately in the event that the development of a course is discontinued prior to launch.

Impairment of Long-Lived Assets

The Company reviews long-lived assets, which consist of property and equipment and capitalized content development costs, for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Recoverability of a long-lived asset is measured by a comparison of the carrying value of an asset or asset group to the future undiscounted net cash flows expected to be generated by that asset or asset group. If such assets are not recoverable, the impairment to be recognized is measured by the amount by which the carrying value of an asset exceeds the estimated fair value (discounted cash flow) of the asset or asset group. In order to assess the recoverability of the capitalized content development costs, the costs are grouped by program, which is the lowest level of independent cash flows. The Company s impairment analysis is based upon forecasted financial and operational results. The actual results could vary from the Company s forecasts, especially in relation to recently launched programs. For the three and six months ended June 30, 2015 and 2014, no impairment of long-lived assets was deemed to have occurred.

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Comprehensive Loss

The Company s net loss equals comprehensive loss for all periods presented as the Company has no material components of other comprehensive income.

Stock-Based Compensation

The Company accounts for stock-based compensation awards based on the fair value of the award as of the grant date. For awards subject to service-based vesting conditions, the Company recognizes stock-based compensation expense on a straight-line basis over the awards requisite service period, adjusted for estimated forfeitures. For awards subject to both performance and service-based vesting conditions, the Company recognizes stock-based compensation expense using an accelerated recognition method when it is probable that the performance condition will be achieved.

See Note 8 for a summary of assumptions used in calculating the fair value of stock options.

Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-05, *Intangibles Goodwill and Other Internal-Use Software*. The ASU provides guidance to customers in a cloud computing arrangement to determine whether the arrangement includes a software license. When a cloud computing arrangement includes a software license, the customer is required to account for the license element of the arrangement consistent with the acquisition of other software licenses. The amendments in this ASU are effective for fiscal years beginning after December 15, 2015. The Company is currently evaluating the effect that the standard will have on its consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU No. 2015-03, *Interest Imputation of Interest*. The ASU simplifies the presentation of debt issuance costs by requiring that such costs be presented in the consolidated balance sheets as a direct deduction from the carrying value of the associated debt instrument, consistent with debt discounts. The amendments in this ASU are effective for fiscal years beginning after December 15, 2015. Adoption of this standard will not have a material impact on the Company s consolidated financial position.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, 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. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In July 2015, the FASB deferred by one year the mandatory effective date of this ASU from January 1, 2017 to January 1, 2018. Early application is permitted, but not prior to the original effective date of January 1, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is currently evaluating the effect that this standard will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

The Company has reviewed other new accounting pronouncements that were issued as of June 30, 2015 and does not believe that these pronouncements are applicable to the Company, or that they will have a material impact on its financial position or results of operations.

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3. Property and Equipment

Property and equipment consisted of the following as of:

[redacted]				
		(in thousands)		
Internally-developed software	$	7,831	$	6,069
Internally-developed software in process		1,441		1,751
Computer hardware		3,114		3,016
Furniture and office equipment		1,469		1,104
Leasehold improvements		1,782		1,801
Total		15,637		13,741
Accumulated depreciation and amortization		(8,284)		(6,986)
Property and equipment, net	$	7,353	$	6,755

Depreciation and amortization expense of property and equipment was $0.7 million and $0.6 million for the three months ended June 30, 2015 and 2014, respectively. Depreciation and amortization expense of property and equipment was $1.3 million and $1.2 million for the six months ended June 30, 2015 and 2014, respectively.

As of June 30, 2015, the estimated future depreciation and amortization expense for property and equipment is as follows (in thousands):

2015	$	1,197
2016		2,008
2017		1,525
2018		732
2019		339
Thereafter		111
Total	$	5,912

4. Capitalized Content Development Costs

Capitalized content development costs consisted of the following as of:

		June 30, 2015		December 31, 2014
		(in thousands)		
Capitalized content development costs	$	21,603	$	16,835
Capitalized content development costs in process		2,956		3,699

Accumulated amortization		(9,186)		(7,379)
Capitalized content development costs, net	$	15,373	$	13,155

The Company recorded amortization expense related to capitalized content development costs of $1.0 million and $0.7 million for the three months ended June 30, 2015 and 2014, respectively. The Company recorded amortization expense related to capitalized content development costs of $2.1 million and $1.4 million for the six months ended June 30, 2015 and 2014, respectively.

As of June 30, 2015, the estimated future amortization expense for the capitalized content development costs is as follows (in thousands):

2015	$	1,949
2016		3,531
2017		2,934
2018		2,420
2019		1,416
Thereafter		167
Total	$	12,417

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5. Commitments and Contingencies

Line of Credit

On December 31, 2013, the Company entered into a credit agreement for a revolving line of credit with an aggregate borrowing base not to exceed $37.0 million. On January 21, 2014, the Company borrowed $5.0 million under this line of credit and repaid this borrowing in full on February 18, 2014; therefore, no amounts were outstanding as of June 30, 2015 or December 31, 2014. Under this revolving line of credit, the Company has the option of borrowing funds subject to (i) a base rate, which is equal to 1.5% plus the greater of Comerica Bank s prime rate, the federal funds rate plus 1% or the 30 day LIBOR plus 1%, or (ii) LIBOR plus 2.5%. For amounts borrowed under the base rate, the Company may make interest-only payments quarterly, and may prepay such amounts with no penalty. For amounts borrowed under LIBOR, the Company makes interest-only payments in periods of one, two and three months and will be subject to a prepayment penalty if such borrowed amounts are repaid before the end of the interest period.

Borrowings under the line of credit are collateralized by substantially all of the Company s assets. The availability of borrowings under this credit line is subject to compliance with reporting and financial covenants, including, among other things, that the Company achieves specified minimum three-month trailing revenue levels during the term of the agreement and specified minimum six-month trailing profitability levels for some client programs, measured quarterly. In addition, the Company is required to maintain a minimum adjusted quick ratio, which measures short-term liquidity, of at least 1.10 to 1.00. As of June 30, 2015 and December 31, 2014, the Company s adjusted quick ratio was 5.26 and 6.45, respectively.

The covenants under the line of credit also place limitations on the Company s ability to incur additional indebtedness or to prepay permitted indebtedness, grant liens on or security interests in its assets, carry out mergers and acquisitions, dispose of assets, declare, make or pay dividends, make capital expenditures in excess of specified amounts, make investments, loans or advances, enter into transactions with affiliates, amend or modify the terms of material contracts, or change its fiscal year. If the Company is not in compliance with the covenants under the line of credit, after any opportunity to cure such non-compliance, or it otherwise experiences an event of default under the line of credit, the lenders may require repayment in full of all principal and interest outstanding. If the Company fails to repay such amounts, the lenders could foreclose on the assets pledged as collateral under the line of credit. The Company is currently in compliance with all such covenants.

Legal Contingencies

From time to time, the Company may become involved in legal proceedings or other contingencies in the ordinary course of its business. The Company is not presently involved in any legal proceeding or other contingency that, if determined adversely to it, would individually or in the aggregate have a material adverse effect on its business, operating results, financial condition or cash flows. Accordingly, the Company does not believe that there is a reasonable possibility that a material loss exceeding amounts already recognized may have been incurred as of the date of the balance sheets presented herein.

Program Marketing and Sales Commitments

Certain of the agreements entered into between the Company and its clients require the Company to commit to meet certain staffing and spending investment thresholds related to program marketing and sales activities. In addition, certain of the agreements require the Company to invest up to agreed-upon levels in marketing the programs to achieve specified program performance. The Company believes it is currently in compliance with all such commitments.

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Operating Leases

The Company leases office facilities under non-cancelable operating leases in California, New York, Maryland, North Carolina, Virginia and Hong Kong. The Company also leases furniture and office equipment under non-cancelable leases. As of June 30, 2015, the future minimum lease payments (net of aggregate expected sublease payments of $0.5 million) were as follows (in thousands):

2015	$	1,638
2016		2,748
2017		2,498
2018		1,849
2019		874
Thereafter		494
Total future minimum lease payments	$	10,101

The future minimum lease payments due under non-cancelable operating lease arrangements contain fixed rent increases over the term of the lease. Rent expense on these operating leases is recognized over the term of the lease on a straight-line basis. The excess of rent expense over future minimum lease payments due has been reported in other non-current liabilities in the accompanying consolidated balance sheets. The deferred rent liability related to these leases totaled $0.5 million as of each of June 30, 2015 and December 31, 2014.

Total rent expense for non-cancelable operating lease agreements (net of sublease income of $0.1 million and $0.1 million) was $0.8 million and $0.6 million for the three months ended June 30, 2015 and 2014, respectively. Total rent expense (net of sublease income of $0.1 million and $0.1 million) was $1.4 million and $1.3 million for the six months ended June 30, 2015 and 2014, respectively.

Payments to Clients

The Company is contractually obligated to make fixed payments to certain of its clients in exchange for various intellectual property and other rights. As of June 30, 2015, the future minimum payments to the Company s clients for intellectual property and other rights were as follows (in thousands):

2015	$	500
2016		800
2017		800
2018		300
2019		300
Thereafter		2,700
Total future minimum program payments	$	5,400

6. Income Taxes

Income taxes are accounted for under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that are included in the financial statements. Deferred tax assets are subject to periodic recoverability assessments. Recognition of deferred tax assets is appropriate only if the likelihood of realization of such assets is more likely than not to occur. At December 31, 2014 and 2013, the Company had federal and state net operating loss (NOL) carryforwards which generally expire between 2029 and 2034. A full valuation allowance has been established to offset the net deferred tax assets. The Company has not generated taxable income since inception and does not have sufficient deferred tax liabilities to recover the deferred tax assets. The utilization of the NOL carryforwards to reduce future income taxes will depend on the Company s ability to generate sufficient taxable income prior to the expiration of the NOL carryforwards.

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The Company determines its annual effective tax rate for the full fiscal year and applies that rate to its income before income taxes in determining its provision for income taxes for interim periods. The Company also records discrete items in each respective period as appropriate. The Company s effective tax rate for the three and six months ended June 30, 2015 and 2014 was 0%.

7. Common Stock and Preferred Stock Reserved for Future Issuance

As of June 30, 2015, the Company was authorized to issue 205,000,000 total shares of capital stock, consisting of 200,000,000 shares of common stock and 5,000,000 shares of preferred stock. At June 30, 2015, the Company had reserved a total of 9,071,988 of its authorized shares of common stock for future issuance as follows:

Outstanding stock options	5,958,578
Possible future issuance under stock option plan	1,877,257
Outstanding restricted stock units	1,236,153
Total shares of common stock reserved for future issuance	9,071,988

The compensation committee of the Company s board of directors, acting under authority delegated from the board of directors, granted on July 1, 2015 option awards to employees to purchase an aggregate of 19,743 shares of common stock at an exercise price of $30.83 and restricted stock unit awards for an aggregate of 23,954 shares of common stock, in each case under the 2014 Equity Incentive Plan (as defined below).

8. Stock-Based Compensation

The Company provides equity-based compensation awards to employees, non-employees and directors as an effective means for attracting, retaining and motivating such individuals by providing them with incentives to exert maximum efforts for the success of the Company and a means by which they may benefit from increases in value of the Company s common stock. The Company maintains two share-based compensation plans: the 2014 Equity Incentive Plan (the 2014 Plan) and the 2008 Stock Incentive Plan (the 2008 Plan). Upon the effective date of the 2014 Plan in January 2014, the Company ceased using the 2008 Plan to grant new equity awards, and began using the 2014 Plan for grants of new equity awards.

The number of shares of the Company s common stock that may be issued under the 2014 Plan will automatically increase on January 1st of each year, for a period of ten years, from January 1, 2015 continuing through January 1, 2024, by 5% of the total number of shares of the Company s common stock outstanding on December 31st of the preceding calendar year, or a lesser number of shares as may be determined by the Company s board of directors. On January 1, 2015, the shares available for issuance increased by 2,036,503 pursuant to the automatic share reserve provision under the 2014 Plan.

Stock-Based Compensation Expense

Stock-based compensation expense related to stock-based awards is included in the following line items in the accompanying consolidated statements of operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Servicing and support	$ 607	$ 401	$ 995	$ 614
Technology and content development	427	226	658	309
Program marketing and sales	277	218	459	321
General and administrative	2,556	1,199	3,803	1,995
Total stock-based compensation expense	$ 3,867	$ 2,044	$ 5,915	$ 3,239

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Stock Options

The following is a summary of the stock option activity for the six months ended June 30, 2015:

	Number of Options	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding balance at December 31, 2014	5,850,211	$ 5.39	7.33	$ 83,487
Granted	666,551	25.52	9.68	
Exercised	(505,156)	4.41	5.81	
Forfeited	(51,071)	11.27		
Expired	(1,957)	4.81		
Outstanding balance at June 30, 2015	5,958,578	7.67	7.16	146,080
Exercisable at June 30, 2015	3,518,972	4.03	6.21	99,080
Vested and expected to vest at June 30, 2015	5,747,424	7.38	7.10	142,599

The total compensation cost related to the nonvested options not yet recognized as of June 30, 2015 was $14.2 million and will be recognized over a weighted-average period of approximately 2.3 years.

The aggregate intrinsic value of the options exercised during the six months ended June 30, 2015 and 2014 was $14.0 million and $6.8 million, respectively.

The following table summarizes the assumptions used for estimating the fair value of the stock options granted for the three and six months ended June 30, 2015 and 2014:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Risk-free interest rate	1.5% 1.9%	1.9%	1.5% 1.9%	1.8% 2.1%
Expected term (years)	6.00 6.08	5.99	5.83 6.08	5.40 6.25
Expected volatility	50%	54%	50%	54% 55%
Dividend yield	0%	0%	0%	0%
Weighted-average grant date fair value per share	$12.51	$6.77	$12.42	$5.91

Restricted Stock Units

The following is a summary of restricted stock unit activity for the six months ended June 30, 2015:

	Number of Restricted Stock Units	Weighted-Average Grant Date Fair Value
Outstanding balance at December 31, 2014	992,665	$ 11.39
Granted	548,912	25.36
Vested	(259,538)	11.31
Forfeited	(45,886)	14.10
Outstanding balance at June 30, 2015	1,236,153	17.51

The total compensation cost related to the nonvested restricted stock units not yet recognized as of June 30, 2015 was $16.8 million and will be recognized over a weighted-average period of approximately 3.0 years.

Other Stock Awards

During the three and six months ended June 30, 2015, the Company granted 26,567 shares of common stock to an employee, with a fair value of $0.8 million.

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9. Net Loss per Share

Diluted net loss per share is the same as basic net loss per share for all periods presented because the effects of potentially dilutive items were anti-dilutive given the Company s net loss. The following securities have been excluded from the calculation of weighted-average shares of common stock outstanding because the effect is anti-dilutive for the three and six months ended June 30, 2015 and 2014:

	Three and Six Months Ended June 30,	
	2015	2014
Stock options	5,958,578	6,388,908
Restricted stock units	1,236,153	1,001,390

Basic and diluted net loss per share attributable to holders of common stock is calculated as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Numerator (in thousands):				
Net loss attributable to holders of common stock	$ (9,630)	$ (10,597)	$ (15,098)	$ (17,734)
Denominator:				
Weighted-average shares of common stock outstanding, basic and diluted	41,362,476	39,304,884	41,171,669	23,588,330
Net loss per share attributable to holders of common stock, basic and diluted	$ (0.23)	$ (0.27)	$ (0.37)	$ (0.75)

10. Segment and Geographic Information

Operating segments are defined as components of an enterprise for which discrete financial information is available that is evaluated regularly by the chief operating decision maker (CODM) for purposes of allocating resources and evaluating financial performance. The Company s CODM reviews the financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. As such, the Company s operations constitute a single operating segment and one reportable segment. The Company offers similar services to substantially all of its clients, which primarily represent well-recognized nonprofit colleges and universities in the United States. Substantially all assets were held and all revenue was generated in the United States during all periods presented.

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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 in conjunction with our consolidated financial statements and the related notes to those statements included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2014. Certain statements contained in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The words or phrases would be, will allow, intends to, will likely result, are expected to, will continue, is anticipated, estimate, project, or similar expressions, or the negative of such words or phrases, are intended to identify forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. Because such statements include risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Many factors could cause or contribute to these differences, including those discussed in Part I, Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2014, and our other filings with the Securities and Exchange Commission, or SEC. Statements made herein are as of the date of the filing of this Form 10-Q with the SEC and should not be relied upon as of any subsequent date. Unless otherwise required by applicable law, we do not undertake, and we specifically disclaim, any obligation to update any forward-looking statements to reflect occurrences, developments, unanticipated events or circumstances after the date of such statement.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes that appear in Item 1 of this Quarterly Report on Form 10-Q and with our audited consolidated financial statements and related notes for the year ended December 31, 2014, which are included in our Annual Report on Form 10-K filed with the SEC on February 26, 2015.

Overview

We are a leading provider of an integrated solution comprised of cloud-based software-as-a-service, or SaaS, technology fused with technology-enabled services, which we refer to as our Platform. Our Platform enables leading nonprofit colleges and universities to deliver their high quality education to qualified students anywhere. Our SaaS technology consists of an innovative online learning environment, which we refer to as Online Campus, and our operations applications. This technology is fused with technology-enabled services, to complete our Platform. Our Platform allows our clients programs to expand and operate at scale by providing the comprehensive infrastructure colleges and universities need to attract, enroll, educate, support and graduate their students. By leveraging our Platform, we believe our clients are able to expand their addressable markets while providing educational engagement, experiences and outcomes to their online students that match or exceed those of their on-campus offerings.

Our clients use the Online Campus portion of our Platform to offer high quality educational content, instructor-led classes in a live, intimate and engaging setting, and a rich social networking experience, all accessible through proprietary web-based and mobile applications. Online Campus challenges every student to learn from the front row and every faculty member to engage students in new and innovative ways. Our clients use the operations applications within our Platform to expand, enable and support their online operations, and integrate those operations with their existing university systems. These applications provide the content management, admissions application processing, customer relationship management and other functionality necessary to effectively operate our clients programs. Our Platform also provides clients with real-time data and deep analytical insight related to student performance and engagement, student and faculty satisfaction and enrollment. We believe that the SaaS technology within our Platform is flexible, easy to use, highly scalable and characterized by a high level of availability and security.

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The technology-enabled services we provide within our Platform are designed to improve enrollment and retention of our clients students as well as to provide those students with a complete and high quality educational experience. We have primary responsibility for identifying qualified students for our clients programs, generating potential student interest in the programs and driving applications to the programs. We have developed sophisticated digital program marketing and student acquisition capabilities, and we work closely with our clients to help them create highly engaging multimedia instructional content for delivery through Online Campus. We also provide other services that support the complete lifecycle of a higher education program, including advising prospective students through the admissions application process, providing technical, success coaching and other support, facilitating accessibility to individuals with disabilities, and facilitating in-program field placements. We provide the significant domain expertise and operating capacity our clients require to scale and operate successfully in the online environment.

Our clients use our Platform to offer full graduate degree programs online, and some offer doctorate and undergraduate degree programs as well. The students in these programs receive the same degree or credit as their on-campus counterparts, and generally pay equivalent tuition. We are currently engaged by 11 well-recognized colleges and universities to enable 17 programs that have launched and in which students have enrolled. The first of our clients programs was launched in 2009. One additional program launched in 2010, two more launched in 2011 and our clients launched five new programs in 2013. An additional four programs launched in 2014, and a dual degree between an additional university client and one of our existing clients also launched in 2014. Thus far in 2015, our clients have launched four programs and we have announced seven new graduate programs with three current university clients and two new university clients. Most of our client contracts have initial terms between 10 and 15 years in length, and since our inception, all of the clients that have engaged us remain active.

A significant percentage of our annual revenue is related to students returning to our clients programs after their first semester. In the three months ended June 30, 2015, 74% of our revenue was related to students who had enrolled and completed their first semester prior to the start of the year. We believe this high percentage of revenue attributable to returning students contributes to the predictability and recurring nature of our business.

We believe our business strategy will continue to offer significant opportunities for growth, but it also presents a number of risks and challenges. In particular, to remain competitive, we will need to continue to innovate in a rapidly changing landscape for the application of technology like ours to the delivery of higher education. As described above, we have added, and we intend to continue to add, degree programs in a number of new academic disciplines each year, as well as to expand the delivery of existing degree programs to new clients and to add new offerings to current programs. To do so, we will need to convince new clients as to the quality and value of our Platform, cost-effectively identify qualified students for our clients programs and help our clients retain those students once enrolled. We must also be able to successfully execute our business strategy while navigating constantly changing higher education laws and regulations applicable to our clients and, in some cases to ourselves, particularly the incentive compensation rule that generally prohibits making incentive payments related to student acquisition. We seek to ensure that addressing all of these risks and challenges does not divert our management s attention from continuing to build on the strengths that we believe have driven the growth of our business over the last several years. We believe our focus on delivering a differentiated Platform, maintaining the integrity of our clients educational brands and enabling strong student outcomes will contribute to the success of our business. However, we may not be successful in addressing and managing the many challenges and risks that we face.

Our Business Model

The key elements of our business model are described below.

Revenue Drivers

Substantially all of our revenue is derived from revenue-share arrangements with our clients, under which we receive a contractually specified percentage of the amounts students pay them in tuition and other fees. Accordingly, the primary driver of our revenue growth is the number of student course enrollments in our clients programs. This in turn is influenced primarily by three factors:

- our ability to increase the number of programs offered by our clients, either by adding new clients or by expanding the number of client programs;
- our ability to identify and acquire prospective students for our clients programs; and
- our ability, and that of our clients, to retain the students who enroll in their programs.

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In the near term, we expect the primary drivers of our financial results to continue to be our two programs with the University of Southern California, which are our longest running programs, that we launched in 2009 and 2010. For the three months ended June 30, 2015 and 2014, 45% and 54%, respectively, of our revenue was derived from these two programs, while for the six months ended June 30, 2015 and 2014, 48% and 58%, respectively, of our revenue was derived from these two programs. We expect the University of Southern California will continue to account for a large portion of our revenue until our other client programs become more mature and achieve significantly higher enrollment levels.

Program Marketing and Sales Expense

Our most significant expense in each fiscal period has been program marketing and sales expense, which relates primarily to student acquisition activities. We do not spend significant amounts on new client or program acquisition and we do not maintain a sales force targeted at potential new clients or programs since our model is not dependent on launching a large number of new programs per year, either with new or existing clients. Instead, our new clients and programs are largely generated through a direct approach by our senior management to selected colleges and universities.

We have primary responsibility for identifying qualified students for our clients programs, generating potential student interest in the programs and driving applications to the programs. While our clients make all admissions decisions, the number of students who enroll in our clients programs in any given period is significantly dependent on the amount we have spent on these student acquisition activities in prior periods. Accordingly, although most of our clients programs span multiple semesters and, therefore, generate continued revenue beyond the term in which initial enrollments occur, we expect that we will need to continue to incur significant program marketing and sales expense for existing programs going forward to generate a continuous pipeline of new enrollments. For new programs, we begin incurring program marketing and sales costs as early as nine months prior to the start of a new client program.

We typically identify prospective students for our clients programs between three months and two or more years before they ultimately enroll. For the students currently enrolled in our clients programs and those who have graduated, the average time from our initial prospective student acquisition to initial enrollment was seven months. For the students who have graduated from these programs, the average time from initial enrollment to graduation was 21 months. However, because our clients programs are relatively new, they have only graduated a limited number of students to date, with many early enrollees still enrolled. Based on the student retention rates and patterns we have observed in our clients programs, we estimate that, for our current programs, the average time from a student s initial enrollment to graduation will be approximately 2.5 years.

Accordingly, our program marketing and sales expense in any period is an investment we make to generate revenue in future periods. Likewise, revenue generated in any period is largely attributable to the investment made in student acquisition activities in earlier periods. Because program marketing and sales expense in any period is almost entirely unrelated to revenue generated in that period, we do not believe it is meaningful to directly compare the two. We believe that the total revenue we will receive in the future from students who enroll in our clients programs as a result of current period program marketing and sales expense will be significantly greater as a multiple of that expense than is implied by the multiple of current period revenue to current period program marketing and sales expense. Further, we believe that our program marketing and sales expense in future periods will generally decline as a percentage of the revenue reported in those same periods as our revenue base from returning students in existing programs increases.

We continually manage our program marketing and sales expense to ensure that across our portfolio of client programs, our cost to acquire students for these programs is appropriate for our business model. We use a ratio of attrition adjusted lifetime revenue of a student, or LTR, to the total cost to acquire that student, or TCA, as the measure of our marketing efficiency and to determine how much we are willing to spend to acquire an additional student for any program. The calculations included in this ratio include certain assumptions. For any period, we know what we spent on program sales and marketing and therefore, can accurately calculate the ratio s denominator. However, given the time lag between when we incur our program marketing and sales expense and when we receive revenue related to students enrolled based on that expense, we have to incorporate forecasts of student enrollments and retention into our calculation of the ratio s numerator, which is our estimate of future revenue related to that period s expense. We use the significant amount of data we have on the effectiveness of various marketing channels, student attrition and other factors to inform our forecasts and are continually testing the assumptions underlying these forecasts against actual results to give us confidence that our forecasts are reasonable. The LTR to TCA ratio may vary from program to program depending on the degree being offered, where that program is in its lifecycle and whether we enable the same or similar degrees at other universities.

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Period-to-Period Fluctuations

Our revenue, cash position, accounts receivable and deferred revenue can fluctuate significantly from quarter to quarter due to variations driven by the academic schedules of our clients programs. These programs generally start classes for new and returning students an average of four times per year. Class starts are not necessarily evenly spaced throughout the year, do not necessarily correspond to the traditional academic calendar and may vary from year to year. As a result, the number of classes our client programs have in session, and therefore the number of students enrolled, will vary from month to month and quarter to quarter, leading to variability in our revenue.

The semesters of our clients programs often straddle two fiscal quarters. Our clients generally pay us when they have billed tuition and specified fees to their students, which is typically early in the semester, and once the drop/add period has passed. We recognize the related revenue ratably over the course of the semester. Because we generally receive payments from our clients prior to our ability to recognize the majority of those amounts as revenue, we record deferred revenue at each balance sheet date equal to the excess of the amounts we have billed or received from our clients over the amounts we have recognized as revenue as of that date. For these reasons, our cash flows typically vary considerably from quarter to quarter and our cash position, accounts receivable and deferred revenue typically fluctuate between quarterly balance sheet dates.

Our expense levels also fluctuate from quarter to quarter, driven primarily by our program marketing and sales activity. We typically reduce our paid search and other program marketing and sales efforts during late November and December because these efforts are less productive during the holiday season. This generally results in lower total program marketing and sales expense during the fourth quarter. In addition, because we begin spending on technology and content development, program marketing and sales, and, to a lesser extent, services and support as much as nine months prior to the start of classes for a new client program, these costs as a percentage of revenue fluctuate, sometimes significantly, depending on the timing of new client programs and anticipated program launch dates.

Key Business and Financial Performance Metrics

We use a number of key metrics to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions. In addition to adjusted EBITDA, which we discuss below, we discuss revenue and the components of operating loss in the section below entitled Components of Operating Results. Additionally, we utilize other key metrics to evaluate the success of our growth strategy, including measures we refer to as Platform revenue retention rate and full course equivalent enrollments in our clients programs.

Platform Revenue Retention Rate

We measure our Platform revenue retention rate for a particular period by first identifying the group of programs that our clients launched before the beginning of the prior year comparative period. We then calculate our Platform revenue retention rate by comparing the revenue we recognized for this group of programs in the reporting period to the revenue we recognized for the same group of programs in the prior year comparative period, expressed as a percentage of the revenue we recognized for the group in the prior year comparative period.

The following table sets forth our Platform revenue retention rate for the periods presented, as well as the number of programs included in the Platform revenue retention rate calculation. For all of these periods, our Platform revenue retention rate was greater than 100% because we had no programs terminate and full course equivalent enrollments in the aggregate increased year-over-year. There is no correlation between the Platform revenue retention rate and the number of programs included in the calculation of that rate. The number of programs may increase while the retention rate declines.

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	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Platform revenue retention rate	130.5%	113.5%	124.8%	117.3%
Number of programs included in comparison (1)	10	6	9	4

(1) Reflects the number of programs operating both in the reported period and in the prior year comparative period.

Full Course Equivalent Enrollments in Our Clients Programs

We measure full course equivalent enrollments in our clients programs by determining, for each of the courses offered during a particular period, the number of students enrolled in that course multiplied by the percentage of the course completed during that period. We use this metric to account for the fact that many courses offered by our clients straddle two or more fiscal quarters. For example, if a course had 25 enrolled students and 40% of the course was completed during a particular period, we would count the course as having 10 full course equivalent enrollments for that period. Any individual student may be enrolled in more than one course during a period.

Average revenue per full course equivalent enrollment represents our weighted-average revenue per course across the mix of courses being offered in our client programs during a period. This number is derived by dividing our total revenue for a period by the number of full course equivalent enrollments during that same period. This amount may vary from period to period depending on the academic calendars of our clients, the relative growth rates of programs with varying tuition levels, the launch of new programs with higher or lower than average net tuition costs and annual tuition increases instituted by our clients. As a part of our growth strategy, we are actively targeting new graduate-level clients in academic disciplines for which we have existing programs. Over time, this strategy is likely to reduce our average revenue per full course equivalent. However, we believe this approach will enable us to leverage our program marketing investments across multiple client programs within specific academic disciplines, significantly decreasing student acquisition costs within those disciplines and more than offsetting any decline in average revenue per full course equivalent enrollment.

The following table sets forth the full course equivalent enrollments and average revenue per full course equivalent enrollment in our clients programs for the periods presented.

	Three Months Ended June 30, 2015	Three Months Ended June 30, 2014	Six Months Ended June 30, 2015	Six Months Ended June 30, 2014
Full course equivalent enrollments in our clients programs	13,557	9,331	26,649	19,140
Average revenue per full course equivalent enrollment in our clients programs	$ 2,599	$ 2,652	$ 2,621	$ 2,669

Adjusted EBITDA

Adjusted EBITDA represents our earnings before net interest (income) expense, income taxes, depreciation and amortization, adjusted to eliminate stock-based compensation expense, which is a non-cash item. Adjusted EBITDA is a key measure used by our management and board of directors to understand and evaluate our core operating performance and trends, to prepare and approve our annual budget and to develop short- and long-term operational plans. In particular, the exclusion of certain expenses in calculating adjusted EBITDA can provide a useful measure for period-to-period comparisons of our core business. Accordingly, we believe that adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.

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Adjusted EBITDA is not a measure calculated in accordance with U.S. GAAP, and should not be considered as an alternative to any measure of financial performance calculated and presented in accordance with U.S. GAAP. In addition, adjusted EBITDA may not be comparable to similarly titled measures of other companies because other companies may not calculate adjusted EBITDA in the same manner as we do. We prepare adjusted EBITDA to eliminate the impact of stock-based compensation expense, which we do not consider indicative of our core operating performance.

Our use of adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our financial results as reported under U.S. GAAP. Some of these limitations are:

- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;

- adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

- adjusted EBITDA does not reflect the potentially dilutive impact of equity-based compensation;

- adjusted EBITDA does not reflect interest or tax payments that may represent a reduction in cash available to us; and

- other companies, including companies in our industry, may calculate adjusted EBITDA differently, which reduces its usefulness as a comparative measure.

Because of these and other limitations, you should consider adjusted EBITDA alongside other U.S. GAAP-based financial performance measures, including various cash flow metrics, net income (loss) and our other U.S. GAAP results. The following table presents a reconciliation of adjusted EBITDA (loss) to net loss for each of the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	**2014**	**2015**	**2014**
	(in thousands)			
Net loss	$ (9,630)	$ (10,595)	$ (15,098)	$ (17,645)
Adjustments:				
Interest expense	126	134	252	918
Interest income	(24)	(31)	(53)	(32)

Depreciation and amortization expense	1,677	1,363	3,390	2,646
Stock-based compensation expense	3,867	2,044	5,915	3,239
Total adjustments	5,646	3,510	9,504	6,771
Adjusted EBITDA (loss)	$ (3,984)	$ (7,085)	$ (5,594)	$ (10,874)

Components of Operating Results

Revenue

Substantially all of our revenue consists of a contractually specified percentage of the amounts our clients bill to their students for tuition and fees, less credit card fees and other specified charges we have agreed to exclude in certain of our client contracts, which we refer to as net program proceeds. Most of our contracts have 10 to 15 year initial terms. We recognize revenue ratably over the service period, which we define as the first through the last day of classes for each semester in a client s program.

We establish a refund allowance for our share of tuition and fees ultimately uncollected by our clients.

We also offered rebates to a limited group of students who enrolled in a specific client program between 2009 and 2011, which we will be required to pay to such students if they complete their degrees and pre-specified, post-graduation work requirements within a defined period of time after graduation. For students in this group who are still enrolled in the program, we accrue the rebate liability as they continue through the program towards graduation. In addition, all students in this group are required to certify to us each September as to their continuing eligibility for these rebates. For those students who do not make such certification and are therefore no longer eligible for the rebate, because, for example, they have failed to meet their post-graduation work requirements, we reduce the allowance accordingly at that time. As of both June 30, 2015 and December 31, 2014, 130 students remained eligible to receive these rebates. These rebates and refunds offset the net program proceeds that we recognize as revenue.

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The following table sets forth the components of our revenue for the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(in thousands)			
Net program proceeds	$ 35,662	$ 24,960	$ 70,725	$ 51,495
Rebates	(1)	8	(3)	5
Refunds	(262)	(225)	(646)	(434)
Other	(161)	1	(226)	10
Revenue	$ 35,238	$ 24,744	$ 69,850	$ 51,076

In addition to providing access to the SaaS technology within our Platform, we provide technology-enabled services that support the complete lifecycle of a higher education program, including attracting students, advising prospective students through the admissions application process, providing technical, success coaching and other support, facilitating accessibility to individuals with disabilities and facilitating in-program field placements. We have determined that no individual deliverable has standalone value upon delivery and, therefore, the multiple deliverables within our arrangements do not qualify for treatment as separate units of accounting. Accordingly, we consider all deliverables to be a single unit of accounting and we recognize revenue from the entire arrangement over the term of the service period.

We generally receive payments from our clients early in each semester, prior to completion of the service period. We record these advance payments as deferred revenue until the services are delivered or until our obligations are otherwise met, at which time we recognize the revenue. As of each balance sheet date, deferred revenue is a current liability and represents the excess amounts we have billed or received over the amounts we have recognized as revenue in the consolidated statements of operations as of that date.

Costs and Expenses

Costs and expenses consist of servicing and support costs, technology and content development costs, program marketing and sales expenses and general and administrative expenses. To support our anticipated growth, we expect to continue to hire new employees, increase our program promotion and student acquisition efforts, expand our technology infrastructure and increase our other program support capabilities. As a result, we expect our costs and expenses to increase in absolute dollars, but to decrease as a percentage of revenue over time as we achieve economies of scale through the expansion of our business.

Servicing and support. Servicing and support expense consists primarily of compensation costs related to program management and operations, as well as costs for technical support for our SaaS technology and faculty and student support. It includes costs to facilitate in-program field placements, student immersions and other student enrichment experiences, and to assist our clients with their state compliance requirements. It also includes software licensing, telecommunications and other costs to provide access to the SaaS technology within our Platform for our clients and their students.

Technology and content development. Technology and content development expense consists primarily of compensation and outsourced services costs related to the ongoing improvement and maintenance of the SaaS technology within our Platform, and the developed content for our client programs. It also includes the costs to support our internal infrastructure, including our cloud-based server usage. Additionally, it includes the associated depreciation and amortization expense related to internally-developed software and content, as well as hosting and other costs associated with maintaining the SaaS technology within our Platform in a cloud environment.

Program marketing and sales. Program marketing and sales expense consists primarily of costs related to student acquisition. This includes the cost of online advertising and prospective student generation, as well as compensation costs for our program marketing, search engine optimization, marketing analytics and admissions application counseling personnel. We expense all costs related to program marketing and sales as they are incurred.

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General and administrative. General and administrative expense consists primarily of compensation costs for employees in our executive, administrative, finance and accounting, legal, communications and human resources functions. Additional expenses include external legal, accounting and other professional fees, telecommunications charges and other corporate costs such as insurance and travel that are not related to another function.

Other Income (Expense)

Other income (expense) consists of interest income and interest expense. Interest income is derived from interest received on our cash and cash equivalents. Interest expense consists primarily of the amortization of deferred financing costs associated with our line of credit and convertible notes prior to their conversion and changes in our preferred stock warrant liability as a result of changes in the fair value of such warrants (through April 2, 2014).

The fair value of our preferred stock warrant liability was reassessed at the end of each reporting period and any increase in fair value was recognized in other expense, while any decrease in fair value was recognized in other income. Upon completion of our initial public offering, or IPO, the preferred stock warrants automatically became warrants to purchase common stock. At that time, we reclassified the preferred stock warrant liability to additional paid-in capital and no further changes in fair value will be recognized in other income or expense.

Income Tax (Expense) Benefit

Income tax expense consists of U.S. federal, state and foreign income taxes. To date, we have not been required to pay U.S. federal income taxes because of our current and accumulated net operating losses. We incurred immaterial state and foreign income tax liabilities for the three and six months ended June 30, 2015 and 2014.

Results of Operations

Comparison of Three Months Ended June 30, 2015 and 2014

The following table sets forth selected consolidated statement of operations data for each of the periods indicated.

	Three Months Ended June 30,					
	2015		2014		Period-to-Period Change	
	Amount	Percentage of Revenue	Amount	Percentage of Revenue	Amount	Percentage
	(dollars in thousands)					

Revenue	$	35,238	100.0%	$	24,744	100.0%	$	10,494	42.4%
Costs and expenses:									
Servicing and support		7,903	22.4		7,000	28.3			