INSTRUCTURE INC
Form 10-Q
November 01, 2017

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, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 001-37629

Instructure, Inc.

(Exact name of registrant as specified in its charter)

Delaware	26-3505687
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6330 South 3000 East, Suite 700

Salt Lake City, UT 84121

(Address of principal executive offices, including zip code)

(800) 203-6755

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 27, 2017, there were 29,775,311 shares of the registrant's common stock outstanding.

Instructure, Inc.

Quarterly Report on Form 10-Q

For the Quarter Ended September 30, 2017

INDEX

In this Quarterly Report on Form 10-Q, “we,” “our,” “us,” “Instructure,” and the “Company” refer to Instructure, Inc. and its wholly-owned subsidiaries.

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements
INSTRUCTURE, INC.

Consolidated Balance Sheets

(in thousands)

	September 30, 2017 (unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 58,716	$ 44,539
Short-term marketable securities	8,089	23,895
Accounts receivable—net of allowance of $355 and $241 at September 30, 2017 and December 31, 2016, respectively	35,465	18,072
Prepaid expenses	6,935	5,434
Other current assets	918	936
Total current assets	110,123	92,876
Property and equipment, net	20,907	14,733
Goodwill	989	989
Intangible assets, net	731	760
Noncurrent prepaid expenses	1,757	984
Other assets	974	994
Total assets	$ 135,481	$ 111,336
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	$ 10,146	$ 5,374
Accrued liabilities	13,771	10,905
Deferred rent	897	773
Deferred revenue	109,280	72,747
Total current liabilities	134,094	89,799
Deferred revenue, net of current portion	3,942	3,144
Deferred rent, net of current portion	8,185	8,372
Warrant liability	123	25
Other long-term liabilities	—	32
Total liabilities	146,344	101,372
Stockholders' equity (deficit):		
Common stock	3	3
Additional paid-in capital	223,957	206,442
Accumulated other comprehensive loss	(1)	(12)

Accumulated deficit	(234,822)	(196,469)
Total stockholders' equity (deficit)	(10,863)	9,964
Total liabilities and stockholders' equity (deficit)	$ 135,481	$ 111,336

See accompanying notes.

INSTRUCTURE, INC.

Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Revenue:				
Subscription and support	$37,427	$25,814	$100,590	$68,807
Professional services and other	5,521	4,331	14,381	10,527
Total revenue	42,948	30,145	114,971	79,334
Cost of revenue:				
Subscription and support	9,278	6,312	24,350	17,335
Professional services and other	3,192	2,326	8,729	6,287
Total cost of revenue	12,470	8,638	33,079	23,622
Gross profit	30,478	21,507	81,892	55,712
Operating expenses:				
Sales and marketing	22,129	17,788	62,429	51,989
Research and development	12,577	9,297	34,816	25,832
General and administrative	8,334	6,689	22,941	18,428
Total operating expenses	43,040	33,774	120,186	96,249
Loss from operations	(12,562)	(12,267)	(38,294)	(40,537)
Other income (expense):				
Interest income	84	104	199	236
Interest expense	—	(31)	(18)	(54)
Change in fair value of warrant liability	(15)	(10)	(98)	52
Other income (expense), net	191	(103)	318	(234)
Total other income (expense), net	260	(40)	401	—
Loss before income taxes	(12,302)	(12,307)	(37,893)	(40,537)
Income tax expense	(71)	(10)	(207)	(109)
Net loss	$(12,373)	$(12,317)	$(38,100)	$(40,646)
Net loss per common share, basic and diluted	$(0.42)	$(0.44)	$(1.31)	$(1.47)
Weighted average common shares used in computing basic and diluted net loss per common share	29,535	28,084	29,120	27,667

See accompanying notes.

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INSTRUCTURE, INC.

Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Net loss	$(12,373)	$(12,317)	$(38,100)	$(40,646)
Other comprehensive gain (loss):				
Net change in unrealized gains (losses) on marketable securities	(1)	(9)	11	(9)
Comprehensive loss	$(12,374)	$(12,326)	$(38,089)	$(40,655)

See accompanying notes.

INSTRUCTURE, INC.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2017	2016
Operating Activities:		
Net loss	$(38,100)	$(40,646)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property and equipment	4,322	2,832
Amortization of intangible assets	330	284
Amortization of deferred financing costs	24	34
Change in fair value of warrant liability	98	(52)
Stock-based compensation	11,707	7,701
Other	(42)	120
Changes in assets and liabilities:		
Accounts receivable, net	(17,620)	(13,887)
Prepaid expenses and other assets	(2,229)	849
Accounts payable and accrued liabilities	8,196	4,303
Deferred revenue	37,331	32,460
Deferred rent	(63)	(379)
Other liabilities	(32)	(361)
Net cash provided by (used in) operating activities	3,922	(6,742)
Investing Activities:		
Purchases of property and equipment	(10,830)	(4,922)
Purchases of intangible assets	(301)	(311)
Proceeds from sale of property and equipment	50	23
Purchases of marketable securities	(8,088)	(24,363)
Maturities of marketable securities	23,900	325
Net cash provided by (used in) investing activities	4,731	(29,248)
Financing Activities:		
Proceeds from issuance of common stock from employee equity plans	5,769	4,494
Shares repurchased for tax withholdings on vesting of restricted stock	(214)	—
Payments for financing costs	(31)	—
Net cash provided by financing activities	5,524	4,494
Net increase (decrease) in cash and cash equivalents	14,177	(31,496)
Cash and cash equivalents, beginning of period	44,539	90,471
Cash and cash equivalents, end of period	$58,716	$58,975
Supplemental cash flow disclosure:		
Cash paid for taxes	$247	$49
Non-cash investing and financing activities:		
Capital expenditures incurred but not yet paid	$24	$210
Issuance of common stock for exercise of common stock warrant	$—	$244
Vesting of common stock subject to repurchase	$—	$20

See accompanying notes.

INSTRUCTURE, INC.

Notes to Unaudited Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Organization

Instructure, Inc. provides an innovative, cloud-based learning management platform for academic institutions and companies worldwide. We built our learning management applications, Canvas, for the education market, and Bridge, for the corporate market, to enable our customers to easily develop, deliver and manage engaging face-to-face and online learning experiences. We offer our platform through a Software-as-a-Service, or SaaS, business model. We were incorporated in the state of Delaware in September 2008. We are headquartered in Salt Lake City, Utah, and have wholly-owned subsidiaries in the United Kingdom, Australia, the Netherlands, Hong Kong, Sweden and Brazil.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) applicable to interim periods, under the rules and regulations of the United States Securities and Exchange Commission (“SEC”). In the opinion of management, we have prepared the accompanying unaudited financial statements on a basis substantially consistent with the audited consolidated financial statements of the Company as of and for the fiscal year ended December 31, 2016, and these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. All intercompany balances and transactions have been eliminated in consolidation. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2017. The year-end balance sheet data was derived from audited financial statements, but this Form 10-Q does not include all disclosures required under GAAP. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted under the rules and regulations of the SEC.

These interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company’s Annual Report on Form 10-K filed with the SEC on February 10, 2017. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s Annual Report on Form 10-K that have had a material impact on our consolidated financial statements and related notes.

Marketable Securities

We hold investments in marketable securities, consisting of corporate debt securities and commercial paper. We classify our marketable securities as available-for-sale investments as we neither buy and hold securities for the purpose of selling them in the near future nor intend to hold securities to maturity. We classify our marketable securities as short-term on the consolidated balance sheet for all purchased investments with contractual maturities that are less than one year as of the balance sheet date. Our marketable securities are carried at estimated fair value with any unrealized gains and losses, net of taxes, included in accumulated other comprehensive loss in stockholders’ equity. Unrealized losses are charged against other income (expense), net when a decline in fair value is determined to be other-than-temporary. We have not recorded any such impairment charge in the periods presented. We determine realized gains or losses on sale or maturity of marketable securities on a specific identification method, and record such gains or losses as other income (expense), net.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Such estimates, which we evaluate on an on-going basis, include allowances for doubtful accounts, useful lives for property and equipment and intangible assets, valuation of marketable securities, valuation allowances for net deferred income tax assets, valuation of stock-based compensation and common stock, the best estimate of selling price of deliverables included in multiple-deliverable revenue arrangements and the weighted average customer life used in the recognition of nonrefundable upfront implementation service revenue. We base our estimates on historical experience and on various other assumptions which we believe to be reasonable.

Liability for Common Stock Warrants

We account for freestanding warrants to purchase shares of our common stock that are not considered indexed to our own stock as warrant liabilities on our consolidated balance sheets. Under Accounting Standards Codification ("ASC") 815, we record the liability-classified common stock warrants issued in conjunction with our credit facility at their estimated fair value because they are free standing and the number of shares exercisable under this warrant to purchase our common stock increases if the loan balance exceeds $7,500,000. At the end of each reporting period, changes in the estimated fair value of the warrants to purchase shares of common stock are recorded as a change in fair value of warrant liability in the consolidated statements of operations. A portion of the warrants were exercised in February 2016 (see Note 9—Fair Value of Financial Instruments).

Recent Accounting Pronouncements

Adopted accounting pronouncements

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, "Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting", which simplifies several aspects of the accounting for share-based payment transactions. The new guidance requires companies to record excess tax benefits and tax deficiencies as income tax benefit or expense in the statement of operations when the awards vest or are settled, and eliminates the requirement to reclassify cash flows related to excess tax benefits from operating activities to financing activities on the statement of cash flows. We adopted the standard in the three months ended March 31, 2017. Upon adoption, we recognized the previously unrecognized excess tax benefits using the modified retrospective transition method through a cumulative-effect adjustment of $3,039,000. The previously unrecognized excess tax effects were recorded as a deferred tax asset, which was fully offset by a valuation allowance. Because of this full valuation allowance, historically we have not reported any excess tax benefits in our consolidated statements of cash flows. Prospectively when our deferred tax asset is no longer fully offset by a valuation allowance, we will apply the change in presentation to the statement of cash flows and will classify the excess tax benefit in the operating section. In addition, we have elected to account for forfeitures as they occur, rather than estimate expected forfeitures over the course of a vesting period. As a result, we recorded a cumulative-effect adjustment to increase our additional paid-in capital and accumulated deficit by $253,000.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles – Goodwill and Other – Internal-Use Software: Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, which provides guidance to clarify the customer's accounting for fees paid in a cloud computing arrangement. This guidance simplifies entities' processes as it provides criteria to determine whether cloud computing arrangements contain a software license and should be accounted for as internal use software under ASC 350-40. We elected to prospectively adopt the accounting standard in the beginning of our first quarter of 2016. Prior periods in our consolidated financial statements were not retrospectively adjusted. Starting in our first quarter of 2016, if an arrangement included a software license, as defined by this ASU, then we accounted for the software license element of the arrangement in the intangible assets, net line item of the consolidated balance sheets rather than recording the amount in property and equipment, net.

Issued accounting pronouncements

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment. This guidance simplifies the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test. Under current guidance, Step 2 of the goodwill impairment test requires entities to calculate the implied fair value of goodwill in the same manner as the amount of goodwill recognized in a business combination by assigning the fair value of a reporting unit to all of the assets and liabilities of the reporting unit. The carrying value in excess of the implied fair value is recognized as goodwill impairment. Under the new standard, goodwill impairment is recognized based on Step 1 of the current guidance, which calculates the carrying value in excess of the reporting unit's fair value. The new standard is effective for us beginning February 1, 2020, with early adoption permitted. We do not believe the adoption of ASU 2017-04 will have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases, requiring lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases. For lessees, leases will continue to be classified as either operating or finance leases in the financial statements. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. Lessors will continue to classify leases as operating, direct financing or sales-type leases. The new standard must be adopted using a modified retrospective transition and requires application of the new guidance at the beginning of the earliest comparative period presented. The updated standard is effective for us beginning in the first quarter of 2019. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers: Topic 606", as amended, ("ASU 2014-09"). The standard supersedes nearly all existing revenue recognition guidance under GAAP. The core principle of the standard is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The standard defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation, among others. The standard also provides guidance on the recognition of costs related to obtaining customer contracts.

ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017. We will adopt the new standard effective January 1, 2018. The new standard permits adoption using either of two methods: (1) full retrospective application of the standard to each prior reporting period presented with the option to elect certain practical expedients as defined within the standard, or (2) modified retrospective application of the standard with the cumulative effect of initially applying the standard recognized at the date of initial application and providing certain additional disclosures as defined per the standard. We plan to adopt the new standard using the full retrospective method. Our ability to adopt using the full retrospective method is dependent on several factors, including the significance of the impact of the new standard to our financial results, system readiness and our ability to accumulate and analyze the information necessary to assess the impact on prior period financial statements, as necessary.

We have substantially completed our evaluation of the impact of the new standard on our accounting policies. While meaningful system configuration progress has been achieved, we are currently in the system implementation stage of adopting the new standard. Internal resources and third-party service providers are actively involved in the implementation of identified system requirements to enable timely and accurate reporting under the new standard.

Under the current revenue recognition guidance, we have historically concluded that nonrefundable upfront fees do not have standalone value, and accordingly, we have recognized those fees over the longer of the contract term or customer life. Under the new standard, we have concluded that nonrefundable upfront fees are not considered a separate performance obligation. As such, the consideration related to the nonrefundable upfront fees would be allocated across the other performance obligations included in the contract. Furthermore, under the current revenue recognition guidance we limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the delivery of future services. Under the new standard, the concept of contingent revenue no longer exists. As a result, the timing of when revenue is recognized could change significantly for nonrefundable upfront fees and our multi-year subscription agreements. We plan to begin quantifying the financial statement impacts resulting from the adoption of the new standard upon completion of the system implementation stage.

As part of our evaluation, we have also considered the impact of the standard's requirements with respect to capitalization and amortization of incremental costs of obtaining a contract. Under our current accounting policy, incremental costs of obtaining a contract are expensed as incurred. The new standard requires the capitalization of all incremental costs that we incur to obtain a contract with a customer that would not have been incurred if the contract had not been obtained, provided we expect to recover those costs.

While we continue to assess all potential impacts under the new standard, including the areas described above, and anticipate this standard could have a material impact on our consolidated financial statements, we do not know or cannot reasonably estimate quantitative information related to the impact of the new standard on the financial statements at this time.

2. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period, less the weighted average unvested common stock subject to repurchase or forfeiture.

Diluted net loss per share is computed by giving effect to all potential dilutive common stock equivalents outstanding for the period. For purposes of the diluted net loss per share calculation, options to purchase common stock, common stock warrants and restricted stock units are considered to be common stock equivalents.

A reconciliation of the denominator used in the calculation of basic and diluted loss per share is as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Numerator:				
Net loss	$(12,373)	$(12,317)	$(38,100)	$(40,646)
Denominator:				
Weighted-average common shares outstanding—basic	29,535	28,090	29,120	27,685
Less: Weighted-average common stock subject to repurchase	—	(6)	—	(18)
Total weighted-average common shares outstanding—basic	29,535	28,084	29,120	27,667
Dilutive effect of share equivalents resulting from stock options, restricted stock units, common stock warrants and common stock subject to repurchase	—	—	—	—
Weighted-average common shares outstanding-diluted	29,535	28,084	29,120	27,667
Net loss per common share, basic and diluted	$(0.42)	$(0.44)	$(1.31)	$(1.47)

For all periods presented, we incurred net losses and, therefore, the effect of our outstanding stock options, restricted stock units, common stock warrants and common stock subject to repurchase was not included in the calculation of diluted loss per share as the effect would be anti-dilutive. The following table contains share totals with a potentially dilutive impact (in thousands):

	As of September 30,	
	2017	2016
Options to purchase common stock	2,489	3,261
Common stock warrants	17	17
Common stock subject to repurchase	—	4
Restricted stock units	1,566	1,000
Total	4,072	4,282

3. Property and Equipment

Property and equipment consist of the following (in thousands):

	September 30, 2017	December 31, 2016
Computer and office equipment	$ 5,220	$ 3,918
Purchased software	1,071	1,074
Capitalized software development costs	13,537	6,947
Furniture and fixtures	3,454	2,701
Leasehold improvements and other	10,837	9,413
Total property and equipment	34,119	24,053
Less accumulated depreciation and amortization	(13,212)	(9,320)
Total	$ 20,907	$ 14,733

Accumulated amortization for capitalized software development costs was $3,813,000 and $2,355,000 at September 30, 2017 and December 31, 2016, respectively. Amortization expense for capitalized software development costs was $639,000 and $260,000 for the three months ended September 30, 2017 and 2016, respectively and $1,645,000 and $838,000 for the nine months ended September 30, 2017 and 2016, respectively. Amortization expense for capitalized software development costs is recorded within cost of revenue on the consolidated statements of operations.

4. Goodwill and Intangible Assets

Goodwill was $989,000 as of September 30, 2017 and December 31, 2016.

Intangible assets consisted of the following (in thousands):

	Average Remaining Useful Life	September 30, 2017	December 31, 2016
Domain names	12 Months	$ 1,268	$ 1,268
Tradenames and trademarks	2 Months	120	109
Software	28 Months	611	321
Capitalized learning content	55 Months	400	400
Accumulated amortization		(1,668)	(1,338)
Total		$ 731	$ 760

Amortization expense for intangible assets was $71,000 and $98,000 for the three months ended September 30, 2017 and 2016, respectively and $330,000 and $284,000 for the nine months ended September 30, 2017 and 2016, respectively.

Based on the recorded intangible assets at September 30, 2017, estimated amortization expense is expected to be as follows (in thousands):

Years Ending December 31,	Amortization Expense
Remainder of 2017	$ 72
2018	285
2019	216
2020	94
2021	64
Total	$ 731

5. Segment Information and Geographic Data

We operate in a single operating segment, cloud-based learning management systems. Operating segments are defined as components of an enterprise for which separate financial information is regularly evaluated by the chief operating decision makers, or CODMs, which are our chief executive officer and chief financial officer, in deciding how to allocate resources and assess performance. Our CODMs evaluate our financial information and resources and assess the performance of these resources on a consolidated basis. Since we operate in one operating segment, all required financial segment information can be found in the consolidated financial statements.

Revenue by geographic region, based on the physical location of the customer, is (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
United States	$36,492	$26,973	$99,370	$72,242
Foreign	6,456	3,172	15,601	7,092
Total revenue	$42,948	$30,145	$114,971	$79,334
Percentage of revenue generated outside of the United States	15 %	11 %	14 %	9 %

6. Marketable Securities

Our investment policy is consistent with the definition of available-for-sale securities. We do not buy and hold securities principally for the purpose of selling them in the near future nor do we intend to hold securities to maturity. Rather, our policy is focused on the preservation of capital, liquidity and return. From time to time, we may sell certain securities but the objectives are generally not to generate profits on short-term differences in price.

The following tables summarize, by major security type, our assets that are measured at fair value on a recurring basis (in thousands):

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate debt securities	$8,090	$ —	$ (1)	$ 8,089

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate debt securities	$23,907	$ —	$ (12)	$ 23,895

The aggregate fair value of investments in an unrealized loss position was $1,806,000 and $17,906,000 as of September 30, 2017 and December 31, 2016, respectively. Because we do not intend to sell the investments that are in an unrealized loss position and it is not likely that we will be required to sell any investments before recovery of their amortized cost basis, we do not consider these investments with an unrealized loss to be other-than-temporarily impaired as of September 30, 2017.

There were no gross realized gains or losses from the sale or maturity of marketable securities during the nine months ended September 30, 2017 and 2016.

During the nine months ended September 30, 2017, we recognized gross interest income on securities of $125,000. Interest income was offset by amortization expense on securities of $9,000 during the nine months ended September 30, 2017, and reported net within interest income on the consolidated statements of operations.

During the nine months ended September 30, 2016, we recognized gross interest income on securities of $173,000. Interest income was offset by amortization expense on securities of $20,000 during the nine months ended September 30, 2016, and reported net within interest income on the consolidated statements of operations.

The estimated fair value of investments by contractual maturity is as follows (in thousands):

	September 30, 2017	December 31, 2016
Due within one year	$ 8,089	$ 23,895
Thereafter	—	—
Total	$ 8,089	$ 23,895

7. Stockholders' Equity (Deficit) and Stock-Based Compensation

Common Stock

As of September 30, 2017 and December 31, 2016, there were 200,000,000 shares of common stock authorized. As of September 30, 2017, there were 29,754,992 and 29,752,977 shares issued and outstanding, respectively. As of December 31, 2016, there were 28,553,808 issued and outstanding. Each share of common stock has the right to one vote on all matters submitted to a vote of stockholders. The share holders of common stock are also entitled to receive dividends whenever funds are legally available and if declared by the board of directors, subject to prior rights of holders of all classes of stock outstanding having priority rights as to dividends. No dividends have been declared or paid on the common stock through September 30, 2017.

Employee Equity Plans

Our 2015 Equity Incentive Plan (the "2015 Plan") serves as the successor to our 2010 Equity Incentive Plan (the "2010 Plan"). Accordingly, no shares are available for issuance under the 2010 Plan; however, any outstanding options granted under the 2010 Plan will remain outstanding and subject to the terms of that plan until exercised, terminated or expired by their terms. As of September 30, 2017, options to purchase 2,073,725 shares of common stock remained outstanding under the 2010 Plan. Pursuant to the terms of the 2015 Plan, the share reserve automatically increased by 1,284,921 shares in January 2017. As of September 30, 2017, we had approximately 2,001,025 shares of common stock available for future grants under the 2015 Plan.

We also have a 2015 Employee Stock Purchase Plan (the "ESPP"). The ESPP allows eligible employees to purchase shares of our common stock at a discount through payroll deductions of up to 15% of their eligible compensation, subject to any plan limitations. Our board of directors approves the ESPP offerings. The offerings need not be identical, but each offering may not exceed 27 months and may specify one or more shorter purchase periods within the offering. Pursuant to the terms of the ESPP, the share reserve increased by 285,538 shares in January 2017. As of September 30, 2017, 466,683 shares of common stock were available for issuance under the ESPP.

The following two tables show stock-based compensation expense by award type and where the stock-based compensation expense was recorded in our consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Options	$939	$994	$3,123	$3,130
Restricted stock units	2,812	1,273	7,109	2,948
Employee stock purchase plan	516	537	1,475	1,623
Total stock-based compensation	$4,267	$2,804	$11,707	$7,701

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Subscription and support cost of revenue	$211	$129	$528	$360
Professional services and other cost of revenue	161	127	422	362
Sales and marketing	1,255	775	3,405	2,219
Research and development	1,637	1,022	4,375	2,742
General and administrative	1,003	751	2,977	2,018
Total stock-based compensation	$4,267	$2,804	$11,707	$7,701

Stock Options

The following table summarizes stock option activity for the nine months ended September 30, 2017 (in thousands, except per share data and years):

	Shares Underlying Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2016	3,106	$ 7.14	7.5	$ 38,558
Granted	185	21.83		
Exercised	(719)	4.70		

Forfeited or cancelled	(83)	10.02		
Outstanding at September 30, 2017	2,489	8.44	7.1	60,511
Vested and expected to vest—September 30, 2017	2,489	8.44	7.1	60,511
Exercisable at September 30, 2017	1,655	6.67	6.6	43,833

As of September 30, 2017, we had $6,056,000 of unrecognized stock-based compensation costs related to non-vested options that are expected to be recognized over a weighted average period of 2.3 years.

As of September 30, 2017, we had $324,000 of unrecognized stock-based compensation expense related to our ESPP that is expected to be recognized over the term of the offering period ending November 30, 2017.

Restricted Stock Units

The following table summarizes the activity of restricted stock units ("RSUs") for the nine months ended September 30, 2017 (in thousands, except per share data):

	RSUs Outstanding	
	Shares	Weighted-Average Grant Date Fair Value Per Share
Unvested and outstanding at December 31, 2016	1,133	$ 18.36
Granted	912	23.76
Vested	(350)	19.00
Cancelled	(129)	20.09
Unvested and outstanding at September 30, 2017	1,566	21.22

As of September 30, 2017, we had $31,164,000 of unrecognized stock-based compensation costs related to outstanding RSUs that are expected to be recognized over a weighted average period of 3.1 years.

8. Income Taxes

Utilization of the net operating loss carryforwards and credits may be subject to substantial annual limitation due to the ownership change limitations provided by Section 382 of the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

We file tax returns in the United States, the United Kingdom, Australia, the Netherlands, Hong Kong, Sweden, Brazil and various state jurisdictions. All of our tax years remain open to examination by major taxing jurisdictions to which we are subject, as carryforward attributes generated in past years may still be adjusted upon examination by the Internal Revenue Service or state and foreign tax authorities if they have or will be used in future periods.

We believe that we have provided adequate reserves for our income tax uncertainties in all open tax years. We do not expect our gross unrecognized tax benefits to change significantly in the next 12 months.

9. Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that could be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. The fair value hierarchy prioritizes the quality and reliability of the information used to determine fair values. Categorization within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is defined into the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

There were no transfers between Level 1 and Level 2 of the fair value measurement hierarchy during the nine months ended September 30, 2017 and the year ended December 31, 2016. Assets and liabilities measured at fair value on a recurring basis as of September 30, 2017, were as follows (in thousands):

	September 30, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$21,558	$—	$—	$21,558
Corporate debt securities	—	8,089	—	8,089
Total Assets	$21,558	$8,089	$—	$29,647
Liabilities:				
Common stock warrant liability	$—	$—	$123	$123

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2016, were as follows (in thousands):

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$17,394	$—	$ —	$17,394
Corporate debt securities	—	23,895	—	23,895
Total assets	$17,394	$23,895	$ —	$41,289
Liabilities:				
Common stock warrant liability	$—	$—	$ 25	$25

Fair value is a market-based measurement that should be determined based on the assumptions that market participants would use in pricing an asset or liability. The hierarchy level assigned to each security in our marketable securities portfolio and cash equivalents is based on our assessment of the transparency and reliability of the inputs used in the valuation of such instrument at the measurement date. The fair value of cash equivalents included in the Level 1 category is based on quoted prices that are readily and regularly available in an active market. The fair value of the marketable securities included in the Level 2 category is based on observable inputs, such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. These values were obtained from an independent pricing service and were evaluated using pricing models that vary by asset class and may incorporate available trade, bid and other market information and price quotes from well-established independent pricing vendors and broker-dealers.

The carrying amount of our cash, receivables and payables approximates fair value because of the short-term nature of these items.

The following table sets forth a summary of the changes in the estimated fair value of the warrant liability. Changes in the fair value are recognized in the change in fair value of warrant liability line item on the consolidated statements of operations. The following balance is measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	Common Stock Warrant Liability
Balance at January 1, 2017	$ 25
Recognized expense	98
Balance at September 30, 2017	$ 123

In November 2012, we issued a warrant to purchase 70,000 shares of common stock to our lender in connection with our line of credit. The warrant was fully exercisable and had a ten-year term with an exercise price of $0.99 per share. In April 2014, we issued our lender an additional warrant to purchase up to 33,332 shares of common stock in connection with an amendment of our line of credit at an exercise price of $4.47 per share. 16,666 of these shares were exercisable without a contingency. The additional 16,666 shares (the “contingent common stock warrant”) may become exercisable if our aggregate outstanding balance of the credit facility exceeds $7,500,000. We anticipate the probability that the contingent common stock warrant becomes exercisable is 25%. On February 2, 2016, warrants for 86,666 shares were exercised. At the lender's request, we withheld 8,260 shares to cover the warrant exercise costs and we issued 78,406 shares. In connection with the exercise of the warrant, the warrant liability was marked to market as of the settlement date. As a result of the exercise, a portion of the warrant liability equal to $244,000 was reversed and recorded as additional paid-in capital. The remaining contingent common stock warrant to purchase 16,666 shares had an estimated common stock warrant liability balance of $123,000 at September 30, 2017. The contingent common stock warrant expires April 1, 2024.

The fair values of these outstanding warrants are measured using an option pricing model and probability weighted expected return model. Inputs used to determine estimated fair value include the estimated fair value of the underlying common stock at the valuation measurement date, the estimated time to exit, risk-free interest rates, expected dividends, probability of contingent event, and estimated volatility. In addition to the above, significant inputs to the common stock warrant also includes the estimated likelihood of the exercise contingency being met. Estimated volatility is based on the volatility of a peer group. We monitor the historical volatility of peer group companies on a quarterly basis and adjust the estimated volatility when significant changes in the peer group volatilities occur. Generally, increases (decreases) in the fair value of the underlying common stock would result in a directionally similar impact to the fair value measurement.

10. Commitments and Contingencies

Litigation

We are involved in legal proceedings from time to time arising in the normal course of business. Management believes that the outcome of these proceedings will not have a material impact on our financial position, results of operations or liquidity.

Lease Commitments

We lease office space under non-cancelable operating leases that contain rent escalation clauses and renewal options. We recognize rent expense on a straight-line basis over the lease period and have accrued for rent expense incurred but not paid. We are also committed to pay a portion of the actual operating expenses under certain of these lease agreements.

Rent expense under operating leases was $1,414,000 and $1,156,000 for the three months ended September 30, 2017 and 2016, respectively, and $3,897,000 and $3,390,000 for the nine months ended September 30, 2017 and 2016, respectively.

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

Forward-Looking Statements

The following discussion of our financial condition and results of operations contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are based on our management's beliefs and assumptions and on information currently available to our management. All statements other than statements of historical facts are "forward-looking statements" for purposes of these provisions, including those relating to future events or our future financial performance and financial guidance. In some cases, you can identify forward-looking statements by terminology such as "may," "might," "will," "should," "expect," "plan," "anticipate," "project," "believe," "estir "predict," "potential," "intend" or "continue," the negative of terms like these or other comparable terminology, and other words or terms of similar meaning in connection with any discussion of future operating or financial performance. These statements are only predictions. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Any or all of our forward-looking statements in this document may turn out to be wrong. Actual events or results may differ materially. Our forward-looking statements can be affected by inaccurate assumptions we might make or by known or unknown risks, uncertainties and other factors. We discuss many of these risks, uncertainties and other factors in this Quarterly Report on Form 10-Q in greater detail under the heading "Item 1A—Risk Factors." We caution investors that our business and financial performance are subject to substantial risks and uncertainties. In addition, statements that "we believe" and similar statements reflect our beliefs and opinions on the relevant subject. These statements are based upon information available to us as of the date of this Quarterly Report on Form 10-Q, and while we believe such information forms a reasonable basis for such statements, such information may be limited or incomplete, and our statements should not be read to indicate that we have conducted an exhaustive inquiry into, or review of, all potentially available relevant information. These statements are inherently uncertain and investors are cautioned not to unduly rely upon these statements.

You should read the following discussion and analysis together with the financial statements and the related notes to those statements included elsewhere in this report. This discussion contains forward-looking statements that involve risks and uncertainties. As a result of many factors, such as those set forth in the section of this report captioned "Risk Factors" and elsewhere in this report, our actual results may differ materially from those anticipated in these forward-looking statements.

Overview

We provide an innovative, cloud-based learning management platform for academic institutions and companies worldwide. We built our learning management applications, Canvas, for the education market, and Bridge, for the corporate market, to enable our customers to easily develop, deliver and manage engaging face-to-face and online learning experiences. Our platform combines powerful, elegant and easy-to-use functionality with the reliability, security, scalability and support required by our customers. We also provide a video platform, Arc, that makes video learning more impactful using contextual comments, robust analytics, and seamless integration with learning management systems such as Canvas and Bridge.

We offer our platform through a Software-as-a-Service, or SaaS, business model. Customers can rapidly deploy our applications with minimal upfront implementation. Customers also benefit from automatic software updates with virtually no downtime. Our SaaS business model substantially reduces the need for our customers to buy and support a broad range of IT infrastructure, and significantly reduces the cost, complexity and disruptions associated with implementations and upgrades of on-premise software.

We were founded in 2008, and in 2011, we launched Canvas, with the goal to make teaching and learning easier. Initially, we focused on the U.S. higher education market, targeting colleges and universities. In 2012, we expanded our focus to include the K-12 market in the United States. We opened our international headquarters in London, England in June 2014 and have offices in Sydney, Australia, Hong Kong and Sao Paulo, Brazil. To date, a substantial majority of our revenue has been derived from our sales of Canvas to the U.S. education market. While our initial efforts were focused on the education market, we discovered that companies also needed a cloud-based learning management platform to enable them to better train their employees. Our initial corporate customers licensed Canvas for this purpose. In February 2015, we launched Bridge to enable companies to further realize the benefits of our cloud-based platform with an application specifically designed to address their needs.

We sell our applications and services primarily through a direct sales force and we engage in a variety of traditional and online marketing activities designed to provide sales lead generation, sales support and market awareness. A majority of our academic customers implement Canvas widely within their institutions and across school districts. This approach to wide initial deployments allows us to efficiently and broadly promote adoption and utilization of Canvas by students and faculty. Our corporate customers generally implement Bridge, by way of initial deployments across a functional area, before purchasing additional seats and expanding within the organization. We believe there is a significant opportunity to continue to penetrate our existing corporate customers and expand the use of Bridge within these customers. We also believe there is significant opportunity to continue to expand internationally.

As of September 30, 2017, we have grown to serve more than 3,000 customers, representing colleges, universities, K-12 school districts, and companies in more than 50 countries. Our customers range from a single school to large corporations and academic institutions and accordingly our total contract values range from thousands of dollars to several million dollars. We generally define a customer as an entity with a subscription contract as of the measurement date. In situations where there is a single contract that applies to entities with multiple subsidiaries or divisions, universities, or governmental organizations, only the entity that has contracted for our platform is counted as a customer. For example, a contracting school district is counted as a single customer even though the school district encompasses multiple schools. In 2016 and the nine months ended September 30, 2017, no single customer represented more than 10% of our revenue.

Our subscription fee includes the use of our platform and our technical support and is based on the number of users. We also generate revenue from training, implementation services and other types of professional services. We have experienced net revenue retention rates of over 100% at September 30, 2017 and 2016. Our revenue was $42.9 million and $30.1 million for the three months ended September 30, 2017 and 2016, respectively, representing year-over-year growth of 43%, and $115.0 million and $79.3 million for the nine months ended September 30, 2017 and 2016, respectively, representing year-over-year growth of 45%. Our net losses were $12.4 million and $12.3 million for the three months ended September 30, 2017 and 2016, respectively, and $38.1 and $40.6 for the nine months ended September 30, 2017 and 2016, respectively.

Key Factors Affecting Our Performance

Investment in Sales and Marketing Organization

We continue to invest in our sales and marketing organization to drive additional revenue and support the growth of our customer base. Any investments we make in our sales and marketing organization will occur in advance of experiencing any benefits from such investments, so it may be difficult for us to determine if we are efficiently allocating our resources in this area. We plan to continue to expand sales and marketing to grow our customer base and increase sales to existing customers. This expansion is expected to include adding sales personnel and expanding our marketing activities to continue to generate additional leads and build brand awareness.

We intend to expand and continue to invest in our international sales and marketing organization, which we believe will be an important factor in our continued growth. As we grow internationally, we may use reseller partnerships as needed to penetrate new markets. During the three months ended September 30, 2017 and 2016, 15% and 11% of our revenue was derived from outside the United States, respectively. During the nine months ended September 30, 2017 and 2016, 14% and 9% of our revenue was derived from outside the United States, respectively. Our international operations are relatively new and we have limited experience operating in international markets, which increases the risk that our international expansion efforts may not be successful.

Investment in Technology

We have aggressively invested, and intend to continue to invest, in developing technology to support our growth. We expect our research and development expenses to increase as we expand headcount. While we invest heavily in research and development, we have also built a foundation for innovation through our approach to the learning management system as a learning platform. However, our investments in research and development may result in enhancements or new applications that may not achieve market adoption, are more expensive to develop than anticipated, may take longer to generate revenue or may generate less revenue than we anticipate.

Net Revenue Retention Rate

We calculate our net revenue retention rate by dividing the total revenue obtained from a particular customer in a given month by the total revenue from that customer from the same month in the immediately preceding year. This calculation contemplates all changes to revenue for the designated customer, which includes customer terminations, changes in quantities of users, changes in pricing, additional applications purchased or applications no longer used. We calculate the net revenue retention for our entire customer base at a given point in time. We believe our net revenue retention rate is an important metric to measure the long-term value of customer agreements and our ability to retain our customers. Our net revenue retention rate was over 100% at each of September 30, 2017 and 2016.

Focus on Free Cash Flow

We define free cash flow as net cash provided by (used in) operating activities less purchases of property and equipment and intangible assets, net of proceeds from disposals of property and equipment. We consider free cash flow to be an important measure that we are focused on to run our business. For more information about free cash flow, see the section titled “Non-GAAP Financial Measures.”

Financial Operations Overview

Revenue

We generate revenue primarily from two main sources: (1) subscription and support revenue, which is comprised of SaaS fees from customers accessing our learning management systems and from customers purchasing additional support beyond the standard support that is included in the basic SaaS fees; and (2) related professional services revenue, which is comprised of training, implementation services and other types of professional services.

Subscription revenue is derived from customers using our cloud-based learning platform and is driven primarily by the number of customers, the number of users at each customer, the price of our applications, and to a lesser extent historically, renewal rates. Support revenue is derived from customers purchasing additional support beyond the standard support that is included in the basic SaaS fee. Our contracts typically vary in length between one and five years. Subscriptions and support are non-cancelable and are billed in advance on an annual basis. All subscription and support fees billed are initially recorded in deferred revenue and recognized ratably over the subscription term. Amounts that have not been billed are not reflected in our consolidated financial statements.

Professional services and other revenue are derived primarily from implementation, training, and other consulting fees. Implementation services includes training and consulting services that generally take anywhere from 30 to 90 days to complete depending on customer-side complexity and timelines. It includes regularly scheduled and highly-structured activities to ensure customers progress toward better utilizing our applications. Most of these interactions take place over the phone and through the use of web meeting technology. Implementation services are recognized upon completion. Implementation services also include nonrefundable upfront fees, which are recorded over the longer of the contract term or the estimated customer life.

We include training with every implementation and offer additional training for a fee. The training offered is focused on creating confidence among users so they can be successful with our applications. Most training is performed remotely using web meeting technology. Because we have an established standalone value, we record training revenue upon the delivery of the training. Subscription training was introduced in 2016 and is recognized ratably in the same manner as subscription and support revenue described above.

In addition to our implementation and training offerings, we provide consulting services for custom application development, integrations, content services and change management consulting. These services are architected to boost customer adoption of our applications and to drive usage of features and capabilities that are unique to our company. We have an established standalone value for these services. In situations where we are unable to utilize the proportional performance method, for example due to either the lack of adequate documentation of time incurred or to be incurred, we recognize revenue based on the milestone method if individual milestones with substantive value to the customer exist. If neither of these two methods is able to be utilized, revenue recognition is deferred until the contract is completed.

Cost of Revenue

Cost of subscription and support revenue consists primarily of the costs of our managed hosting provider and other third-party service providers, employee-related costs including payroll, benefits and stock-based compensation expense for our operations and customer support teams, amortization of capitalized software development costs and acquired technology, and allocated overhead costs, which we define as rent, facilities and costs related to information technology, or IT.

Cost of professional services and other revenue consists primarily of personnel costs of our professional services organization, including salaries, benefits, travel, bonuses and stock-based compensation, as well as allocated overhead costs.

Operating Expenses

Sales and Marketing. Sales and marketing expenses consist primarily of personnel costs of our sales and marketing employees, including sales commissions and incentives, benefits and stock-based compensation expense, marketing programs, including lead generation, costs of our annual InstructureCon user conference and allocated overhead costs. We immediately expense sales commissions related to acquiring new customers and upsells from existing customers. We expect sales and marketing expenses will increase as a result of hiring net new quota-carrying sales representatives inside and outside the United States, adding to the marketing staff and expanding our annual InstructureCon user conference and potentially adding other annual conferences. Over time, we expect sales and marketing expenses will decline as a percentage of total revenue.

Research and Development. Research and development expenses consist primarily of personnel costs of our development team, including payroll, benefits and stock-based compensation expense and allocated overhead costs. We capitalize certain software development costs that are attributable to developing new applications, features and adding incremental functionality to our platform and amortize such costs as costs of subscription revenue over the estimated life of the new application or incremental functionality, which is generally three years. We expect research and development expenses to increase in absolute dollars as we continue to increase the functionality of our software platform.

General and Administrative. General and administrative expenses consist of personnel costs and related expenses for executive, finance, legal, human resources, recruiting, employee-related information technology, administrative personnel, including payroll, benefits and stock-based compensation expense; professional fees for external legal, accounting and other consulting services; and allocated overhead costs. We expect that general and administrative expenses will increase on an absolute dollar basis but decrease as a percentage of total revenue as we focus on processes, systems and controls to enable our internal support functions to scale with the growth of our business. We also anticipate increases to general and administrative expenses as we incur the costs of compliance associated with being a publicly-traded company, including legal, audit and consulting fees.

Other Income (Expense)

Other income (expense) consists primarily of interest income, interest expense, the change in fair value of warrant liability, which is subject to mark-to-market adjustments as of each reporting period, and the impact of foreign currency transaction gains and losses. We have historically had a minimal amount of debt outstanding on which we pay interest. As we have expanded our international operations, our exposure to fluctuations in foreign currencies has increased.

Income Tax Expense

We are subject to income taxes in the United States and foreign jurisdictions in which we do business. These foreign jurisdictions have statutory tax rates different from those in the United States. Accordingly, our effective tax rates will vary depending on the relative proportion of foreign to U.S. income and changes in tax laws. Income tax expense consists primarily of state income taxes in the United States and income taxes in certain foreign jurisdictions in which we conduct business.

Results of Operations

The following tables set forth our results of operations for the periods presented and as a percentage of our total revenue for those periods. The data has been derived from the unaudited consolidated financial statements contained in this Quarterly Report on Form 10-Q which include, in our opinion, all adjustments, consisting only of normal recurring adjustments, that we consider necessary for a fair presentation of the financial position and results of operations for the interim periods presented. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Revenue:				
Subscription and support	$37,427	$25,814	$100,590	$68,807
Professional services and other	5,521	4,331	14,381	10,527
Total revenue	42,948	30,145	114,971	79,334
Cost of revenue:				
Subscription and support[1]	9,278	6,312	24,350	17,335
Professional services and other[1]	3,192	2,326	8,729	6,287
Total cost of revenue	12,470	8,638	33,079	23,622
Gross profit	30,478	21,507	81,892	55,712
Operating expenses:				
Sales and marketing[1][3]	22,129	17,788	62,429	51,989
Research and development[1][2][3]	12,577	9,297	34,816	25,832
General and administrative[1][3]	8,334	6,689	22,941	18,428
Total operating expenses	43,040	33,774	120,186	96,249
Loss from operations	(12,562)	(12,267)	(38,294)	(40,537)
Other income (expense):				
Interest income	84	104	199	236
Interest expense	—	(31)	(18)	(54)
Change in fair value of warrant liability	(15)	(10)	(98)	52
Other income (expense), net	191	(103)	318	(234)
Total other income (expense), net	260	(40)	401	—
Loss before income taxes	(12,302)	(12,307)	(37,893)	(40,537)
Income tax expense	(71)	(10)	(207)	(109)
Net loss	$(12,373)	$(12,317)	$(38,100)	$(40,646)

(1) Includes stock-based compensation as follows:

	Three Months Ended September 30,	Nine Months Ended September 30,

	2017	2016	2017	2016
	(in thousands)			
Cost of revenue:				
Subscription and support	$211	$129	$528	$360
Professional services and other	161	127	422	362
Sales and marketing	1,255	775	3,405	2,219
Research and development	1,637	1,022	4,375	2,742
General and administrative	1,003	751	2,977	2,018
Total stock-based compensation	$4,267	$2,804	$11,707	$7,701

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(2) Includes amortization of acquisition-related intangibles as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Cost of revenue:				
Subscription and support	$—	$ —	$ —	$ —
Professional services and other	—	—	—	—
Sales and marketing	—	—	—	—
Research and development	—	2	—	6
General and administrative	—	—	—	—
Total amortization of acquisition-related intangibles	$—	$ 2	$ —	$ 6

(3) Includes reversal of tax expense on secondary stock purchase transactions due to the reduction of the estimated liability as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(in thousands)			
Cost of revenue:				
Subscription and support	$—	$ —	$—	$—
Professional services and other	—	—	—	—
Sales and marketing	—	—	(256)	(57)
Research and development	—	—	(256)	(57)
General and administrative	—	—	(22)	(103)
Total payroll tax expense	$—	$ —	$(534)	$(217)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
	(as a percentage of total revenue)			
Revenue:				
Subscription and support	87 %	86 %	87 %	87 %
Professional services and other	13	14	13	13

Total revenue	100	100	100	100
Cost of revenue:				
Subscription and support	22	21	21	22
Professional services and other	7	8	8	8
Total cost of revenue	29	29	29	30
Gross profit	71	71	71	70
Operating expenses:				
Sales and marketing	52	59	54	66
Research and development	29	31	30	33
General and administrative	19	22	20	23
Total operating expenses	100	112	104	122
Loss from operations	(29)	(41)	(33)	(52)
Other income (expense):				
Interest income	0	0	0	0
Interest expense	0	(0)	(0)	(0)
Change in fair value of warrant liability	(0)	(0)	(0)	0
Other income (expense), net	0	(0)	0	(0)
Total other expense, net	(0)	(0)	0	—
Loss before income taxes	(29)	(41)	(33)	(52)
Income tax expense	(0)	(0)	(0)	(0)
Net loss	(29)%	(41)%	(33)%	(52)%

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Three and Nine Months Ended September 30, 2017 Compared to the Three and Nine Months Ended September 30, 2016

Revenue

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2017	2016	Amount	%	2017	2016	Amount	%
	(dollars in thousands)							
Subscription and support	$37,427	$25,814	$11,613	45%	$100,590	$68,807	$31,783	46%
Professional services and other	5,521	4,331	1,190	27	14,381	10,527	3,854	37
Total revenue	$42,948	$30,145	$12,803	42	$114,971	$79,334	$35,637	45

Three month and nine month change

Subscription and support revenue increased $11.6 million and $31.8 million for the three and nine months ended September 30, 2017, respectively, primarily due to an increase in the total number of customers, which has grown to over 3,000 as of September 30, 2017, net revenue retention in excess of 100% as of September 30, 2017 and continued growth in international revenue, which contributed 15% and 14% of total revenue for the three and nine months ended September 30, 2017, respectively, versus 11% and 9% of total revenue for the three and nine months ended September 30, 2016, respectively.

Professional services and other revenue increased $1.2 million and $3.9 million for the three and nine months ended September 30, 2017, respectively, primarily due to the increase in new customers discussed above.

Cost of Revenue and Gross Margin

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2017	2016	Amount	%	2017	2016	Amount	%
	(dollars in thousands)							
Cost of revenue:								
Subscription and support	$9,278	$6,312	$2,966	47%	$24,350	$17,335	$7,015	40%
Professional services and other	3,192	2,326	866	37	8,729	6,287	2,442	39
Total cost of revenue	$12,470	$8,638	$3,832	44	$33,079	$23,622	$9,457	40
Gross margin percentage:								
Subscription and support revenue	75%	76%			76%	75%		
Professional services and other	42	46			39	40		
Total gross margin	71	71			71	70		

Three month change

Total cost of revenue increased $3.8 million for the three months ended September 30, 2017 primarily due to an increase in employee-related costs, web hosting and third-party software license costs, amortization of developed technology and outside contractor costs. Total gross margin remained steady.

Subscription and support cost of revenue increased $3.0 million for the three months ended September 30, 2017 primarily due to an increase in web hosting and third-party software license costs, employee-related costs, amortization of developed technology and overhead allocations. Web hosting and third-party software license costs increased $1.4 million due to the increase in total customers. Employee-related costs increased $1.0 million as we continued to grow our customer support organization to support our customer growth and improve service levels and offerings. Amortization of capitalized software development costs increased $0.4 million due to the continued development of our software platform. Allocated overhead expenses and other insignificant items increased $0.2 million primarily due to higher rent and maintenance on our facilities.

Professional services and other costs of revenue increased $0.9 million for the three months ended September 30, 2017 primarily due to an increase in employee-related costs of $0.6 million, as we continued to grow our professional services organization to support our customer growth and improve service levels and offerings, travel and outside contractor costs of $0.2 million, as customer growth increases the demand for training and professional services, and other insignificant items of $0.1 million.

Nine month change

Total cost of revenue increased $9.5 million for the nine months ended September 30, 2017 primarily due to an increase in employee-related costs, web hosting costs, amortization of developed technology and outside contractor costs. Total gross margin increased due to the impact of improved leverage of our web hosting costs relative to the growth in subscription and support revenue.

Subscription and support cost of revenue increased $7.0 million for the nine months ended September 30, 2017 primarily due to an increase in web hosting and third-party license costs, employee-related costs, amortization of developed technology and overhead allocations. Web hosting costs and third-party license costs increased $3.5 million due to the increase in total customers. Employee-related costs increased $2.2 million as we continued to grow our customer support organization to support our customer growth and improve service levels and offerings. Amortization of capitalized software development costs increased $0.9 million due to the continued development of our software platform. Allocated overhead expenses and other insignificant items increased $0.4 million primarily due to higher rent and allocated software expense.

Professional services and other costs of revenue increased $2.4 million for the nine months ended September 30, 2017 primarily due to an increase in employee-related costs, travel, outside services and third-party software costs. Employee-related costs increased $1.4 million as we continued to grow our professional services organization to support our customer growth and improve service levels and offerings. Travel and outside services costs increased $0.5 million, as customer growth increases the demand for training and professional services. Third-party software costs increased $0.3 million and allocated overhead and other insignificant items increased by $0.2 million due to higher rent and allocated software expense.

Operating Expenses

Sales and Marketing

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2017	2016	Amount	%	2017	2016	Amount	%
	(dollars in thousands)							
Sales and marketing	$22,129	$17,788	$4,341	24%	$62,429	$51,989	$10,440	20%

Three month change

Sales and marketing expenses increased $4.3 million for the three months ended September 30, 2017 primarily due to an increase in employee-related costs, marketing expense and overhead allocations. Employee-related costs increased $4.0 million as a result of hiring of additional employees domestically and internationally to continue to grow our customer base. Marketing expense increased by $0.2 million due to lead generation expenses and our annual user conference. Allocated overhead expenses increased $0.1 million primarily due to higher rent and allocated software expense.

Nine month change

Sales and marketing expenses increased $10.4 million for the nine months ended September 30, 2017 primarily due to an increase in employee-related costs, travel, outside services, third-party software expense and overhead allocations.

Employee-related costs increased $8.4 million as a result of hiring additional employees domestically and internationally to continue to grow our customer base. Travel costs increased $0.6 million as we continue to expand our sales and marketing organization. Outside services increased $0.3 million due to international consultants working in new jurisdictions. Third-party software expense increased $0.3 million as we continue to automate our internal systems. Marketing expense increased by $0.4 million due to lead generation expenses and our annual user conference. Allocated overhead expenses and other insignificant items increased $0.4 million primarily due to higher rent and allocated software expense.

Research and Development

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2017	2016	Amount	%	2017	2016	Amount	%
	(dollars in thousands)							
Research and development	$12,577	$9,297	$3,280	35%	$34,816	$25,832	$8,984	35%

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Three month change

Research and development expenses increased $3.3 million for the three months ended September 30, 2017 due to an increase in employee-related costs, outside contractor costs, third-party software expense and overhead allocations. Employee-related costs increased $2.5 million as we continue to grow our engineering organization. Outside contractor costs increased by $0.4 million due to outsourced development. Third-party software expense increased $0.1 million in order to equip and support our engineering organization. Overhead allocations and other insignificant items increased by $0.3 million primarily due to higher rent and allocated software expense.

Nine month change

Research and development expenses increased $9.0 million for the nine months ended September 30, 2017 primarily due to an increase in employee-related costs, third-party software, outside contractors, overhead allocations and travel. Employee-related costs increased $6.4 million as we continue to grow our engineering organization. Outside contractor costs increased by $1.1 million due to outsourced development. Third-party software expense increased $0.6 million in order to equip and support our engineering organization. Allocated overhead expenses increased $0.5 million primarily due to higher rent and allocated software expense. Travel expense and other insignificant items increased by $0.4 million as we have significant development offices in Chicago and Seattle.

General and Administrative

	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2017	2016	Amount	%	2017	2016	Amount	%
	(dollars in thousands)							
General and administrative	$8,334	$6,689	$1,645	25%	$22,941	$18,428	$4,513	24%

Three month change

General and administrative expenses increased $1.6 million for the three months ended September 30, 2017 primarily due to an increase in employee-related costs and outside services costs. Employee-related costs increased $1.3 million as a result of recruiting and hiring additional employees to support our growth. Costs related to outside services and consultants increased by $0.3 million due to increased audit and consulting fees.

Nine month change

General and administrative expenses increased $4.5 million for the nine months ended September 30, 2017 primarily due to an increase in employee-related costs, third-party software expense, outside services cost and overhead allocations. Employee related costs increased $3.2 million as a result of recruiting and hiring additional employees to support our growth. Third-party software expense increased by $0.5 million as we continue to invest in and automate our internal systems. Depreciation, amortization and other insignificant items increased $0.5 million due to increased headcount. Costs related to outside services and consultants increased by $0.3 million due to increased audit and consulting fees.

Other Income (Expense)

	Three Months Ended September 30, 2017	2016	Change Amount	%	Nine Months Ended September 30, 2017	2016	Change Amount	%
	(dollars in thousands)							
Other income (expense), net	$260	$(40)	$300	(750)%	$ 401	$ —	$401	100%

Three and Nine month change

Other income (expense), net includes interest income and expense, the change in fair value of warrant liability and the impact of foreign currency transaction gains and losses. Other income (expense), net increased by $0.3 and $0.4 million for the three and nine months ended September 30, 2017, respectively, primarily as a result of fluctuations in foreign exchange rates during the period and the change in the fair value of the warrant liability.

Liquidity and Capital Resources

As of September 30, 2017, we had $58.7 million of cash and cash equivalents and $8.1 million in short-term marketable securities. We believe our cash and cash equivalents, short-term marketable securities, cash flows from operations and available borrowings under our credit facility will be sufficient to support our planned operations for at least the next 12 months. Our future capital requirements will depend on many factors including our growth rate, net revenue retention rates, the timing and extent of spending to support the expansion of sales and marketing and research and development activities, the introduction of new and enhanced offerings, and the continuing market acceptance of our platform. We may in the future enter into arrangements to acquire or invest in complementary businesses, services and technologies, and intellectual property rights. We may be required to seek additional equity or debt financing. If additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition may be adversely affected.

In June 2017, we entered into an amended and restated loan and security agreement, or credit facility, with Silicon Valley Bank (“SVB”). The agreement provides for up to $15.0 million in revolving borrowings (subject to increase to $35.0 million in the lender’s sole discretion). Availability is subject to a formula based on our monthly recurring revenue. Advances under the credit facility accrue interest at a floating per year rate equal to the prime rate plus 0.5%. The credit facility terminates in June 2018, at which time the principal amount of all outstanding advances becomes due and payable. We are obligated to pay a fee equal to 0.25% per year, payable quarterly in respect of any unused borrowing capacity under the credit facility. As of September 30, 2017, we did not have any outstanding borrowing under the credit facility.

To secure our obligations under the credit facility, we granted SVB a security interest in substantially all of our tangible and intangible assets, excluding intellectual property. The credit facility contains customary events of default, conditions to borrowing, and covenants, including restrictions on our ability to dispose of assets, make acquisitions, incur debt, incur liens and make distributions and dividends to stockholders. The agreement also includes a financial covenant requiring the achievement of minimum bookings on a trailing three-month basis, tested quarterly. During the continuance of an event of default, SVB may accelerate amounts outstanding, terminate the credit facility and foreclose on the collateral. As of September 30, 2017, we were in compliance with all covenants under the terms of the credit facility.

The following table shows our cash flows for the nine months ended September 30, 2017 and 2016:

	Nine Months Ended September 30,	
	2017	2016
	(in thousands)	
Net cash provided by (used in) operating activities	$ 3,922	$