APPFOLIO INC
Form 10-Q
August 08, 2016
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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, 2016.
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 001-37468
AppFolio, Inc.
(Exact name of registrant as specified in its charter)

Delaware	26-0359894
(State of incorporation or organization)	(I.R.S. Employer Identification No.)
50 Castilian Drive Santa Barbara, California	93117
(Address of principal executive offices)	(Zip Code)

(805) 364-6093
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x
As of July 25, 2016, the number of shares of the registrant’s Class A common stock outstanding was 11,021,812 and the number of shares of the registrant’s Class B common stock outstanding was 22,624,442.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2016, or Quarterly Report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, which statements are subject to considerable risks and uncertainties. Forward-looking statements include all statements that are not statements of historical facts contained in this Quarterly Report and can be identified by words such as “anticipates,” “believes,” “seeks,” “estimates,” “expects,” “intends,” “may,” “plans,” “potential,” “predicts, “projects,” “should “would” or similar expressions and the negatives of those expressions. In particular, forward looking statements contained in this Quarterly Report relate to, among other things, our future or assumed financial condition, results of operations, business forecasts and plans, capital needs and financing plans, research and product development plans, growth in the size of our business and number of customers, strategic plans and objectives, acquisitions and investments, and the application of accounting guidance. We caution you that the foregoing list may not include all of the forward-looking statements made in this Quarterly Report.

Forward-looking statements represent our management’s current beliefs and assumptions based on information currently available. Forward-looking statements involve numerous known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. We discuss these risks and uncertainties in greater detail in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this Quarterly Report and
in the section entitled “Risk Factors” in our 2015 Annual Report on Form 10-K, or Annual Report, as well as in our other filings with the Securities and Exchange Commission or SEC. You should read this Quarterly Report, and the other documents we have filed with the SEC, with the understanding that our actual future results may be materially different from the results expressed or implied by these forward-looking statements.

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

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

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

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PART I. FINANCIAL INFORMATION
Item 1. Condensed Consolidated Financial Statements

APPFOLIO, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except par values)

	June 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$10,963	$ 12,063
Investment securities—current	11,234	10,235
Accounts receivable, net	3,045	2,048
Prepaid expenses and other current assets	3,807	3,160
Total current assets	29,049	27,506
Investment securities—noncurrent	28,977	34,417
Property and equipment, net	7,143	6,107
Capitalized software, net	12,804	10,022
Goodwill	6,737	6,737
Intangible assets, net	3,808	4,516
Other assets	1,236	1,176
Total assets	$89,754	$ 90,481
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$1,090	$ 2,369
Accrued employee expenses	6,235	5,159
Accrued expenses	3,751	3,340
Deferred revenue	6,101	4,953
Other current liabilities	1,631	1,084
Total current liabilities	18,808	16,905
Other liabilities	1,865	879
Total liabilities	20,673	17,784
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, $0.0001 par value, 25,000 authorized and no shares issued and outstanding as of June 30, 2016 and December 31, 2015	—	—
Class A common stock, $0.0001 par value, 250,000 shares authorized as of June 30, 2016 and December 31, 2015; 11,018 and 9,005 shares issued and outstanding as of June 30, 2016 and December 31, 2015, respectively;	1	1
Class B common stock, $0.0001 par value, 50,000 shares authorized as of June 30, 2016 and December 31, 2015; 22,625 and 24,541 shares issued and outstanding as of June 30, 2016 and December 31, 2015, respectively;	3	3
Additional paid-in capital	143,406	141,528
Accumulated other comprehensive income (loss)	220	(153)
Accumulated deficit	(74,549)	(68,682)
Total stockholders' equity	69,081	72,697
Total liabilities and stockholders' equity	$89,754	$ 90,481

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue	$26,203	$18,425	$49,414	$34,273
Costs and operating expenses:				
Cost of revenue (exclusive of depreciation and amortization)	11,212	8,109	21,742	15,174
Sales and marketing	7,567	6,239	15,118	11,948
Research and product development	3,024	2,154	6,067	4,163
General and administrative	4,389	3,707	7,938	7,099
Depreciation and amortization	2,359	1,431	4,476	2,614
Total costs and operating expenses	28,551	21,640	55,341	40,998
Loss from operations	(2,348)	(3,215)	(5,927)	(6,725)
Other income (expense), net	2	(5)	(22)	(7)
Interest income (expense), net	95	(243)	119	(275)
Loss before provision for income taxes	(2,251)	(3,463)	(5,830)	(7,007)
Provision for (benefit from) income taxes	13	(63)	37	11
Net loss	$(2,264)	$(3,400)	$(5,867)	$(7,018)
Net loss per share, basic and diluted	$(0.07)	$(0.36)	$(0.18)	$(0.77)
Weighted average common shares outstanding, basic and diluted	33,523	9,328	33,493	9,122

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	$(2,264)	$(3,400)	$(5,867)	$(7,018)
Other comprehensive income:				
Net changes in unrealized gains on investment securities	73	—	373	—
Comprehensive loss	$(2,191)	$(3,400)	$(5,494)	$(7,018)

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

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APPFOLIO, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)
(in thousands)

	Common Stock Class A		Common Stock Class B		Additional Paid-in Capital	Accumulated Other Comprehensive (Loss)/Income	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount				
Balance at December 31, 2015	9,005	$ 1	24,541	$ 3	$ 141,528	$ (153)	$ (68,682)	$ 72,697
Exercise of stock options	74	—	1		153	—	—	153
Stock-based compensation	—	—	—	—	1,614	—	—	1,614
Vesting of early exercised shares	—	—	—	—	111	—	—	111
Conversion of Class B stock to Class A stock	1,917	—	(1,917)	—	—	—	—	—
Issuance of restricted stock	22	—	—	—	—	—	—	—
Unrealized gain on investment securities	—	—	—	—	—	373	—	373
Net loss	—	—	—	—	—	—	(5,867)	(5,867)
Balance at June 30, 2016	11,018	$ 1	22,625	$ 3	$ 143,406	$ 220	$ (74,549)	$ 69,081

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

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

	Six Months Ended June 30,	
	2016	2015
Cash from operating activities		
Net loss	$(5,867)	$(7,018)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,476	2,614
Purchased investment premium, net of amortization	95	—
Amortization of deferred financing costs	32	31
Loss on disposal of property and equipment	32	13
Noncash interest expense	—	223
Stock-based compensation	1,555	345
Lease abandonment	60	—
Changes in operating assets and liabilities:		
Accounts receivable	(996)	(1,222)
Prepaid expenses and other current assets	(647)	(608)
Other assets	(92)	(83)
Accounts payable	(571)	883
Accrued employee expenses	906	1,064
Accrued expenses	751	560
Deferred revenue	1,148	475
Other liabilities	1,495	(84)
Net cash provided by (used in) operating activities	2,377	(2,807)
Cash from investing activities		
Purchases of property and equipment	(3,161)	(1,510)
Additions to capitalized software	(5,159)	(3,155)
Purchases of investment securities	(16,685)	—
Sales and calls of investment securities	19,074	—
Maturities of investment securities	2,330	—
Cash paid in business acquisition, net of cash acquired	—	(4,039)
Purchases of intangible assets	—	(11)
Net cash used in investing activities	(3,601)	(8,715)
Cash from financing activities		
Proceeds from stock option exercises	153	318
Proceeds from issuance of restricted stock	—	141
Proceeds from issuance of options	—	208
Principal payments under capital lease obligations	(15)	(15)
Proceeds from the initial public offering, net of underwriting discounts and commissions	—	69,192
Payments of initial public offering costs	—	(807)
Payment of contingent consideration	—	(2,429)
Proceeds from issuance of debt	57	10,000
Principal payments on debt	(71)	(42)
Payment of debt issuance costs	—	(532)

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

	Six Months Ended June 30,	
	2016	2015
Net cash provided by financing activities	124	76,034
Net (decrease) increase in cash and cash equivalents	(1,100)	64,512
Cash and cash equivalents		
Beginning of period	12,063	5,412
End of period	$10,963	$69,924
Noncash investing and financing activities		
Purchases of property and equipment included in accounts payable and accrued expenses	$172	$120
Additions of capitalized software included in accrued employee expenses	459	240
Stock-based compensation capitalized for software development	177	67
Debt issuance and other financing costs accrued, not paid	—	13
Initial public offering costs included in accrued expenses	—	3,317
Conversion of convertible preferred stock into common stock in connection with the initial public offering	—	63,166
Interest expense paid through drawdown from the revolving credit facility	—	223

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

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APPFOLIO, INC.
NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

1. Nature of Business

Overview

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

2. Summary of Significant Accounting Policies

Basis of Presentation and Significant Accounting Policies

The accompanying unaudited Condensed Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. Certain information and disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted. Accordingly, these Condensed Consolidated Financial Statements should be read in conjunction with our consolidated financial statements and the related notes included in our Annual Report filed with the SEC on February 29, 2016. Our unaudited interim Condensed Consolidated Financial Statements have been prepared on a basis consistent with that used to prepare our audited annual consolidated financial statements and include, in the opinion of management, all adjustments, consisting of normal and recurring items, necessary for the fair statement of the Condensed Consolidated Financial Statements. The operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results expected for the full year ending December 31, 2016.

Changes in Accounting Policies

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

Stock-Based Compensation

During the three and six months ended June 30, 2016, we granted performance based stock options (" PSOs") and performance based restricted stock units ("PSUs"). For additional information regarding the PSOs and PSUs granted refer to Note 7, Stock-Based Compensation.

Use of Estimates

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

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Net Loss per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Weighted average shares outstanding	33,610	9,474	33,591	9,278
Less: Weighted average unvested restricted shares subject to repurchase	87	146	98	156
Weighted average number of shares used to compute basic and diluted net loss per share	33,523	9,328	33,493	9,122

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

The following table presents the number of anti-dilutive Class A and Class B common shares excluded from the calculation of diluted net loss per share as of June 30, 2016 and 2015 (in thousands):

	June 30,	
	2016	2015
Options to purchase common stock	1,824	1,141
Unvested restricted stock awards	76	158
Unvested restricted stock units	475	—
Contingent restricted stock units (1)	49	—
Total shares excluded from net loss per share attributable to common stockholders	2,424	1,299

(1) The reported shares are based on 49,000 shares with a fixed price restricted stock unit (“RSU”) commitment for which the number of shares has not been determined at the grant date. The 49,000 shares included in the table above are based on the closing price of our stock at June 30, 2016 divided by the fixed price commitment to issue shares in the future. For additional information regarding the RSUs granted refer to Note 7, Stock-Based Compensation.

The diluted net loss per common share was the same for our Class A and Class B common shares because they are entitled to the same liquidation and dividend rights.

Recent Accounting Pronouncements

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

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

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). Under ASU 2016-02, an entity will be required to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. ASU 2016-02 offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires a modified retrospective adoption, with early adoption permitted. We will adopt this guidance beginning with its first quarter ending March 31, 2019. We have not determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

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In March 2016, the FASB issued ASU 2016-08, "Revenue from Contracts with Customers (Topic 606), Principal versus Agent Considerations (Reporting of Revenue Gross versus Net) ("ASU 2016-08"), which provides additional guidance to improve the operability and understandability of the implementation guidance on principal versus agent considerations and provides additional illustrative examples to assist with the application of the guidance. The amendment does not change the core principles in Topic 606. ASU 2016-08 is effective on January 1, 2018 with the adoption of ASU 2014-09. Early adoption is permitted as of January 1, 2017. We have not determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 781), Improvements to Employee Share-Based Payment Accounting ("ASU 2106-09"), which amends and simplifies the accounting for share-based payment awards in three areas; (1) income tax consequences, (2) classification of awards as either equity or liabilities, and (3) classification on the statement of cash flows. For public companies, ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any interim or annual period. We have not determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing ("ASU 2016-10"), which provides additional guidance on identifying performance obligations and also to improve the operability and understandability of the licensing implementation guidance. The amendment does not change the core principles in Topic 606. ASU 2016-10 is effective on January 1, 2018 with the adoption of ASU 2014-09. Early adoption is permitted as of January 1, 2017. We have not determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

In May 2016, the FASB issued ASU No. 2016-12, "Revenue from Contracts with Customers (Topic 606), Narrow-Scope Improvements and Practical Expedients ("ASU 2016-12"), which clarifies the collectibility criterion and transition guidance for contracts for which substantially all revenue was recognized under legacy accounting guidance. The amendment does not change the core principles in Topic 606. ASU 2016-12 is effective on January 1, 2018 with the adoption of ASU 2014-09. Early adoption is permitted as of January 1, 2017. We have not determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

In June 2016, he FASB issued ASU No. 2016-13, "Financial Instruments -Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"), which amends the current accounting guidance and requires all expected losses based on historical experience, current conditions and reasonable and supportable forecasts. This guidance amends the accounting for credit losses for available-for-sale securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. Early adoption is permitted for any interim or annual period after December 15, 2018. We have not determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

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3. Investment Securities and Fair Value Measurements
Investment Securities

Investment securities classified as available-for-sale consist of the following at June 30, 2016 and December 31, 2015 (in thousands):

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	$31,766	$ 188	$ (1)	$ 31,953
Agency securities	2,000	—	—	2,000
Certificates of deposit	6,225	33	—	6,258
Total available-for-sale investment securities	$39,991	$ 221	$ (1)	$ 40,211
	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	$30,568	$ —	$ (126)	$ 30,442
Agency securities	8,012	—	(12)	8,000
Certificates of deposit	6,225	—	(15)	6,210
Total available-for-sale investment securities	$44,805	$ —	$ (153)	$ 44,652

We had certain investment securities in an unrealized loss position at June 30, 2016 and December 31, 2015, and we have held these securities for less than twelve months. These unrealized loss positions are considered temporary and there were no impairments considered "other-than-temporary" as it is more likely than not we will hold the securities until maturity or a recovery of the cost basis.
At June 30, 2016 and December 31, 2015, the contractual maturities of our investments did not exceed 36 months. The fair values of available-for-sale investments, by remaining contractual maturity, are as follows (in thousands):

	June 30, 2016		December 31, 2015	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in 1 year or less	$11,228	$ 11,234	$10,249	$ 10,235
Due after 1 year through 3 years	28,763	28,977	34,557	34,417
Total available-for-sale investment securities	$39,991	$ 40,211	$44,806	$ 44,652

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During the six months ended June 30, 2016, we had sales, calls and maturities of investment securities, as follows (in thousands):

	Six months ended June 30, 2016			
	Gross Realized Gains	Gross Realized Losses	Gross Proceeds from Sales and Calls	Gross Proceeds from Maturities
Corporate bonds	$1	$ —	$ 5,011	$ —
Agency securities	5	—	9,063	1,500
Treasury bills	—	—	5,000	830
	$6	$ —	$ 19,074	$ 2,330

Fair Value Measurements

Recurring Fair Value Measurements

The following tables summarize our financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2016 and December 31, 2015 by level within the fair value hierarchy. Financial assets and financial liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands):

	June 30, 2016			
	Level 1	Level 2	Level 3	Total Fair Value
Cash equivalents:				
Money market funds	$143	$—	$ —	$ 143
Available-for-sale - investment securities:				
Corporate bonds	—	31,953	—	31,953
Agency securities	—	2,000	—	2,000
Certificates of deposit	6,258	—	—	6,258
Total Assets	$6,401	$33,953	$ —	$ 40,354

	December 31, 2015			
	Level 1	Level 2	Level 3	Total Fair Value
Cash equivalents:				
Money market funds	$7,102	$—	$ —	$ 7,102
Available-for-sale - investment securities:				
Corporate bonds	—	30,442	—	30,442
Agency securities	—	8,000	—	8,000
Certificates of deposit	6,210	—	—	6,210
Total Assets	$13,312	$38,442	$ —	$ 51,754

The carrying amounts of cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities approximate fair value because of the short maturity of these items.

There were no changes to our valuation techniques used to measure asset and liability fair values on a recurring basis during the six months ended June 30, 2016. The valuation techniques for the items in the table, above are as follows:

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Cash and Cash Equivalents

As of June 30, 2016 and December 31, 2015, cash and cash equivalents include cash invested in money market funds. Market prices are based on market prices for identical assets.

Available-for-Sale - Investment Securities

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

Contingent Consideration

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

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

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Fair value, at beginning of period	$—	$2,429	$—	$2,429
Payment of contingent consideration	—	(2,429)	—	(2,429)
Fair value, at end of period	$—	$—	$—	$—

The contingent consideration liability was recorded in other current liabilities in the consolidated balance sheets as of December 31, 2014. On May 6, 2015, we paid the final earn-out payment in the amount of $2.4 million.

Non-Recurring Fair Value Measurements

Certain assets, including goodwill, intangible assets and our note receivable with SecureDocs are also subject to measurement at fair value on a non-recurring basis using Level 3 measurement when they are deemed to be impaired as a result of an impairment review. For the three and six months ended June 30, 2016 and 2015, no impairments were identified on those assets required to be measured at fair value on a non-recurring basis.

4. Internal-Use Software Development Costs

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

	June 30, 2016	December 31, 2015
Internal use software development costs, gross	$27,283	$ 21,894
Less: Accumulated amortization	(14,479)	(11,872)
Internal use software development costs, net	$12,804	$ 10,022

Capitalized software development costs were $3.0 million and $1.9 million for the three months ended June 30, 2016 and 2015, respectively and were $5.4 million and $3.3 million for the six months ended June 30, 2016 and 2015, respectively. Amortization expense with respect to software development costs totaled $1.4 million and $0.8 million for the three months ended June 30, 2016 and 2015, respectively and $2.7 million and $1.4 million for the six months ended June 30, 2016 and 2015, respectively.

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5. Intangible Assets

Intangible assets consisted of the following as of June 30, 2016 and December 31, 2015 (in thousands, except years):

	June 30, 2016			
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life in Years
Customer relationships	$790	$ (313)	$ 477	5.0
Technology	4,811	(2,669)	2,142	6.0
Trademarks	930	(354)	576	9.0
Partner relationships	680	(283)	397	3.0
Non-compete agreements	40	(17)	23	3.0
Domain names	274	(221)	53	5.0
Patents	282	(142)	140	5.0
	$7,807	$ (3,999)	$ 3,808	5.9

	December 31, 2015			
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life in Years
Customer relationships	$790	$ (234)	$ 556	5.0
Technology	4,811	(2,268)	2,543	6.0
Trademarks	930	(293)	637	9.0
Partner relationships	680	(170)	510	3.0
Non-compete agreements	40	(10)	30	3.0
Domain names	274	(199)	75	5.0
Patents	286	(121)	165	5.0
	$7,811	$ (3,295)	$ 4,516	5.9

Amortization expense for the three months ended June 30, 2016 and 2015 was $0.4 million and $0.4 million, respectively and $0.7 million and $0.6 million for the six months ended June 30, 2016 and 2015, respectively.

A summary of the activity within our intangible assets since December 31, 2015 is as follows (in thousands):

Intangible assets, net at December 31, 2015	$ 4,516
Disposals	(4)
Amortization	(704)
Intangible assets, net at June 30, 2016	$ 3,808

6. Commitments and Contingencies

Lease Obligations

As of June 30, 2016, we had operating lease obligations of approximately $9.4 million through 2022. We recorded rent expense of $0.5 million and $0.3 million for the three months ended June 30, 2016 and 2015, respectively, and $1.0 million and $0.6 million for the six months ended June 30, 2016 and 2015, respectively.

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During the six months ended June 30, 2016, we moved into a new location in Richardson, Texas, and permanently exited the prior location which expires on December 31, 2016. We are in the process of finding a sublessee for the prior location. Due to our remaining commitment, under the terms of the prior lease agreement, and our abandonment of the facilities, we recorded a $0.1 million loss and a corresponding liability, which represents the amount of future payments that must be made under the terms of the original lease reduced by the estimated amount of rent that could be reasonably collected from a sub-lessee at current market rates.

Line of Credit

On October 9, 2015, we entered into Amendment Number One to our Credit Agreement with Wells Fargo, as administrative agent, and the lenders that are parties thereto (as amended, the "Credit Agreement"). Under the terms of the Credit Agreement, the lenders made available to us a $25.0 million revolving line of credit (the "Revolving Facility"). Borrowings under the Revolving Facility are subject to the satisfaction of customary conditions. The Revolving Facility matures on October 9, 2020. However, we can make payments on, and cancel in full, the Revolving Facility at any time without premium or penalty.

As of June 30, 2016, there was no outstanding balance and at December 31, 2015 there was a balance of $12,000 under the Credit Agreement.

Insurance

We have a wholly owned subsidiary, Terra Mar Insurance Company, Inc. ("Terra Mar"), which was established to provide our customers with the option to purchase tenant liability insurance. If our customers choose to use our insurance services, they are issued an insurance policy underwritten by our third-party service provider. The policy has a limit of $100,000 per incident for each insured residence. We have entered into a reinsurance agreement with our third-party service provider and, as a result, we assume a 100% quota share of the tenant liability insurance provided to our customers through our third-party service provider. Included in cost of revenue we accrue for reported claims and an estimate of losses incurred but not reported by our property manager customers, as we bear the risk related to these claims. Our liability for reported claims and incurred but not reported claims as of June 30, 2016 and December 31, 2015 was $0.5 million and $0.5 million, respectively, and is included in other current liabilities on the Condensed Consolidated Balance Sheets.

Included in other current assets as of June 30, 2016 and December 31, 2015 are $1.1 million and $1.0 million, respectively, of deposits held with a third party related to requirements to maintain collateral for our insurance services.

Litigation

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

Indemnification

In the ordinary course of business, we may provide indemnification of varying scope and terms to customers, investors, directors and officers with respect to certain matters, including, but not limited to, losses arising out of our breach of any applicable agreements, services to be provided by us, or intellectual property infringement claims made by third parties. These indemnification provisions may survive termination of the underlying agreement and the maximum potential amount of future payments we could be required to make under these indemnification provisions may not be subject to maximum loss clauses. The maximum potential amount of future payments we could be required to make under these indemnification provisions is indeterminable. We have never paid a material claim, nor have we been sued in connection with these indemnification arrangements. As of June 30, 2016 and December 31, 2015, we had not accrued a liability for these indemnification arrangements because we have determined that the likelihood of incurring a payment obligation, if any, in connection with these indemnification arrangements is not probable or reasonably possible and the amount or range of amounts of any such liability is not reasonably estimable.

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7. Stock-Based Compensation

Stock Options

A summary of our stock option activity for the six months ended June 30, 2016 is as follows (number of shares in thousands):

	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life in Years
Options outstanding as of December 31, 2015	1,171	$ 5.30	8.0
Options granted	750	12.85	
Options exercised	(74)	2.07	
Options cancelled/forfeited	(23)	8.45	
Options outstanding as of June 30, 2016	1,824	$ 8.50	8.6

During the six months ended June 30, 2016, we granted PSOs to purchase up to 750,000 shares of our Class A common stock. The PSOs have a weighted average exercise price of $12.85 per share. Vesting of the PSOs is based on our achievement of a pre-established free cash flow performance metric for the years ended December 31, 2016, 2017 and 2018 and continued employment throughout the performance period. We recognize expense for the PSOs based on the grant date fair value of the PSOs that we determine are probable of vesting. Adjustments to compensation expense are made each period based on changes in our estimate of the number of PSOs that are probable of vesting. The number of PSOs granted, as included in the above table, assumes achievement of the performance metric at the maximum level, which is 150% of the targeted performance metric. For performance at 100% of the targeted metric, approximately 67% of the PSOs would vest. For performance at 80% of the targeted metric, approximately 33% of the PSOs would vest. For performance below 80% of the 2016 and 2018 targeted metric, no PSOs would vest , no compensation expense would be recognized and all previously recognized compensation expense for PSOs would be reversed. For performance below 50% of the 2017 targeted metric, no PSOs would vest, no compensation expense would be recognized and all previously recognized compensation expense for PSOs would be reversed.

Our stock-based compensation expense for stock options, including the PSOs for the three months ended June 30, 2016 and 2015 was $578,000 and $167,000, respectively, and for the six months ended June 30, 2016 and 2015 was $865,000 and $269,000 respectively.

The fair value of stock options granted is estimated on the date of grant using the Black-Scholes option-pricing model. The following table summarizes information relating to our stock options granted during the three and six months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Stock options granted (in thousands)	500	82	750	277
Weighted average exercise price per share	$13.43	$12.00	$12.85	$7.51
Weighted average grant-date fair value per share	$5.20	$5.42	$4.85	$6.77
Weighted average Black-Scholes model assumptions:				
Risk-free interest rate	1.53 %	1.91 %	1.45 %	1.53 %
Expected term (in years)	6.1	6.0	5.9	6.2
Expected volatility	38 %	45 %	37 %	47 %
Expected dividend yield	—	—	—	—

As of June 30, 2016, the total estimated remaining stock-based compensation expense for unvested stock options, including the PSOs was $4.3 million, which is expected to be recognized over a weighted average period of 2.1 years.

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Restricted Stock Units

A summary of activity in connection with our restricted stock units for the six months ended June 30, 2016 is as follows (number of shares in thousands):

	Number of Shares	Weighted- Average Grant Date Fair Value per Share
Unvested as of December 31, 2015	17	$ 15.45
Granted	463	12.46
Vested	—	—
Forfeited	(5)	12.60
Unvested as of June 30, 2016	475	$ 12.56

During the six months ended June 30, 2016, we granted 376,000 RSUs that vest annually over four years and 87,000 PSUs that vest based upon achievement of a pre-established free cash flow performance metric for the years ended December 31, 2016, 2017 and 2018 and continued employment throughout the performance period. We recognize expense for the PSUs based on the grant date fair value of the PSUs that we determine are probable of vesting. Adjustments to compensation expense are made each period based on changes in our estimate of the number of PSUs that are probable of vesting. The number of PSUs granted, as included in the above table, assumes achievement of the performance metric at 100% of the targeted performance metric. The actual number of shares to be issued at the end of the performance period will range from 0% to 150% of the initial target awards. For performance at 150% of the targeted metric, 150% of the PSUs would vest. For performance at 80% of the targeted metric, approximately 50% of the PSUs would vest. For performance below 80% of targeted metric for 2016 and 2018, no PSUs would vest and no compensation expense would be recognized and all previously recognized compensation expense for PSUs would be reversed. For performance below 50% of targeted metric for 2017, no PSUs would vest and no compensation expense would be recognized and all previously recognized compensation expense for PSUs would be reversed.

Our stock-based compensation expense for the RSUs and PSUs was $527,000 and $638,000 for the three and six months ended June 30, 2016, respectively. As of June 30, 2016, the total remaining estimated stock-based compensation expense for the RSUs and PSUs was $5.4 million, which is expected to be recognized over a weighted average period of 3.1 years.

Restricted Stock Awards

A summary of activity in connection with our restricted stock awards for the six months ended June 30, 2016 is as follows (number of shares in thousands):

	Number of Shares	Weighted- Average Grant Date Fair Value per Share
Unvested as of December 31, 2015	120	$ 4.68
Granted	22	13.46
Vested	(66)	6.10
Forfeited	—	—
Unvested as of June 30, 2016	76	$ 6.00

We have the right to repurchase any unvested restricted stock awards. Restricted stock awards vest over a four-year period for employees and a one-year period for non-employee directors. We recognized stock-based compensation expense of $114,000 and $80,000 for the three months ended June 30, 2016 and 2015, respectively, and $229,000 and $143,000 for the six months ended June 30, 2016 and 2015, respectively.

As of June 30, 2016, the total remaining stock-based compensation expense for unvested restricted stock awards with a repurchasing right was $0.5 million, which is expected to be recognized over a weighted average period of 1.3 years.

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8. Income Taxes

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

For the three and six months ended June 30, 2016, we recorded income tax expense of $13,000 and $37,000, respectively on pre-tax losses of $2.3 million and $5.8 million, respectively, for an effective tax rate of (0.6%) and (0.6%), respectively. The income tax expense is based on our payments of state minimum taxes and the amortization of tax deductible goodwill that is not an available source of income to realize the deferred tax asset.

For the three and six months ended June 30, 2015, we recorded income tax (benefit) expense of $(63,000) and $11,000 respectively on pre-tax losses of $3.5 million and $7.0 million, respectively for an effective tax rate of 1.8% and (0.2%), respectively. The income tax benefit was based on the reversal of income tax expense recorded when the statutory rate was applied to actual year-to-date earnings of our subsidiary, Terra Mar, which became part of our U.S. consolidated group for tax purposes at June 30, 2015. Terra Mar’s earnings were then offset by the losses of our U.S. consolidated group for tax purposes. The income tax expense is based on state minimum taxes and the amortization of tax deductible goodwill that is not an available source of income to realize the deferred tax asset.

9. Revenue and Other Information

Our chief operating decision maker reviews separate revenue information for our core solutions, Value+ and other service offerings as a measure of growth in the number of our customers and growth in the adoption and utilization of our core solutions and Value+ services by new and existing customers. The following table presents our revenue categories for the three and six months ended June 30, 2016 and 2015 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Core solutions	$10,572	$7,697	$20,335	$14,831
Value+ services	14,399	9,408	26,653	17,112
Other	1,232	1,320	2,426	2,330
Total revenues	$26,203	$18,425	$49,414	$34,273

Value+ services presented above include revenue from subscriptions or usage-based fees. Subscription Value+ services include website hosting services and contact center services. Usage-based Value+ services include fees for electronic payment processing, resident screening services, tenant liability insurance program, and online vacancy advertising services based on the RentLinx software platform acquired in April 2015. Other services included above are for one-time services related to on-boarding our core solutions, website design services and online vacancy advertising services offered to legacy RentLinx customers.

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

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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 together with our Condensed Consolidated Financial Statements and the related notes included elsewhere in this Quarterly Report and in our Annual Report. This discussion and analysis contains forward-looking statements that are based on our current expectations and reflect our plans, estimates and anticipated future financial performance. These statements involve numerous risks and uncertainties. Our actual results may differ materially from those expressed or implied by these forward-looking statements as a result of many factors, including those set forth in the section entitled “Risk Factors” in Part I, Item 1A of our Annual Report. Please also refer to "Cautionary Note Regarding Forward-Looking Statements".

Overview

AppFolio is a provider of industry-specific, cloud-based software solutions for small and medium-sized businesses, or SMBs, in the property management and legal industries. We were formed in 2006 with a vision to revolutionize the way that SMBs grow and compete.

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

We launched our first product, APM, a property management solution, in 2008. Recognizing that our customers would benefit from additional mission-critical services that they can purchase as needed, we launched our first Value+ service in 2009 by offering website design and hosting services to our property manager customers. Our websites give our customers a professional online presence and serve as the hub for our system of engagement. In 2010, we commenced the roll out of our electronic payments platform with the introduction of ACH payment processing and, in 2011, we launched resident screening as additional Value+ services. In 2012, we introduced our tenant liability insurance program as a further Value+ service. Also in 2012, after completing our market validation process, we decided to enter the legal market. We expedited our time-to-market by acquiring MyCase, a legal practice and case management solution, and we leveraged our AppFolio Business System, including our experience gained in the property management vertical, to advance our software solution in the legal vertical. In 2013, we extended our website design and hosting services to our law firm customers and expanded our electronic payments platform by allowing residents to pay rent by Electronic Cash Payment and credit or debit card. In 2014, we launched an additional Value+ service for our property manager customers with our contact center to resolve or route incoming maintenance requests. In February 2016, we launched Premium Leads, an additional Value+ service for our property manager customers. Through our disciplined market validation approach and ongoing investment in product development, we continuously update our software solutions through new and innovative core functionality and Value+ services, as well as assess opportunities in adjacent markets and new verticals.

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

Customer count is summarized in the table below:

	June 30, 2016

	2016	2015	% Change
Property manager	9,275	7,016	32 %
Law firm	7,349	4,891	50 %

We have invested in growth in a disciplined manner across our organization. As a result, our costs and operating expenses have increased significantly in absolute dollars primarily due to our significant growth in employees and personnel-related costs. For example, we increased our employee headcount from 528 employees as of June 30, 2015 to 634 employees as of June 30, 2016, representing a period-over-period increase of 20%. We intend to continue to invest across our organization. These investments to

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

To date, we have experienced rapid revenue growth due to our investments in research and product development, sales and marketing, customer service and support, and infrastructure. During the six months ended June 30, 2016, we have derived more than 90% of our revenue from our property management solution, as it has been available for a longer period of time, is more established within its vertical with a larger customer base, and currently offers a greater number of Value+ services.

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

Key Components of Results of Operations

Revenue

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

We also charge our customers usage-based fees for using certain Value+ services, although fees for electronic payment processing are generally paid by the clients of our customers. Usage-based fees are charged on a flat fee per transaction basis with no minimum usage commitments. We recognize revenue for usage-based services in the period the service is rendered. We generally invoice our customers for usage-based services on a monthly basis for services rendered in the preceding month. Revenue from usage-based services is impacted by the change in the number and type of our customers, the size and needs of our customers' businesses, and the level of adoption and utilization of our Value+ usage-based services by new and existing customers. In 2016, we began offering Premium Leads as a Value+ service to our property manager customers. The usage-based fees derived from Premium Leads are included in Value+ services.

We also offer our customers assistance with on-boarding our core solutions, as well as website design services. These services are generally purchased as part of a subscription agreement, and are typically performed within the first several months of the arrangement. We generally invoice our customers for other services in advance of the services being completed. We recognize revenue for these other services upon completion of the related service. We also generate revenue from RentLinx customers by providing services that allow their customers to advertise rental houses and apartments online. Revenue derived from customers using the RentLinx services outside of our property manager platform that are currently not subscribing to our core solution is being recorded under other services.

Costs and Operating Expenses

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

Sales and Marketing. Sales and marketing expense consists of personnel-related costs (including salaries, sales commissions, incentive-based compensation, benefits, and stock-based compensation) for our employees focused on sales and marketing, costs associated with sales and marketing activities, and allocated shared costs. Marketing activities include advertising,

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

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

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

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

Interest Income (Expense). Interest expense includes interest paid on outstanding borrowings under our Credit Agreement. Interest income includes interest earned on investment securities, amortization and accretion of the premium and discounts paid from the purchase of investment securities, notes receivable and on cash deposited within our bank accounts.

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Results of Operations

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2016		2015		2016		2015	
	Amount	%	Amount	%	Amount	%	Amount	%
Consolidated Statements of Operations Data:								
Revenue	$26,203	100 %	$18,425	100 %	$49,414	100 %	$34,273	100 %
Costs and operating expenses:								
Cost of revenue (exclusive of depreciation and amortization) (1)	11,212	43	8,109	44	21,742	44	15,174	44
Sales and marketing (1)	7,567	29	6,239	34	15,118	31	11,948	35
Research and product development (1)	3,024	12	2,154	12	6,067	12	4,163	12
General and administrative (1)	4,389	17	3,707	20	7,938	16	7,099	21
Depreciation and amortization	2,359	9	1,431	8	4,476	9	2,614	8
Total costs and operating expenses	28,551	109	21,640	117	55,341	112	40,998	120
Operating loss	(2,348)	(9)	(3,215)	(17)	(5,927)			