

APPFOLIO INC
Form 10-Q
May 02, 2019
Table of Contents

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

FORM 10-Q
(Mark one)

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

For the quarterly period ended March 31, 2019.

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 NO

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer

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

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.

Edgar Filing: APPFOLIO INC - Form 10-Q

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

Table of Contents

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Class A Common Stock, \$0.0001 par value	APPF	NASDAQ Global Market

As of April 25, 2019, the number of shares of the registrant's Class A common stock outstanding was 15,944,323 and the number of shares of the registrant's Class B common stock outstanding was 18,061,471.

Table of Contents

TABLE OF CONTENTS

Section	Page No.
<u>Cautionary Note Regarding Forward-Looking Statements</u>	<u>1</u>
<u>Part I. Financial Information</u>	<u>2</u>
<u>Item 1. Condensed Consolidated Financial Statements (Unaudited)</u>	<u>2</u>
<u>Condensed Consolidated Balance Sheets as of March 31, 2019 and December 31, 2018</u>	<u>2</u>
<u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2019 and 2018</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2019 and 2018</u>	<u>4</u>
<u>Condensed Consolidated Statements of Stockholders' Equity for the Three Months Ended March 31, 2019 and 2018</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2019 and 2018</u>	<u>6</u>
<u>Notes to Condensed Consolidated Unaudited Financial Statements</u>	<u>8</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>24</u>
<u>Item 3. Qualitative and Quantitative Disclosure about Market Risk</u>	<u>34</u>
<u>Item 4. Controls and Procedures</u>	<u>35</u>
<u>Part II. Other Information</u>	<u>36</u>
<u>Item 1. Legal Proceedings</u>	<u>36</u>
<u>Item 1A. Risk Factors</u>	<u>36</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>57</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>57</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>57</u>
<u>Item 5. Other Information</u>	<u>57</u>
<u>Item 6. Exhibits</u>	<u>58</u>
<u>Signatures</u>	
<u>Exhibit Index</u>	

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2019 (this "Quarterly Report"), includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (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. Forward-looking statements also include the assumptions underlying or relating to such statements. In particular, forward-looking statements contained in this Quarterly Report relate to, among other things, our future or assumed financial condition, results of operations and liquidity, business forecasts and plans, certain trends affecting our business and industry, capital needs and financing plans, capital resource allocation plans, potential repurchase of our shares, research and product development plans, future products and Value+ services, growth in the size of our business and number of customers, strategic plans and objectives, the impact of acquisitions and investments, changes in the competitive environment, the outcome of legal proceedings or regulatory matters, 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.

Our forward-looking statements are based on our management's current beliefs, assumptions and expectations about future events and trends, which affect or may affect our business, strategy, operations or financial performance. Although we believe these forward-looking statements are based upon reasonable assumptions, they are subject to numerous known and unknown risks and uncertainties and are made in light of information currently available to us. Our actual financial condition and results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed in the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Quarterly Report and in the section entitled "Risk Factors" of this Quarterly Report and in our Annual Report on form 10-K for the fiscal year ended December 31, 2018 (our "Annual Report"), as well as in the other reports we file with the Securities and Exchange Commission (the "SEC"). You should read this Quarterly Report, and the other documents that we have filed with the SEC, with the understanding that our actual future results may be materially different from the results expressed or implied by these forward-looking statements.

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

Forward-looking statements speak only as of the date they were made, and, except to the extent required by law or the rules of the NASDAQ Global Market, we undertake no obligation to update or review any forward-looking statement because of new information, future events or other factors.

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

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

APPFOLIO, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except par values)

	March 31, 2019	December 31, 2018
Assets		
Current assets		
Cash and cash equivalents	\$ 16,783	\$ 74,076
Investment securities—current	17,712	16,631
Accounts receivable, net	7,966	5,516
Prepaid expenses and other current assets	15,086	11,775
Total current assets	57,547	107,998
Investment securities—noncurrent	6,300	11,256
Property and equipment, net	7,169	6,871
Operating lease right-of-use assets	16,004	—
Capitalized software, net	22,396	20,485
Goodwill	57,496	15,548
Intangible assets, net	26,644	5,895
Other long-term assets	7,026	7,688
Total assets	\$ 200,582	\$ 175,741
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 1,557	\$ 1,481
Accrued employee expenses	10,795	12,377
Accrued expenses	9,450	8,281
Deferred revenue	4,045	3,414
Other current liabilities	11,099	1,447
Long-term debt, net—current portion	1,213	1,213
Total current liabilities	38,159	28,213
Operating lease liabilities	19,064	—
Long-term debt, net	48,290	48,602
Other long-term liabilities	14	7,080
Total liabilities	105,527	83,895
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, \$0.0001 par value, 25,000 authorized and no shares issued and outstanding at March 31, 2019 and December 31, 2018	—	—
Class A common stock, \$0.0001 par value, 250,000 shares authorized at March 31, 2019 and December 31, 2018; issued - 16,269 and 16,159, shares at March 31, 2019 and December 31, 2018; outstanding - 15,899 and 15,789 shares at March 31, 2019 and December 31, 2018, respectively;	2	2
Class B common stock, \$0.0001 par value, 50,000 shares authorized at March 31, 2019 and December 31, 2018; 18,071 and 18,109 shares issued and outstanding at March 31, 2019 and December 31, 2018, respectively;	2	2

Edgar Filing: APPFOLIO INC - Form 10-Q

Additional paid-in capital	157,253	157,898
Accumulated other comprehensive loss	(49)	(178)
Treasury stock, at cost, 370 Class A shares at March 31, 2019 and December 31, 2018	(21,562)	(21,562)
Accumulated deficit	(40,591)	(44,316)
Total stockholders' equity	95,055	91,846
Total liabilities and stockholders' equity	\$200,582	\$ 175,741

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

Table of Contents

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

	Three Months Ended March 31,	
	2019	2018
Revenue	\$57,091	\$42,340
Costs and operating expenses:		
Cost of revenue (exclusive of depreciation and amortization)	24,181	16,613
Sales and marketing	11,219	7,405
Research and product development	8,481	5,333
General and administrative	8,192	5,316
Depreciation and amortization	5,076	3,500
Total costs and operating expenses	57,149	38,167
Income (loss) from operations	(58)	4,173
Other expense, net	(1)	(3)
Interest income (expense), net	(497)	176
Income (loss) before provision for (benefit from) income taxes	(556)	4,346
Provision for (benefit from) income taxes	(4,281)	26
Net income	\$3,725	\$4,320
Net income per common share:		
Basic	\$0.11	\$0.13
Diluted	\$0.11	\$0.12
Weighted average common shares outstanding:		
Basic	33,913	34,070
Diluted	35,342	35,300

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

Table of Contents

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

	Three Months Ended March 31,	
	2019	2018
Net income	\$3,725	\$4,320
Other comprehensive income (loss):		
Changes in unrealized gains (losses) on investment securities	129	(148)
Comprehensive income	\$3,854	\$4,172

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

Table of Contents

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	Treasury Stock	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount					
Balance at December 31, 2017	14,879	\$ 1	19,102	\$ 3	\$152,531	\$ (209)	\$—	\$ (67,247)	\$85,079
Exercise of stock options	98	—	—	—	470	—	—	—	470
Stock-based compensation	—	—	—	—	1,495	—	—	—	1,495
Vesting of restricted stock units, net of shares withheld for taxes	68	—	—	—	(1,650)	—	—	—	(1,650)
Vesting of early exercised shares	—	—	—	—	9	—	—	—	9
Conversion of Class B stock to Class A stock	47	—	(47)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	—	(148)	—	—	(148)
Cumulative-effect adjustment resulting from adoption of ASU 2014-09	—	—	—	—	—	—	—	2,964	2,964
Net income	—	—	—	—	—	—	—	4,320	4,320
Balance at March 31, 2018	15,092	\$ 1	19,055	\$ 3	\$152,855	\$ (357)	\$—	\$ (59,963)	\$92,539

	Common Stock Class A		Common Stock Class B		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Treasury Stock	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount					
Balance at December 31, 2018	15,789	\$ 2	18,109	\$ 2	\$157,898	\$ (178)	\$(21,562)	\$(44,316)	\$91,846
Exercise of stock options	14	—	—	—	90	—	—	—	90
Stock-based compensation	—	—	—	—	1,831	—	—	—	1,831
Vesting of restricted stock units, net of shares withheld for taxes	58	—	—	—	(2,572)	—	—	—	(2,572)
Vesting of early exercised shares	—	—	—	—	6	—	—	—	6
	38	—	(38)	—	—	—	—	—	—

Edgar Filing: APPFOLIO INC - Form 10-Q

Conversion of Class B stock
to Class A stock

Other comprehensive income	—	—	—	—	—	129	—	—	129
Net income	—	—	—	—	—	—	—	3,725	3,725
Balance at March 31, 2019	15,899	\$ 2	18,071	\$ 2	\$157,253	\$ (49)	\$(21,562)	\$(40,591)	\$95,055

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

Table of Contents

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

	Three Months Ended March 31,	
	2019	2018
Cash from operating activities		
Net income	\$3,725	\$4,320
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,076	3,500
Stock-based compensation	1,552	1,318
Deferred income taxes	(4,281)	—
Other	27	79
Changes in operating assets and liabilities:		
Accounts receivable	(2,051)	(1,148)
Prepaid expenses and other current assets	(3,340)	441
Other long-term assets	1,365	(766)
Accounts payable	100	415
Accrued employee expenses	(2,867)	(3,842)
Accrued expenses	1,580	611
Deferred revenue	268	(1,334)
Other long-term liabilities	(859)	(252)
Net cash provided by operating activities	295	3,342
Cash from investing activities		
Purchases of property and equipment	(1,030)	(263)
Additions to capitalized software	(4,658)	(2,936)
Purchases of investment securities	—	(15,573)
Sales of investment securities	1,750	5
Maturities of investment securities	2,250	8,296
Acquisition, net of cash acquired	(54,004)	—
Net cash used in investing activities	(55,692)	(10,471)
Cash from financing activities		
Proceeds from stock option exercises	90	470
Tax withholding for net share settlement	(1,315)	(901)
Proceeds from issuance of debt	597	32
Principal payments on debt	(909)	(32)
Payment of debt issuance costs	(360)	—
Net cash used in financing activities	(1,897)	(431)
Net decrease in cash, cash equivalents and restricted cash	(57,294)	(7,560)
Cash, cash equivalents and restricted cash		
Beginning of period	74,506	16,537
End of period	\$17,212	\$8,977

Table of Contents

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

	Three Months Ended March 31, 2019 2018	
Noncash investing and financing activities		
Purchases of property and equipment included in accounts payable and accrued expenses	\$445	\$114
Additions of capitalized software included in accrued and accrued employee expenses	391	243
Stock-based compensation capitalized for software development	338	235
Tax withholding for net share settlement included in accrued employee expenses	1,258	749
Purchase consideration for acquisitions included in other current liabilities	6,000	—

The following table presents a reconciliation of cash, cash equivalents and restricted cash reported within the Condensed Consolidated Balance Sheets to the total of the same such amounts shown above (in thousands):

	March 31,	
	2019	2018
Cash and cash equivalents	\$16,783	\$8,549
Restricted cash included in other assets	429	428
Total cash, cash equivalents and restricted cash	\$17,212	\$8,977

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

Table of Contents

APPFOLIO, INC.

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

1. Nature of Business

AppFolio, Inc. ("we," "us" or "our") provides industry-specific, cloud-based business software solutions, services and data analytics to the real estate market, which comprises a significant majority of our revenue, and, to a lesser extent, to the legal market. Our mission is to revolutionize vertical industry businesses by providing great software and services. We believe we accomplish this mission by providing our customers with a system of record to automate essential business processes, a system of engagement to enhance business interactions between our customers and their clients and other stakeholders, and a system of intelligence designed to leverage data to predict and optimize business workflows in order to enable superior customer experiences and increase efficiency across our customers' businesses. Customers in our real estate market directly and indirectly account for more than 90% of our annual revenue. Real estate customers include third-party property managers, owner-operators and real estate investment managers who manage and/or invest in single- and multi-family residences, commercial properties, community associations, student housing, as well as mixed real estate portfolios. Our legal customers are typically small law firms that directly and indirectly account for less than 10% of our annual revenue.

Recent Developments

Acquisition of Dynasty Marketplace, Inc.

On January 7, 2019, we completed the acquisition of Dynasty Marketplace, Inc. ("Dynasty"), a provider of advanced artificial intelligence ("AI") solutions for the real estate market. Dynasty offers advanced conversational AI solutions that automate leasing communications, replace manual tasks and help customers grow their portfolios. Dynasty's technology is designed to enable operational efficiency in the leasing process including consistent prospect experience, lead conversion, and improved market insights. For additional information regarding this acquisition, refer to Note 3, Business Combinations.

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 ("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 audited consolidated financial statements and the related notes included in our Annual Report filed with the Securities and Exchange Commission ("SEC") on February 28, 2019. The year-end condensed balance sheet was derived from our audited consolidated financial statements. Our unaudited interim Condensed Consolidated Financial Statements 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 months ended March 31, 2019 are not necessarily indicative of the results expected for the full year ending December 31, 2019.

Changes in Accounting Policies

On January 1, 2019, we adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-02, Leases (as amended, "ASU 2016-02" or the "new lease standard"), and have revised certain related accounting policies as follows:

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use ("ROU") assets, other current liabilities, and operating lease liabilities on our Condensed Consolidated Balance Sheets. Operating lease ROU assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. As none of our leases provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining

the present value of future payments. The operating lease ROU assets also include any lease payments made and excludes lease incentives and initial direct costs incurred. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option.

Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term. We have lease arrangements with lease and non-lease components, which are generally accounted for as a single lease component. Leases with

8

Table of Contents

an initial term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term.

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

Net Income per Common Share

The net income per common share was the same for shares of our Class A and Class B common stock because they are entitled to the same liquidation and dividend rights and are therefore combined in the table below. The following table presents a reconciliation of our weighted average number of shares of our Class A and Class B common stock used to compute net income per common share (in thousands):

	Three Months Ended	
	March 31, 2019	March 31, 2018
Weighted average common shares outstanding	33,918	34,085
Less: Weighted average unvested restricted shares subject to repurchase	5	15
Weighted average common shares outstanding; basic	33,913	34,070
Plus: Weighted average options, restricted stock units and restricted shares used to compute diluted net income per common share	1,429	1,230
Weighted average common shares outstanding; diluted	35,342	35,300

For the three months ended March 31, 2019 and 2018, an aggregate of approximately 362,000 and 607,000 shares, respectively, underlying performance based options ("PSOs") and performance based restricted stock units ("PSUs"), are not included in the computations of diluted and anti-dilutive shares as they are considered contingently issuable upon the satisfaction of pre-defined performance measures and their respective performance measures have not been met.

The following table presents the number of anti-dilutive common shares excluded from the calculation of weighted average number of shares used to compute diluted net income per common share for the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended March 31, 2019		2018	
Unvested restricted stock units	24	16		
Contingent restricted stock units ⁽¹⁾	—	6		
Total shares excluded from diluted net income per common share	24	22		

⁽¹⁾ The reported shares are based on fixed price restricted stock unit ("RSU") commitments for which the number of shares was not determined at the grant date. For the purposes of this table, the number of shares has been determined by dividing the fixed price commitment to issue shares in the future by the closing price of our common stock as of the applicable reporting period date.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, which requires an entity 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. In July 2018, the FASB issued ASU No. 2018-11, Leases (Topic 842): Targeted Improvements ("ASU 2018-11"). Among other things, ASU 2018-11 provides administrative relief by allowing entities to implement the lease standard on a modified retrospective basis (the "Optional Transition Method"). Effectively, the Optional

Table of Contents

Transition Method permits us to adopt the lease standard through a cumulative effect adjustment to our opening balance sheet as of January 1, 2019, and report under the new lease standard on a post-adoption basis.

We adopted ASU 2016-02 effective January 1, 2019 using the Optional Transition Method. We elected the package of practical expedients permitted under the transition guidance, which allows us to carry forward our historical lease classification, our assessment of whether a contract is or contains a lease, and our initial direct costs for any leases that existed prior to adoption of the lease new standard. We also elected to combine lease and non-lease components and to keep leases with an initial term of 12 months or less off the balance sheet and recognize the associated lease payments in the Consolidated Statements of Operations on a straight-line basis over the lease term. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. We updated our accounting policies, processes, internal controls and information systems that were required to meet the new lease standard's reporting and disclosure requirements.

The adoption of ASU 2016-02 had a material impact on our Condensed Consolidated Balance Sheets, but did not have an impact on our Condensed Consolidated Statements of Operations or our Condensed Consolidated Statements of Cash Flows. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases. We also reclassified prepaid and deferred rent to the ROU asset balance as of January 1, 2019.

The cumulative effect of the changes made to our Condensed Consolidated Balance Sheet at January 1, 2019 for the adoption of the new lease standard was as follows (in thousands):

	Balance at December 31, 2018	Adjustments	Balance at January 1, 2019
Assets			
Prepaid expenses and other current assets	\$ 11,775	\$ (317)	\$ 11,458
Operating lease right-of-use assets	—	16,945	16,945
Liabilities and Stockholders' Equity			
Other current liabilities	\$ 1,447	\$ 3,493	\$ 4,940
Operating lease liabilities	—	20,056	20,056
Other long-term liabilities	7,080	(6,921)	159

In March 2017, the FASB issued ASU No. 2017-08, Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities ("ASU 2017-08"). ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium. Specifically, ASU 2017-08 requires the premium to be amortized to the earliest call date. ASU 2017-08 does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments should be applied on a modified retrospective basis, with a cumulative-effect adjustment made directly to retained earnings at the beginning of the period of adoption. The adoption of this guidance did not have a material impact on our financial condition, results of operations, cash flows or disclosures.

In June 2018, the FASB issued ASU No. 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting ("ASU 2018-07"). This amendment expands the scope of Topic 718, Compensation—Stock Compensation (which only included share-based payments to employees) to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. The adoption of this guidance did not have a material impact on our financial condition, results of operations, cash flows or disclosures.

Recent Accounting Pronouncements Not Yet Adopted

In June 2016, the 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 the measurement of 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 investment 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 are currently evaluating the effect of the adoption of ASU 2016-13 on our Consolidated Financial Statements. The effect will largely depend on the composition and credit quality of our investment portfolio and the economic conditions at the time of adoption.

Table of Contents

In August 2018, the FASB issued ASU No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, a series of amendments which align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by these amendments. For public business entities, the amendments are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2019. We have not yet determined the effect of this guidance on our financial condition, results of operations, cash flows or disclosures.

3. Business Combinations

Acquisition of Dynasty

On January 7, 2019, we acquired 100% of the voting equity interest of Dynasty, a provider of advanced artificial intelligence ("AI") solutions for the real estate market. Dynasty offers advanced conversational AI solutions that automate leasing communications, replace manual tasks and help customers grow their portfolios. Dynasty’s technology is designed to enable operational efficiency in the leasing process including consistent prospect experience, lead conversion, and improved market insights.

The total purchase consideration was \$60.2 million, subject to certain adjustments, of which \$6.0 million (the "Holdback Amount") was retained by the Company to satisfy any such adjustments, including without limitation certain indemnification claims. The balance of the Holdback Amount, less any amount retained (the "Retained Amount") with respect to any unresolved indemnification claims (each, an "Unresolved Claim"), will be released to the stockholders of Dynasty, within three business days after the one-year anniversary of the Closing Date (the "Holdback Release Date"). If an Unresolved Claim is finally resolved after the Holdback Release Date, then, within three business days after the final resolution of such Unresolved Claim, the balance of the Retained Amount after satisfying such Unresolved Claim, less any amounts associated with all remaining Unresolved Claims, will be released to the Stockholders. The Holdback Amount is recorded in other current liabilities on the Condensed Consolidated Balance Sheet as of March 31, 2019.

The transaction was accounted for using the acquisition method, and as a result, assets acquired and liabilities assumed were recorded at their estimated fair values as of the acquisition date. We are in the process of finalizing the valuation of the assets. The following table summarizes the preliminary purchase price allocation (in thousands) as well as the estimated useful lives of the acquired intangible assets over which they are amortized on a straight-line basis, as this approximates the pattern in which economic benefits are consumed:

Table of Contents

	Amount (in thousands)	Estimated Useful Life (in years)
Total current assets	\$ 305	
Identified intangible assets:		
Technology	7,450	4.0
Database	4,710	10.0
Customer relationships	1,110	5.0
Backlog	100	1.0
Trademark & trade name	1,390	10.0
Non-compete agreement	7,340	5.0
Total intangible assets subject to amortization	22,100	6.0
Goodwill	41,948	Indefinite
Other noncurrent assets	35	
Total assets acquired	64,388	
Accrued and other liabilities	48	
Deferred tax liability, net	4,109	
Total liabilities assumed	4,157	
Purchase consideration	\$ 60,231	

Goodwill is mainly attributable to synergies expected from the acquisition and assembled workforce and is non-deductible for U.S. federal income tax purposes.

We incurred a total of \$291,000 in transaction costs related to the acquisition and expensed all transaction costs incurred during the period in which such service was received. The results of operations of Dynasty since the acquisition are included in our Condensed Consolidated Statements of Operations for the three months ended March 31, 2019. Revenue and net loss attributable to Dynasty, in the period from the acquisition date of January 7, 2019 through March 31, 2019, was \$0.5 million and \$1.9 million, respectively.

Acquisition of WegoWise

On August 31, 2018, we completed the acquisition of substantially all of the assets of WegoWise, Inc. ("WegoWise"), a provider of cloud-based utility analytics software solutions serving the real estate market. The WegoWise platform empowers building owners and third-party property managers to better manage operating and capital expenditures relating to utilities, and we expect that the acquisition will provide enhanced functionality to our real estate customers over time, such as a future utility analytics and management Value+ services.

The consideration paid in cash for the assets was \$14.4 million, of which \$2.0 million will be held in escrow for 12 months to satisfy WegoWise's indemnity obligations.

The transaction was accounted for using the acquisition method, and as a result, assets acquired and liabilities assumed were recorded at their estimated fair values as of the acquisition date. The following table summarizes the final purchase price allocation (in thousands) as well as the estimated useful lives of the acquired intangible assets over which they are amortized on a straight-line basis, as this approximates the pattern in which economic benefits are consumed:

Table of Contents

	Amount (in thousands)	Estimated Useful Life (in years)
Net tangible assets	\$ 270	
Identified intangible assets:		
Customer relationships	1,170	5.0
Database	3,620	10.0
Trademark and trade name	370	10.0
Non-compete agreement	60	5.0
Backlog	140	1.0
Total intangible assets subject to amortization	5,360	8.6
Goodwill	8,811	Indefinite
Purchase consideration, paid in cash	\$ 14,441	

Goodwill is mainly attributable to synergies expected from the acquisition and assembled workforce and is deductible for U.S. federal income tax purposes.

We incurred a total of \$240,000 in transaction costs related to the acquisition and expensed all transaction costs incurred during the period in which such service was received.

Pro Forma Results of Acquisitions

The following unaudited pro forma information has been prepared for illustrative purposes only, and assumes that the aforementioned Dynasty and WegoWise acquisitions occurred on January 1, 2018 and January 1, 2017, respectively, and includes pro forma adjustments related to the amortization of acquired intangible assets, elimination of historical interest and amortization expense, income taxes, compensation arrangements, and the transaction costs incurred. The unaudited pro forma results have been prepared based on estimates and assumptions, which we believe are reasonable; however, they are not necessarily indicative of the consolidated results of operations had the acquisitions occurred at the beginning of the periods presented, or of future results of operations. The unaudited pro forma results are as follows (in thousands):

	Three Months Ended March 31, 2019 2018	
Revenue	\$57,126	\$43,058
Net income (loss)	\$(546)	\$4,798
Net income (loss) per common share:		
Basic	\$(0.02)	\$0.14
Diluted	\$(0.02)	\$0.14

Table of Contents

4. Investment Securities and Fair Value Measurements

Investment Securities

Investment securities classified as available-for-sale consisted of the following at March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	\$19,711	\$ 19	\$ (66)	\$ 19,664
Agency securities	4,350	8	(10)	4,348
Total available-for-sale investment securities	\$24,061	\$ 27	\$ (76)	\$ 24,012
	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	\$23,720	\$ —	\$ (163)	\$ 23,557
Agency securities	4,345	4	(19)	4,330
Total available-for-sale investment securities	\$28,065	\$ 4	\$ (182)	\$ 27,887

At March 31, 2019, the unrealized losses on investment securities which have been in a net loss position for 12 months or greater were not material. These unrealized losses are considered temporary and there were no impairments considered to be "other-than-temporary" based on our evaluation of available evidence, which includes our intent to hold these investments to maturity or until a recovery of the cost basis.

At March 31, 2019 and December 31, 2018, the contractual maturities of our investments did not exceed 36 months. The fair values of available-for-sale investment securities, by remaining contractual maturity, are as follows (in thousands):

	March 31, 2019		December 31, 2018	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$17,761	\$ 17,712	\$16,738	\$ 16,631
Due after one year through three years	6,300	6,300	11,327	11,256
Total available-for-sale investment securities	\$24,061	\$ 24,012	\$28,065	\$ 27,887

Table of Contents

During the three months ended March 31, 2019 and 2018, we had sales and maturities (which include calls) of investment securities, as follows (in thousands):

Three Months Ended March 31,
2019

	Gross Realized Gains	Gross Proceeds from Sales	Gross Proceeds from Maturities
Corporate bonds	\$ (1)	\$ 1,750	\$ 2,250

Three Months Ended March 31,
2018

	Gross Realized Gains	Gross Proceeds from Sales	Gross Proceeds from Maturities
Corporate bonds	\$—	—	\$ 6,300
Agency securities	—	—	1,000
Certificates of deposit	—	—	996
Treasury securities	—	5	—
	\$—	—\$ 5	\$ 8,296

Interest income, net of the amortization and accretion of the premium and discount was \$0.2 million for the three months ended March 31, 2019 and 2018.

Fair Value Measurements

Recurring Fair Value Measurements

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. The following tables summarize our financial assets measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018 by level within the fair value hierarchy (in thousands):

	March 31, 2019			Total Fair Value
	Level 1	Level 2	Level 3	
Cash equivalents:				
Money market funds	\$2,617	\$—	\$—	—\$ 2,617
Available-for-sale investment securities:				
Corporate bonds	—	19,664	—	19,664
Agency securities	—	4,348	—	4,348
Total	\$2,617	\$24,012	\$—	—\$ 26,629
	December 31, 2018			
	Level 1	Level 2	Level 3	Total Fair Value
Cash equivalents:				
Money market funds	\$10,694	\$—	\$—	—\$ 10,694
Available-for-sale investment securities:				
Corporate bonds	—	23,557	—	23,557
Agency securities	—	4,330	—	4,330
Total	\$10,694	\$27,887	\$—	—\$ 38,581

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.

Table of Contents

The estimated fair value of the Term Loan approximates its carrying value due to the variable interest rates. We consider the fair value of the Term Loan to be a Level 2 measurement as the Term Loan is not actively traded. We carry the Term Loan at face value less the unamortized discount on our Consolidated Balance Sheets. Refer to Note 8, Long-term Debt of our Condensed Consolidated Financial Statements for more information about the Term Loan. There were no changes to our valuation techniques used to measure financial asset and financial liability fair values on a recurring basis during the three months ended March 31, 2019. The valuation techniques for the financial assets in the tables above are as follows:

Cash Equivalents

As of March 31, 2019 and December 31, 2018, cash equivalents include cash invested in money market funds. Fair value is based on market prices for identical assets.

Available-for-Sale Investment Securities

Our Level 2 securities were priced by a pricing vendor. The pricing vendor utilizes the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, use of other observable inputs like market transactions involving comparable securities. The fair value of our certificates of deposit is based on market prices for identical assets.

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, but only when they are deemed to be impaired as a result of an impairment review. For the three months ended March 31, 2019 and 2018, no impairments were identified on those assets required to be measured at fair value on a non-recurring basis.

5. Internal-Use Software Development Costs

Internal-use software development costs as of March 31, 2019 and December 31, 2018 were as follows (in thousands):

	March 31, December 31,	
	2019	2018
Internal use software development costs, gross	\$ 63,189	\$ 58,237
Less: Accumulated amortization	(40,793)	(37,752)
Internal use software development costs, net	\$ 22,396	\$ 20,485

Capitalized software development costs for the three months ended March 31, 2019 and 2018 were \$5.0 million and \$3.0 million, respectively. Amortization expense with respect to software development costs totaled \$3.0 million and \$2.6 million for the three months ended March 31, 2019 and 2018, respectively.

Future amortization expense with respect to capitalized software development costs as of March 31, 2019 is estimated as follows (in thousands):

Years Ending December 31,	
2019	\$8,847
2020	8,498
2021	4,603
2022	448
Total amortization expense	\$22,396

Table of Contents

6. Intangible Assets and Goodwill

Intangible assets consisted of the following as of March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019			Weighted
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Average Useful Life in Years
Customer relationships	\$3,070	\$ (870)	\$ 2,200	5.0
Database	8,330	(329)	8,001	10.0
Technology	12,261	(5,006)	7,255	5.0
Trademarks and trade names	2,690	(706)	1,984	10.0
Partner relationships	680	(680)	—	3.0
Non-compete agreements	7,440	(414)	7,026	5.0
Domain names	273	(273)	—	5.0
Patents	285	(240)	45	5.0
Backlog	240	(107)	133	1.0
	\$35,269	\$ (8,625)	\$ 26,644	6.4

	December 31, 2018			Weighted Average Useful Life in Years
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	
Customer relationships	\$1,960	\$ (728)	\$ 1,232	5.0
Database	3,620	(121)	3,499	10.0
Technology	4,811	(4,506)	305	8.0
Trademarks & trade names	1,300	(642)	658	9.0
Partner relationships	680	(680)	—	3.0
Non-compete agreements	100	(44)	56	4.0
Domain names	273	(273)	—	5.0
Patents	285	(233)	52	5.0
Backlog	140	(47)	93	1.0
	\$13,169	\$ (7,274)	\$ 5,895	7.0

Amortization expense with respect to intangible assets for the three months ended March 31, 2019 and 2018 was \$1.4 million and \$0.3 million, respectively.

Future amortization expense with respect to intangible assets as of March 31, 2019 is estimated as follows (in thousands):

Years Ending December 31,	
2019	\$4,003
2020	5,066
2021	4,931
2022	4,869
2023	2,863
Thereafter	4,912
Total amortization expense	\$26,644

Our goodwill balance is solely attributable to acquisitions. There have been no impairment charges recorded against goodwill. Goodwill recorded during the three months ended March 31, 2019 related to the acquisition of Dynasty was allocated

Table of Contents

to our one operating segment. The change in the carrying amount of goodwill is as follows (in thousands):

Goodwill at December 31, 2018	\$15,548
Goodwill from acquisition of Dynasty	41,948
Goodwill at March 31, 2019	\$57,496

7. Leases

We have operating leases for our corporate offices and data centers. Our leases have remaining lease terms ranging from one to nine years, with various term extensions available. Our lease agreements do not contain any residual value guarantees or material restrictive covenants. Leases with an initial term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term. The total lease cost associated with our operating leases for the three months ended March 31, 2019 was \$1.2 million.

Lease-related assets and liabilities were as follows at March 31, 2019 (in thousands):

Assets	
Operating lease right-of-use assets	\$16,004
Liabilities	
Other current liabilities	\$4,013
Operating lease liabilities	19,064
Total lease liabilities	\$23,077

Weighted-average remaining lease term (years)	6.6	
Weighted-average discount rate	4.1	%

Supplemental cash flow information related to leases was as follows for the three months ended March 31, 2019 (in thousands):

Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$970

Future minimum lease payments under non-cancellable leases as of March 31, 2019 were as follows (in thousands):

Years ending December 31,	
2019	\$3,677
2020	5,171
2021	4,048
2022	2,717
2023	2,053
Thereafter	9,128
Total future minimum lease payments	26,794
Less: imputed interest	(3,717)
Total	\$23,077

Table of Contents

A summary of our future minimum payments for obligations under non-cancellable operating leases as of December 31, 2018 was as follows (in thousands):

Years Ending December 31,	
2019	\$4,211
2020	4,889
2021	4,038
2022	2,717
2023	2,053
Thereafter	9,128
Total lease commitments	\$27,036

At March 31, 2019 we have additional leases that have not yet commenced with a total commitment of \$0.7 million. These leases will commence in 2019 with lease terms of two to three years.

On January 22, 2019, we signed a new sublease for approximately 10,500 square feet of office space located at 130 Castilian Drive, Santa Barbara, California. The sublease is for 32 months commencing on April 1, 2019 and ending on February 28, 2021. The total commitment under this sublease is \$0.45 million.

On January 28, 2019, we signed an amendment to our existing lease at 9201 Spectrum Center Boulevard in San Diego, California which increased the square footage leased by approximately 4,500 square feet. The total commitment under this lease extension is \$0.7 million. All other terms and conditions from the original lease remain the same.

On April 1, 2019, we signed a new lease with Rose Studios, LLC to lease approximately 5,000 square feet of office space located at 215-221 Rose Avenue, Venice, California. The lease is for a five-year term commencing August 1, 2019 and ending on July 31, 2024. The total commitment under this lease is \$2.0 million.

8. Long-Term Debt

The following is a summary of our long-term debt at March 31, 2019 (in thousands):

Principal amounts due under term loan	\$49,688
Less: Debt financing costs	(185)
Long-term debt, net of unamortized debt financing costs	49,503
Less: Current portion of long-term debt	(1,213)
Total long-term debt, net of current portion	\$48,290

Scheduled principal payments for the Term Loan at March 31, 2019 are as follows (in thousands):

Years Ending December 31,	
2019	\$938
2020	1,250
2021	2,500
2022	2,500
2023	42,500
Total principal payments	\$49,688

Credit Agreement

On December 24, 2018, we amended our credit agreement (Amendment Number Two to the Credit Agreement, or "Second Amendment") with Wells Fargo Bank, National Association ("Wells Fargo"), as administrative agent, and the lenders that are parties thereto (as amended, the "Credit Agreement"). Under the terms of the Second Amendment, the lenders made available to us a \$50.0 million term loan (the "Term Loan") and increased the existing revolving line of credit from \$25.0 million to \$50.0

Table of Contents

million ("Revolving Credit Agreement"). The maturity date of the Term Loan and Revolving Facility is December 24, 2023. In addition, the Second Amendment permits us to make certain restricted junior payments, including without limitation stock repurchases and enter into acquisitions in which we are the purchaser ("Acquisitions"), with no dollar cap on such Acquisitions, so long as we maintain certain specified liquidity requirements and leverage ratios.

The Second Amendment also modifies certain financial covenants by, among other things, requiring us to maintain (i) an EBITDA to interest expense ratio of not less than 3.0 to 1.0, and (ii) a funded indebtedness to EBITDA ratio of not more than 3.5:1.0 (the "Required Leverage Ratio") (decreasing by 0.25 per year until the Required Leverage Ratio is 2.5 to 1.0); provided, however, that we are not required to maintain the foregoing ratios if our liquidity (sum of remaining borrowing capacity and available cash) has equaled or exceeded the greater of \$20.0 million and 20% of the sum of the outstanding principal amount of the Term Loan and commitments under the Revolving Facility. If we enter into an Acquisition with a purchase price greater than or equal to \$20.0 million, then the Required Leverage Ratio will be increased by 0.5 for the 12-month period immediately following the consummation of such Acquisition.

The Credit Agreement contains customary affirmative, negative and financial covenants. The affirmative covenants require us to, among other things, disclose financial and other information to the lenders, maintain our business and properties, and maintain adequate insurance. The negative covenants restrict us from, among other things, incurring additional indebtedness, prepaying certain types of indebtedness, encumbering or disposing of our assets, making fundamental changes to our corporate structure, and making certain dividends and distributions. At March 31, 2019, we were in compliance with the financial covenants under the Credit Agreement.

Under the terms of the Second Amendment, borrowings under the Credit Agreement bear interest at a fluctuating rate per annum equal to, at our option, (i) the adjusted London Interbank Offered Rate ("LIBOR") or (ii) an alternate base rate, in each case plus the applicable interest rate margin. The interest rate will fluctuate between adjusted LIBOR plus 1.5% per annum and adjusted LIBOR plus 2.0% per annum (or between the alternate base rate plus 0.5% per annum and the alternate base rate plus 1.0% per annum), based upon our leverage ratio. The average interest rate during the three months ended March 31, 2019 was 4.4%.

Fees payable on the unused portion of the Revolving Facility are 25 basis points per annum, unless the average usage of the Revolving Facility is equal to or less than \$30.0 million for the applicable period, in which case the fees on the unused portion of the Revolving Facility are 0.375% per annum.

At March 31, 2019 and December 31, 2018, there was no outstanding balance under the Revolving Facility.

Debt Financing Costs

As a result of the Second Amendment, we incurred \$0.4 million in financing fees that were capitalized and will be amortized over the remaining life of the related debt, \$0.2 million of which was related to the Term Loan and \$0.2 million of which was related to the Revolving Facility. The Second Amendment is accounted for as a debt modification, and as a result, the unamortized deferred debt financing costs related to the Revolving Facility prior to the Second Amendment were added to the \$0.2 million of deferred debt financing costs related to the Second Amendment and are amortized over the remaining life of the Revolving Facility.

Debt financing costs are deferred and amortized using the straight-line method, which approximates the effective interest method, for costs related to the Term Loan and the straight-line method for costs related to the Revolving Facility over the term of the debt arrangement; such amortization is included in interest expense in the Condensed Consolidated Statements of Operations. Amortization of deferred debt financing costs was \$24,000 and \$16,000 for the three months ended March 31, 2019 and 2018, respectively. At March 31, 2019 and December 31, 2018, the remaining unamortized deferred debt financing costs were \$0.5 million, of which \$0.2 million was offset against debt. At March 31, 2019 and December 31, 2018, \$0.3 million of the remaining unamortized deferred debt financing costs were recorded in Prepaid expenses and other current assets and Other assets on the Condensed Consolidated Balance Sheets, as they pertained to the Revolving Facility.

Table of Contents

9. Commitments and Contingencies

Legal Liability to Landlord Insurance

We have a wholly owned subsidiary, Terra Mar Insurance Company, Inc., which was established to provide our customers with the option to purchase legal liability to landlord insurance. If our customers choose to use this insurance service, 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 legal liability to landlord 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 all such claims. Our liability for reported claims and incurred but not reported claims as of March 31, 2019 and December 31, 2018 was \$0.7 million and \$0.6 million, respectively, and is included in Other current liabilities on the Condensed Consolidated Balance Sheets.

Included in Prepaid expenses and other current assets as of March 31, 2019 and December 31, 2018, are \$1.7 million and \$1.8 million, respectively, of deposits held with a third party related to requirements to maintain collateral for this insurance service.

Litigation

In December 2018, we received a Civil Investigative Demand ("CID") from the Federal Trade Commission ("FTC") requesting certain information relating to our compliance with the Fair Credit Reporting Act ("FCRA") in connection with our tenant screening Value+ service. We continue to fully cooperate with the FTC, and do not presently have sufficient information to predict the outcome of, or any potential costs or penalties associated with, the investigation. In September 2017, a putative federal class action styled *Leo v. AppFolio, Inc.* (Civ. No. 3:17-cv-05771; W.D. Wash.) was filed naming us as a defendant and alleging certain violations of the FCRA in connection with our tenant screening Value+ service (the "Leo Litigation"). The parties reached an agreement to settle the Leo Litigation on a class-wide basis in the fourth quarter of 2018. The court has approved the proposed settlement on a preliminary basis, and the parties continue to work through the class settlement process. We have not admitted and will not admit any liability whatsoever in connection with the claims and allegations in the Leo Litigation. The final settlement will be subject to court approval.

From time to time, we are involved in various other legal proceedings arising from or related to claims incident to the ordinary course of our business activities, including without limitation actions involving intellectual property, employment and contractual matters. Although the results of such legal proceedings and claims cannot be predicted with certainty, we believe that we are not currently a party to any legal proceeding(s) which, if determined adversely to us, would, individually or taken together, have a material adverse effect on our business, operating results, financial condition or cash flows.

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 and is indeterminable. We have never paid a material claim, nor have any legal claims been brought against us in connection with these indemnification arrangements. As of March 31, 2019 and December 31, 2018, we had not accrued a liability for these indemnification arrangements because we determined that the likelihood of incurring any payment obligation, in connection with these indemnification arrangements is not probable or reasonably possible and the amount or range of amounts of any such liability is not reasonably estimable.

10. Share Repurchase Program

On February 20, 2019, the Board of Directors authorized a \$100.0 million Share Repurchase Program (the "Program") of our outstanding Class A Common Stock. Under the Program, share repurchases may be made from time to time as directed by a Committee consisting of three Directors, in open market purchases or privately negotiated transactions at a repurchase price that the members of the Committee unanimously believe is below intrinsic value conservatively

determined. The Program does not obligate us to repurchase any specific dollar amount or number of shares, there is no expiration date to the Program, and it may be modified, suspended or terminated at any time and for any reason. We did not repurchase any Class A Common Stock under the Program during the three months ended March 31, 2019.

Table of Contents

11. Stock-Based Compensation

Stock Options

A summary of our stock option activity for the three months ended March 31, 2019, 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 at December 31, 2018	1,513	\$ 11.31	6.4
Options granted	—	—	
Options exercised	(14)	6.35	
Options cancelled/forfeited	(50)	13.43	
Options outstanding at March 31, 2019	1,449	\$ 11.29	6.3

Included in the options outstanding as of March 31, 2019 are 172,000 PSOs granted in 2017. Vesting of these PSOs is based on the achievement of pre-established performance targets for the year ending December 31, 2019 and continued employment throughout the performance period. Of these PSOs, 132,000 shares vest based on the achievement of a pre-established free cash flow performance target for the year ending December 31, 2019, assuming achievement of the performance metric at the maximum level, which is 150% of the performance target, resulting in a maximum payout of 100% of the initial target award. The remaining 40,000 PSOs have a pre-established adjusted gross margin target for the year ending December 31, 2019. PSOs tied to the gross margin performance target have two levels of vesting, with 50% vesting based on the achievement of 110% of the targeted amount and the remaining 50% vesting based on the achievement of 115% of the targeted amount.

During the three months ended March 31, 2019, 200,000 PSOs vested based on the achievement of 120% of the pre-established free cash flow performance target for the year ended December 31, 2018.

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. Our stock-based compensation expense for stock options, including the PSOs, for the three months ended March 31, 2019 and 2018, was \$0.2 million and \$0.3 million, respectively.

The fair value of stock options is estimated on their date of grant using the Black-Scholes option-pricing model. No stock options were granted during the three months ended March 31, 2019 or the three months ended March 31, 2018.

At March 31, 2019, the total estimated remaining stock-based compensation expense for unvested stock options, including the PSOs, was \$0.5 million, which is expected to be recognized over a weighted average period of 1.1 years.

Restricted Stock Units

A summary of activity in connection with our RSUs for the three months ended March 31, 2019 is as follows (number of shares in thousands):

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested at December 31, 2018	674	\$ 32.61
Granted	109	71.40
Vested	(93)	14.86
Forfeited	(14)	33.89
Unvested at March 31, 2019	676	\$ 41.26

During the three months ended March 31, 2019, we granted a total of 109,000 RSUs and PSUs: 99,000 RSUs are subject to time-based vesting in equal annual installments over four years; 4,000 PSUs vest based on the achievement of a pre-established consolidated net revenue growth target for the year ending December 31, 2021 and continued

employment throughout the performance period; and 6,000 PSUs were granted and vested as a result of the achievement of a pre-established free cash flow performance target for the year ended December 31, 2018. The number of PSUs granted, as included in the above table, assumes

Table of Contents

achievement of the performance metric at 100% of the performance target. The actual number of shares to be issued at the end of the performance period will range from 0% to 100% of the initial target awards. Achievement of the performance target between 100% and 150% of the performance target will result in a performance based cash bonus payment between 100% and 165% of the initial target awards.

During the three months ended March 31, 2019, 29,000 of the PSUs vested and an additional 6,000 PSUs were granted and vested based on the achievement of 120% of the pre-established free cash flow performance target for the year ended December 31, 2018.

Included in the unvested RSUs as of March 31, 2019 are 102,000 and 88,000 PSUs granted in 2018 and 2017, respectively. Of the PSUs granted in 2018, 54,000 vest based on the achievement of a pre-established consolidated net revenue growth target for the year ending December 31, 2020 and 48,000 vest based on the achievement of a pre-established consolidated net revenue growth target for the year ending December 31, 2021. Vesting of the PSUs granted in 2017 is based on the achievement of pre-established free cash flow performance targets for the year ending December 31, 2019, and continued employment throughout the performance period. The number of PSUs granted assumes achievement of the performance metric at 100% of the performance target. For the PSUs granted in 2018, the actual number of shares to be issued at the end of the performance period will range from 0% to 100% of the initial target awards. Achievement of the performance target between 100% and 150% of the performance target will result in a performance based cash bonus payment between 100% and 165% of the initial target awards. For the PSUs granted in 2017, the actual number of shares to be issued at the end of the performance period will range from 0% to 165% of the initial target award.

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. Our stock-based compensation expense for the RSUs and PSUs for the three months ended March 31, 2019 and 2018 was \$1.6 million and \$1.1 million, respectively.

As of March 31, 2019, the total estimated remaining stock-based compensation expense for the RSUs and PSUs was \$19.1 million, which is expected to be recognized over a weighted average period of 2.4 years.

Restricted Stock Awards

A summary of activity in connection with our restricted stock awards for the three months ended March 31, 2019, is as follows (number of shares in thousands):

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested at December 31, 2018	6	\$ 51.36
Granted	—	—
Vested	(1)	5.64
Forfeited	—	—
Unvested at March 31, 2019	5	\$ 61.05

We have the right to repurchase any unvested restricted stock awards subject to certain conditions. 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 for restricted stock awards of \$0.1 million for each of the three months ended March 31, 2019 and 2018.

As of March 31, 2019, the total estimated remaining stock-based compensation expense for unvested restricted stock awards with a repurchasing right was \$0.1 million which is expected to be recognized over a weighted average period of 0.2 years.

Table of Contents

12. Income Taxes

For the three months ended March 31, 2019, we recorded an income tax benefit of \$4.3 million. The tax benefit recorded and the difference between the US federal statutory rate of 21% and our tax rate is primarily due to changes in the deferred tax asset valuation allowance resulting from \$4.1 million of deferred tax liabilities acquired through the Dynasty acquisition. The acquired deferred tax liabilities are expected to provide a source of income to support realizability of AppFolio's existing deferred tax assets.

For the three months ended March 31, 2018, we recorded income tax expense of \$26,000 on pre-tax income of \$4.3 million for an effective tax rate of 0.6%. The income tax expense was based on our payments of state minimum and franchise taxes, and the amortization of tax deductible goodwill that was not an available source of income to realize the deferred tax asset.

We have recorded a full valuation allowance related to our NOLs, credit carryforwards, and other net deferred tax assets due to the uncertainty of the ultimate realization of the future benefits of those assets. To the extent we determine that all, or a portion of, our valuation allowance is no longer necessary, we will reverse the valuation allowance and recognize an income tax benefit in the reported financial statement earnings in that period. Once the valuation allowance is eliminated or reduced, its reversal will no longer be available to offset our current financial statement tax provision in future periods. We believe that there is a possibility that, within the next three to 12 months, sufficient positive evidence may become available to allow us to reach a conclusion that some or all of the valuation allowance will no longer be needed. Release of the valuation allowance would result in the recognition of certain net deferred tax assets and a decrease to income tax expense for the period the release is recorded. However, the timing and amount of the valuation allowance release are subject to change on the basis of the level of our profitability and other factors.

13. Revenue and Other Information

The following table presents our revenue categories for the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended March 31,	
	2019	2018
Core solutions	\$20,822	\$16,205
Value+ services	33,698	24,640
Other	2,571	1,495
Total revenue	\$57,091	\$42,340

During the three months ended March 31, 2019 and 2018, we recognized \$1.7 million and \$3.7 million of revenues, respectively, that were included in the deferred revenue balances at December 31, 2018 and 2017, respectively.

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

14. Subsequent Events

On April 1, 2019, we entered into a new lease with Rose Studios, LLC to lease approximately 5,000 square feet of office space located at 215-221 Rose Avenue, Venice, California. The lease is for five years commencing August 1, 2019 and ending on July 31, 2024. The total commitment under this lease is \$2.0 million.

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 this Quarterly Report and in our Annual Report, as well as our other public filings with the SEC. Please also

refer to the section of this Quarterly Report entitled "Cautionary Note Regarding Forward-Looking Statements" for additional information.

Table of Contents

Overview

Our mission is to revolutionize vertical industry businesses by providing great software and services. To that end, today we offer industry-specific, cloud-based business software solutions, services and data analytics to the real estate market, which comprises a significant majority of our revenue, and, to a lesser extent, to the legal market. Our real estate software solutions provide our customers with a system of record to automate essential business processes, a system of engagement to enhance business interactions between our customers and their clients and other stakeholders, and a system of intelligence designed to leverage data to predict and optimize business workflows in order to enable superior customer experiences and increase efficiency across our customers' businesses. Our mobile-optimized software solutions are designed for use across multiple devices and operating systems. Our software solutions are all offered as a service for our customers and hosted using a modern cloud-based architecture. This architecture leads to rich data sets that have a consistent schema across our customer base and enables us to deploy data-powered products and services for our customers. We also provide software solutions to the legal market that enable law firms to administer their practice and manage their caseloads more efficiently by centralizing case details in a single system of record and system of engagement.

We were formed in 2006 with a vision to revolutionize the way that small and medium-sized businesses ("SMBs"), grow and compete by enabling their digital transformation. In 2008, we entered the real estate market with our first product, AppFolio Property Manager ("APM"), a property management solution designed to address the unique operational and business requirements of property management companies. Recognizing that our customers and their stakeholders would benefit from additional business critical services, we launched a series of Value+ services beginning in 2009. Our first Value+ service assisted our customers in the marketing of their rental properties by offering property level website design and hosting services. In 2010, we commenced the roll out of our electronic payment services, thereby facilitating the payment of rent via ACH by tenants. In 2011, we launched tenant screening services, further assisting our customers with the leasing process. In 2012, we introduced our legal liability to landlord insurance program, which protects property owners and managers from certain defined losses. In 2013, we expanded our electronic payment services by allowing residents to pay rent by Electronic Cash Payment and credit or debit card. In 2014, we launched a tenant-facing contact center solution to assist our property managers with resolving incoming maintenance requests. In 2015, with the acquisition of RentLinx, we expanded the marketing services offered to our property manager customers with a premium leads service and expanded our electronic payment services to facilitate payments made between our customers and property owners and vendors. In 2016, we introduced a tenant debt collection Value+ service to assist our property managers with running a more efficient business. In 2017, we expanded our insurance services to enable tenants to purchase renters insurance from within APM, protecting both our property manager customers and their tenants. In 2018, we acquired substantially all of the assets of WegoWise, Inc. ("WegoWise"), a provider of cloud-based utility analytics software solutions and have recently began offering AppFolio Utility Management as Value+ service to our property manager customers. In 2018, we also released AppFolio Property Manager PLUS, ("APM PLUS"), a new tier of APM designed for larger businesses with more complex needs. APM PLUS builds upon the functionality of APM and additionally offers data analytics, configurable workflows, and revenue management and optimization functionality for our customers. In January 2019, we acquired Dynasty Marketplace, Inc., ("Dynasty"), and expect the team and technology related to this acquisition, combined with our internal resources, technology and data, will serve as a foundation for future artificial-intelligence, ("AI"), software and services for the real estate market. In April 2019, we launched AppFolio Investment Management, which enables real estate investment managers to better manage their investor relationships by increasing transparency and streamlining fundraising, reporting, and communications.

We entered the legal market with the acquisition of MyCase in 2012. In 2013, we introduced website design and hosting services, our first Value+ service for our legal market customers, designed to assist smaller law firms and solo practitioners with the marketing of their practices, electronic storage of case information and communications. In 2016, we launched electronic payments services for the legal market, which streamlined the billing and receivables process through MyCase.

We have focused on growing our revenue by increasing the size of our customer base in the markets we serve, increasing the number of units under management, introducing new or expanded Value+ services, retaining customers,

and increasing the adoption and utilization of our Value+ services by new and existing customers.

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. We intend to continue to invest in growth across our organization as we expand in our current markets, adjacent markets and into new verticals. These investments to grow our business will continue to increase our costs and operating expenses on an absolute basis. Many of these investments will occur in advance of our realization of revenue or any other benefit, which will make it difficult to determine if we are allocating our resources efficiently. We expect our operating margins will improve over the long term, but this trend may be interrupted from time to time as a result of accelerated investment opportunities occurring in advance of realization of revenue.

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. Accordingly, if opportunities arise that might cause us to sacrifice our performance with

Table of Contents

respect to short-term financial or business metrics, but that we believe are in the best interests of our stockholders in the long term, we will take those opportunities.

Today our real estate property manager customers directly and indirectly account for more than 90% of our annual revenue. We define our real estate property manager customer base as the number of customers subscribing to AppFolio Property Manager and AppFolio Property Manager PLUS core solutions. Customer count and property manager units under management are presented in the table below:

	Quarter Ended				
	March 31, 2019	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
Property manager customers	13,409	13,046	12,641	12,317	12,030
Property manager units under management (in millions)	4.08	3.91	3.70	3.55	3.40

Our legal software solution, MyCase, enables small law firms to administer their practices and manage their caseloads more efficiently. MyCase is continuously evolving to help our customers more effectively market, manage and grow their businesses, and contains core functionality that addresses key operational issues, including managing calendars, contacts and documents, time tracking, billing and collections, communicating with clients and sharing sensitive and privileged materials.

Our legal customers directly and indirectly account for less than 10% of our annual revenue. We define our legal customer base as the number of customers subscribing to MyCase core solutions, exclusive of free trial periods. Legal customer count is summarized in the table below:

	Quarter Ended				
	March 31, 2019	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
Law firm customers	10,485	10,279	10,173	10,001	9,706

At March 31, 2019, we had approximately 1,040 employees, and we consider our relationship with them to be very good. We also hire temporary employees and consultants, and feel similarly about our relationships with them. None of our employees is represented by a labor union or covered by a collective bargaining agreement.

Key Components of Results of Operations

Revenue

We charge our customers on a subscription basis for our core solutions and certain of our Value+ services. Our subscription fees are designed to scale to the size of our customers' businesses. We recognize subscription revenue over time on a straight-line basis over the contract term beginning on the date that our service is made available to the customer. We generally invoice our customers for subscription services in monthly or annual installments, typically in advance of the subscription period. Revenue from subscription services is impacted by a number of factors, including the change in the number and type of our customers, the size and needs of our customers' businesses, our customer renewal rates, and the level of adoption of our Value+ subscription services by new and existing customers.

We also charge our customers usage-based fees for using certain Value+ services. Certain of the usage-based fees are paid by either our customers or 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 a number of factors, including the number of new and existing customers that adopt and utilize our Value+ services, the size and needs of our customers and our customer renewal rates.

We experience limited seasonality in our Value+ services revenue, primarily with respect to certain leasing-related services we provide to our property manager customers, including our tenant screening services and new tenant applications. These customers historically have processed fewer applications for new tenants during the winter holiday season; therefore, revenue associated with our leasing services typically declines in the fourth quarter. As a result of

this seasonal decline in revenue, we have typically experienced slower sequential revenue growth or a sequential decline in revenue in the fourth quarter of each of our most

Table of Contents

recent fiscal years. We expect this seasonality to continue in the foreseeable future although the impact from seasonality may decline as our revenue from other services increases.

We offer assistance to our customers with on-boarding to our core solutions, as well as website design services. We generally invoice our customers for these other services in advance of the services being completed. We recognize revenue for these other services upon completion of the related service. We generate revenue from legacy RentLinx customers by providing services that allow these customers to advertise rental houses and apartments online. Revenue derived from customers using the RentLinx services outside of our property manager core solution platform is recorded in other revenue. We also generate revenue from legacy WegoWise by providing utility analytics services and from Dynasty customers by providing artificial intelligence solutions for the real estate market. Revenue derived from customers using the WegoWise and Dynasty services outside of our property manager core solution platform is also recorded in other revenue.

Costs and Operating Expenses

Cost of Revenue. Cost of revenue consists of fees paid to third-party service providers associated with delivering certain of our Value+ services (including legal fees and costs associated with the delivery and provision of those services, as well as loss reserves and other costs associated with our legal liability to landlord insurance services), 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), 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 depreciation of property and equipment, and amortization of capitalized software development costs and intangible assets. 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, enter new markets and offer additional Value+ services. These investments could impact cost of revenue both in absolute dollars and as an overall percentage of revenue.

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, online lead generation, lead nurturing, customer and industry events, and the creation of industry-related content and collateral. Sales commissions and other incremental costs to acquire customers and grow adoption and utilization of our Value+ services by our new and existing customers are deferred and then amortized on a straight-line basis over a period of benefit that we have determined to be three years. 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 as we grow to increase our customer base in new and existing markets 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 and services for new and existing markets. We capitalize the portion of our software development costs that meets the criteria for capitalization. Amortization of capitalized 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 services, and expand into adjacent markets and new verticals.

General and Administrative. General and administrative expense consists of personnel-related costs (including salaries, a majority of total incentive-based compensation, benefits, and stock-based compensation) for employees in our executive, finance, information technology, human resources, corporate development, legal and administrative organizations. In addition, general and administrative expense includes fees for third-party professional services

(including audit, legal, tax, and consulting services), transaction costs related to business combinations, other corporate expenses, and allocated shared costs. We intend to continue to incur incremental general and administrative costs associated with supporting the growth of our business.

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. 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. Further, we may incur additional amortization expense to the extent that we enter into additional arrangements to acquire or invest in new technologies or markets adjacent to those we serve today

Table of Contents

or entirely new verticals. Finally, as we expand our facilities footprint and increase our base of employees, we expect to have increased property and equipment expenditures and incremental depreciation expense.

Interest Income (Expense), net. Interest income includes interest earned on investment securities, amortization and accretion of the premium and discounts paid from the purchase of investment securities, and interest earned on notes receivable and on cash deposited in our bank accounts. Interest expense includes interest paid on outstanding borrowings under the credit agreement with Wells Fargo, as administrative agent, and the lenders that are parties thereto, ("the Credit Agreement").

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			
	March 31, 2019		2018	
	Amount	%	Amount	%
Consolidated Statements of Operations Data:				
Revenue	\$57,091	100.0 %	\$42,340	100.0 %
Costs and operating expenses:				
Cost of revenue (exclusive of depreciation and amortization) ⁽¹⁾	24,181	42.4	16,613	39.2
Sales and marketing ⁽¹⁾	11,219	19.7	7,405	17.5
Research and product development ⁽¹⁾	8,481	14.9	5,333	12.6
General and administrative ⁽¹⁾	8,192	14.3	5,316	12.6
Depreciation and amortization	5,076	8.9	3,500	8.3
Total costs and operating expenses	57,149	100.1	38,167	90.1
Income (loss) from operations	(58)	(0.1)	4,173	9.9
Other expense, net	(1)	—	(3)	—
Interest income (expense), net	(497)	(0.9)	176	0.4
Income (loss) before provision for income taxes	(556)	(1.0)	4,346	10.3
Provision for (benefit from) income taxes	(4,281)	(7.5)	26	0.1
Net income	\$3,725	6.5 %	\$4,320	10.2 %

⁽¹⁾ Includes stock-based compensation expense as follows (in thousands):

	Three Months Ended	
	March 31, 2019	2018
Stock-based compensation expense included in costs and operating expenses:		
Cost of revenue (exclusive of depreciation and amortization)	\$324	\$220
Sales and marketing	248	210
Research and product development	308	225
General and administrative	672	663
Total stock-based compensation expense	\$1,552	\$1,318

Table of Contents

Comparison of the Three Months Ended March 31, 2019 and 2018

The following comparative financial information includes the impact of ongoing investment in our business that we believe will positively impact long-term stockholder value, including (i) the acquisition of substantially all of the assets of WegoWise completed in August 2018, (ii) the development and launch of AppFolio Property Manager PLUS in September 2018, (iii) the acquisition of Dynasty completed in January 2019, and (iv) the development and launch of AppFolio Investment Management in April 2019. The WegoWise platform empowers building owners and third-party property managers to better manage operating and capital expenditures relating to utilities, and the new AppFolio Utility Management Value+ service, which has been developed from certain key aspects of the WegoWise platform, is a fully integrated offering that provides enhanced functionality to our real estate customers for utility analytics and management. Dynasty offers advanced conversational artificial intelligence solutions that automate leasing communications, replace manual tasks and help customers grow their portfolios. We believe that the acquisition of Dynasty strengthens AppFolio's system of intelligence capabilities, and better enables us to offer advanced AI products and services to real estate customers over time.

Revenue

	Three Months Ended		Change	
	2019	2018	Amount	%
	(dollars in thousands)			
Core solutions	\$20,822	\$16,205	\$4,617	28%
Value+ services	33,698	24,640	9,058	37%
Other	2,571	1,495	1,076	72%
Total revenue	\$57,091	\$42,340	\$14,751	35%

Total revenue was \$57.1 million for the three months ended March 31, 2019 compared to \$42.3 million for the three months ended March 31, 2018, an increase of \$14.8 million, or 35%. Core solutions revenue was \$20.8 million for the three months ended March 31, 2019 compared to \$16.2 million for the three months ended March 31, 2018, an increase of \$4.6 million, or 28%. Value+ services revenue was \$33.7 million for the three months ended March 31, 2019 compared to \$24.6 million for the three months ended March 31, 2018, an increase of \$9.1 million, or 37%. Other revenue was \$2.6 million for the three months ended March 31, 2019, compared to \$1.5 million for the three months ended March 31, 2018, an increase of \$1.1 million or 72%. The increase in Core solutions and Value+ services revenue was mainly attributed to the growth in the number of property manager customers and units under management. Combining new customer acquisition and strong customer renewal rates, we experienced an 11% year over year increase in the number of property manager customers and a 20% year over year increase in the number of property management units under management. In addition to the growth in customer count and units, property managers, residents, applicants and owners increased usage of our Value+ services platforms during the period. The increase in Other revenue was primarily attributed to revenue generated from customer subscriptions for the WegoWise platform and Dynasty technology services.

For the three months ended March 31, 2019 and 2018, we derived more than 90% of our revenue from our property manager customers.

Cost of Revenue (Exclusive of Depreciation and Amortization)

	Three Months Ended		Change	
	2019	2018	Amount	%
	(dollars in thousands)			
Cost of revenue (exclusive of depreciation and amortization)	\$24,181	\$16,613	\$7,568	46%
Percentage of revenue	42.4	% 39.2	%	

Cost of revenue (exclusive of depreciation and amortization) was \$24.2 million for the three months ended March 31, 2019 compared to \$16.6 million for the three months ended March 31, 2018, an increase of \$7.6 million, or 46%. The

increase in cost of revenue was primarily attributed to the 35% increase in revenue over the same period and an increase in personnel related investments made in advance of expected revenue generation. Personnel-related expense increased by \$3.5 million, related to increased headcount to support the increased number of customers, including those acquired in our recent acquisitions and investments made for future growth of our business. There was also an increase in expenditures to third parties of \$2.9 million

Table of Contents

directly associated with the increased adoption and utilization of our Value+ services, as evidenced by the 37% increase in Value+ services revenues. Allocated and other costs increased by \$1.2 million primarily driven by an increase in facilities, IT and other expenses incurred in support of our overall growth in personnel.

As a percentage of revenue, cost of revenue (exclusive of depreciation and amortization) fluctuates primarily based on the mix and prices of Value+ services in the period and investments made in advance of expected revenue generation. For the three months ended March 31, 2019 compared to the three months ended March 31, 2018, cost of revenue (exclusive of depreciation and amortization), as a percentage of revenue, increased to 42.4% from 39.2%. This increase in cost as a percentage of revenue was primarily due to increased personnel related investments made in advance of expected revenue generation associated with growth initiatives including the Dynasty and WegoWise acquisitions.

Sales and Marketing

	Three Months Ended		Change	
	March 31, 2019	2018	Amount	%
	(dollars in thousands)			
Sales and marketing	\$11,219	\$7,405	\$3,814	52%
Percentage of revenue	19.7	% 17.5	%	

Sales and marketing expense was \$11.2 million for the three months ended March 31, 2019 compared to \$7.4 million for the three months ended March 31, 2018, an increase of \$3.8 million, or 52%. This increase was primarily due to an increase in personnel-related costs of \$2.4 million driven by an increase in the average headcount to support our growth and investments made in advance of expected revenue generation. There was also an increase in advertising and promotion costs of \$0.7 million related to our new and expanding service offerings, and in allocated and other costs of \$0.7 million driven by an increase in facilities, IT and other expenses incurred in support of our overall growth in personnel.

As a percentage of revenue, sales and marketing expense increased to 19.7% from 17.5% for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. This increase was primarily driven by personnel-related investments made in advance of expected revenue generation associated with growth initiatives in the business.

Research and Product Development

	Three Months		Change	
	Ended March 31, 2019	2018	Amount	%
	(dollars in thousands)			
Research and product development	\$8,481	\$5,333	\$3,148	59%
Percentage of revenue	14.9	% 12.6	%	

Research and product development expense was \$8.5 million for the three months ended March 31, 2019 compared to \$5.3 million for the three months ended March 31, 2018, an increase of \$3.1 million, or 59%. The increase was the result of an increase in personnel-related costs, net of capitalized software development costs, of \$2.1 million due to investments in headcount growth within our research and product development organization, and in allocated and other costs of \$1.1 million driven by an increase in facilities, IT and other expenses incurred in support of our overall growth in personnel.

We intend to continue to invest in research and product development as we continue to introduce additional functionality into our software solutions, services and data offerings, develop or integrate acquired Value+ services to attract new customers and expand offerings to existing customers, develop new products to serve new or existing customers and expand into adjacent markets or new verticals.

Table of Contents

General and Administrative

	Three Months Ended March 31,		Change	
	2019	2018	Amount	%
	(dollars in thousands)			
General and administrative	\$8,192	\$5,316	\$2,876	54%
Percentage of revenue	14.3	% 12.6	%	

General and administrative expense was \$8.2 million for the three months ended March 31, 2019 compared to \$5.3 million for the three months ended March 31, 2018, an increase of \$2.9 million, or 54%. The increase was primarily due to an increase in personnel-related costs of \$1.6 million driven by growth in headcount and in professional services fees and allocated and other costs of \$1.3 million related to expanded audit services, legal and other services fees associated with increased leasing activities, due diligence and acquisition related activities, as well as other costs incurred to support our growth.

Depreciation and Amortization

	Three Months Ended March 31,		Change	
	2019	2018	Amount	%
	(dollars in thousands)			
Depreciation and amortization	\$5,076	\$3,500	\$1,576	45%
Percentage of revenue	8.9	% 8.3	%	

Depreciation and amortization expense was \$5.1 million for the three months ended March 31, 2019 compared to \$3.5 million for the three months ended March 31, 2018, an increase of \$1.6 million, or 45%. The increase was primarily due to increased amortization expense associated with intangible assets acquired from WegoWise and Dynasty and in amortization expense associated with higher accumulated capitalized software development balances.

Interest Income (Expense), net

	Three Months Ended March 31,		Change	
	2019	2018	Amount	%
	(dollars in thousands)			
Interest income (expense), net	\$(497)	\$176	\$(673)	(382)%
Percentage of revenue	(0.9)	% 0.4	%	

Interest expense, net, was \$0.5 million for the three months ended March 31, 2019 compared to interest income of \$0.2 million for the three months ended March 31, 2018, a decrease of \$0.7 million, due to an increase in interest expense associated with increased borrowings under the Credit Agreement and a decrease in interest income due to lower investment security balances in the more recent period.

Provision for (Benefit from) Income Taxes

	Three Months Ended March 31,		Change	
	2019	2018	Amount	%
	(dollars in thousands)			
Provision for (benefit from) income taxes	\$(4,281)	\$26	\$(4,307)	(16,566)%
Percentage of revenue	(7.5)	% 0.1	%	

The benefit from income taxes was \$4.3 million for the three months ended March 31, 2019 compared to a provision for income taxes of \$26 thousand for the three months ended March 31, 2018, a decrease of \$4.3 million primarily due to the partial release of the valuation allowance resulting from \$4.1 million of deferred tax liabilities acquired through

the Dynasty acquisition.

31

Table of Contents

Liquidity and Capital Resources

Cash and Cash Equivalents

As of March 31, 2019, our principal sources of liquidity were cash and cash equivalents and investment securities, which had an aggregate balance of \$40.8 million.

Working Capital

As of March 31, 2019, we had working capital of \$19.4 million, compared to working capital of \$79.8 million as of December 31, 2018. The decrease in our working capital was primarily due a decrease in cash and cash equivalents related to the acquisition of Dynasty, an increase in other current liabilities due to the \$6.0 million Holdback Amount related to the Dynasty acquisition and recording of lease liabilities associated with the adoption of ASU 2016-02, and increases in accrued expenses and deferred revenue. The decrease in our working capital was partially offset by increases in prepaid expenses and other current assets, accounts receivable due to an increase in revenue from Value+ services and a decrease in accrued employee expenses.

Revolving Facility

As of March 31, 2019, we had a \$50.0 million revolving line of credit, ("the Revolving Facility"), under the terms of the Credit Agreement, as further described in Note 8, Long-Term Debt of our Condensed Consolidated Financial Statements. As of both March 31, 2019 and December 31, 2018, we had no outstanding balance under the Revolving Facility.

Liquidity Requirements

We believe that our existing cash and cash equivalents, investment securities, available borrowing capacity of \$50.0 million under the Revolving Facility, and cash generated from operating activities will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months.

Capital Requirements

Our future capital requirements will depend on many factors, including the continued market acceptance of our software solutions, the change in the number of our customers, the adoption and utilization of our Value+ services by new and existing customers, the timing and extent of the introduction of new core functionality, products and Value+ services, the timing and extent of our expansion into adjacent or new markets and the timing and extent of our investments across our organization. In addition, we have in the past entered into, and may in the future enter into, arrangements to acquire or invest in new technologies or markets adjacent to those we serve today or entirely new verticals. Furthermore, our board of directors has authorized our management to repurchase up to \$100.0 million of shares of our Class A common stock in open market transactions, privately negotiated transactions or otherwise. For additional information regarding our share repurchase program, refer to Note 10, Share Repurchase Program of our Condensed Consolidated Financial Statements.

Cash Flows

The following table summarizes our cash flows for the periods indicated (in thousands):

	Three Months Ended March 31,	
	2019	2018
Net cash provided by operating activities	\$295	\$3,342
Net cash used in investing activities	(55,692)	(10,471)
Net cash used in financing activities	(1,897)	(431)
Net decrease in cash, cash equivalents and restricted cash	\$(57,294)	\$(7,560)

Cash Provided by Operating Activities

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

For the three months ended March 31, 2019, cash provided by operating activities was \$0.3 million resulting from net income of \$3.7 million, adjusted by non-cash charges of \$2.4 million and a net decrease in our operating assets and liabilities of \$5.8 million. The non-cash charges primarily consist of \$5.1 million of depreciation and amortization of

our property and equipment and capitalized software development costs, \$4.3 million in deferred income taxes, and \$1.6 million of stock-based compensation.

32

Table of Contents

The net decrease in our operating assets and liabilities was mostly attributable to an increase of \$3.3 million in prepaid expenses and other current assets, a \$2.9 million decrease in accrued employee expenses due to the payout of accrued employee bonuses and commissions, and a \$2.1 million increase in accounts receivable primarily driven by growth in our Value+ services. The decrease in our operating assets and liabilities was partially offset by a \$1.6 million increase in accrued expenses, a \$1.4 million decrease in other long-term assets primarily due to the amortization of right-of-use ("ROU") assets in accordance with ASU 2016-02, and a \$0.3 million increase in deferred revenue.

Cash Used in Investing Activities

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

For the three months ended March 31, 2019, investing activities used \$55.7 million in cash primarily due to \$54.0 million used to acquire Dynasty, as well as capitalized software development costs of \$4.7 million for the continued investment in our software development, and capital expenditures of \$1.0 million to purchase property and equipment for the continued growth and expansion of our business. These uses were partially offset by sales and maturities of investment securities of \$1.8 million and \$2.3 million, respectively.

Cash Used in Financing Activities

Cash used in financing activities is generally comprised of proceeds from the exercise of stock options, net share settlements for employee tax withholdings associated with the vesting of restricted stock units, ("RSUs"), and activities associated with the Revolving Facility.

For the three months ended March 31, 2019, financing activities used \$1.9 million in cash primarily as a result of net share settlements for employee tax withholdings associated with the vesting of RSUs of \$1.3 million, as well as principal payments on debt of \$0.9 million, and payments of debt issuance costs of \$0.4 million, partially offset by proceeds from issuance of debt of \$0.6 million and proceeds from stock option exercises of \$0.1 million.

Table of Contents

Contractual Obligations and Other Commitments

There have been no material changes to our contractual obligations and other commitments as disclosed in our Annual Report.

Off-Balance Sheet Arrangements

As of March 31, 2019, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

Our Condensed Consolidated Financial Statements and the related notes are prepared in accordance with accounting principles generally accepted in the United States. The preparation of our Condensed Consolidated Financial Statements 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.

Except for the accounting policies for leases that were updated as a result of adopting ASU 2016-02, there have been no changes to our critical accounting policies and estimates described in our Annual Report that have had a material impact on our Condensed Consolidated Financial Statements and related notes.

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease ROU assets, other current liabilities, and operating lease liabilities on our Condensed Consolidated Balance Sheets. Operating lease ROU assets and operating lease liabilities are recognized based on the present value of the future minimum lease payments over the lease term at commencement date. As none of our leases provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of future payments. The operating lease ROU assets also include any lease payments made and excludes lease incentives and initial direct costs incurred. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option.

Lease expense for minimum lease payments is recognized on a straight-line basis over the lease term. We have lease arrangements with lease and non-lease components, which are generally accounted for as a single lease component. Leases with an initial term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term.

Recent Accounting Pronouncements

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

Item 3. Qualitative and Quantitative Disclosure about Market Risk

Interest Rate Risk

Short-Term Investments

At March 31, 2019, we had cash and cash equivalents of \$16.8 million consisting of bank deposits and money market funds, and \$24.0 million of investment securities consisting of corporate bonds and United States government agency securities. The primary objective of investing in securities is to support our liquidity and capital needs. We did not purchase these investments for trading or speculative purposes and have not used any derivative financial instruments to manage our interest rate risk exposure.

As of March 31, 2019, a hypothetical 100 basis point decrease in interest rates would have resulted in an increase in the fair value of our investment securities of approximately \$0.2 million, and a hypothetical 100 basis point increase in interest rates would have resulted in a decrease in the fair value of our investment securities of approximately \$0.2 million. This estimate is based on a sensitivity model which measures an instant change in interest rates by 1% or 100

basis points at March 31, 2019.

Revolving Facility

At March 31, 2019, we had a \$49.7 million balance outstanding under our Term Loan, which bears interest at a variable rate (refer to Note 8, Long-Term Debt of our Condensed Consolidated Financial Statements for additional information). If interest rates rise, our debt service obligations on the borrowings under the Revolving Facility would increase even if the amount borrowed

34

Table of Contents

remained the same, which would affect our results of operations. At March 31, 2019, a hypothetical 100 basis point increase in interest rates would have had an immaterial impact on our interest expense under our Term Loan.

Inflation Risk

We have not been exposed to, nor do we anticipate being exposed to, material risks due to changes in inflation rates. As of March 31, 2019, except as discussed above, there were no material changes in the market risks described in the section of our Annual Report entitled “Quantitative and Qualitative Disclosure about Market Risk.”

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the supervision and participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and other procedures designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Based on our management’s evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

Except as set forth below, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

During the three months ended March 31, 2019, we implemented changes to our internal control processes in response to the adoption of the new leasing standard that became effective January 1, 2019. This implementation resulted in changes to our internal controls relating to the evaluation, accounting and disclosure of leases. The operating effectiveness of these changes will be evaluated as part of our annual assessment of the effectiveness of our internal control over financial reporting.

Inherent Limitations on Effectiveness of Disclosure Controls

In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable and not absolute assurance of achieving the desired control objectives. In reaching a reasonable level of assurance, management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. In addition, the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Control systems can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various legal proceedings arising from or related to claims incident to the ordinary course of our business activities, including without limitation actions involving intellectual property, employment and contractual matters. Although the results of such legal proceedings and claims cannot be predicted with certainty, we believe that we are not currently a party to any legal proceeding(s) which, if determined adversely to us, would, individually or taken together, have a material adverse effect on our business, operating results, financial condition or cash flows. However, regardless of the merit of any claims raised or the ultimate outcome, legal proceedings may generally have an adverse impact on us as a result of defense and settlement costs, diversion of management resources, and other factors.

For additional information regarding legal proceedings, refer to Note 9, Commitments and Contingencies of our Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

Please be advised that certain of the risks and uncertainties described below contain “forward-looking statements.” See the section of this Quarterly Report entitled “Cautionary Note Regarding Forward-Looking Statements” for additional information.

Risks Related to Our Business and Our Industry

We manage our business towards the achievement of long-term growth, which may not be consistent with the short-term expectations of some investors.

We 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. If opportunities arise that might cause us to sacrifice our performance with respect to short-term financial or business metrics, but that we believe are in the best interests of our stockholders, we will take those opportunities.

We focus on growing our customer base by launching new and innovative core functionality and Value+ services to address our customers’ evolving business needs, developing and/or acquiring new products for adjacent markets and additional verticals, and improving the experience of our users across our targeted verticals. We prioritize product innovation and user experience over short-term financial or business metrics. We will make product decisions that may reduce our short-term operating results if we believe that these decisions are consistent with our strategic objective to achieve long-term growth. These decisions may not be consistent with the short-term expectations of some investors, and may cause significant fluctuations in our operating results from period to period. In addition, notwithstanding our intention to make strategic decisions that positively impact long-term stockholder value, the decisions we make may not produce the long-term benefits we expect.

Our executive officers, directors and principal stockholders control a majority of the combined voting power of our outstanding capital stock. As a result, they are able to exercise significant influence and control over the establishment and implementation of our future business plans and strategic objectives, as well as control all matters submitted to our stockholders for approval. These persons may manage our business in ways with which you disagree and which may be adverse to your interests.

If we fail to manage our growth effectively, it could adversely affect our operating results and preclude us from achieving our strategic objectives.

We have experienced significant growth since our formation in 2006, and we anticipate that we will continue to experience growth and expansion of our operations. This growth in the size, complexity and diversity of our business has placed, and we expect it will continue to place, a significant strain on our management, administrative, operational and financial resources, as well as our company culture. Our future success will depend, in part, on our ability to manage this growth effectively. To manage the expected growth of our operations, we will need to continue to develop and improve our operational and financial controls and our reporting systems and procedures, continue to attract and retain highly qualified and motivated personnel across our organization, and continue to nurture and build on our company culture. Failure to effectively manage growth could adversely impact our business, including by resulting in errors or delays in deploying new core functionality to our customers, delays or difficulties in introducing

new Value+ services or other products, declines in the quality or responsiveness of our customer service organization, enhanced legal and regulatory risks, increases in costs and operating expenses, and other operational difficulties. We expect these risks will only be increased as a result of our recent launch of AppFolio Investment Management and acquisitions of WegoWise and Dynasty, and any future acquisitions or adjacent markets we may pursue. If any of these risks actually occur, it could adversely affect our operating results, and preclude us from achieving our strategic objectives.

Table of Contents

We have a limited operating history and limited experience selling our solutions. We expect to make substantial investments across our organization to grow our business and, as a result, we expect our financial results may fluctuate significantly from period to period and we may not sustain profitability.

We were formed in 2006 and in 2008 entered the real estate market with our first product, APM, to serve property managers; we recently expanded our offerings to the real estate market with the launch of APM PLUS in late 2018 and AppFolio Investment Management in April 2019. In 2012, we entered the legal vertical through the acquisition of MyCase. As a result, we have a limited operating history and limited experience selling our software solutions in two continually evolving vertical markets. These and other factors combine to make it more difficult for us to accurately forecast our future operating results, which in turn makes it more difficult for us to prepare accurate budgets and implement strategic plans. We expect that this uncertainty will continue to exist in our business for the foreseeable future, and will be exacerbated to the extent we introduce new functionality, or enter adjacent markets or new verticals, or complete additional acquisitions.

We have made substantial investments across our organization to develop our software solutions and capitalize on our market opportunity. In order to implement our business strategy, we intend to continue to make substantial investments in, among other things:

- our research and product development organization to enhance the ease of use and functionality of our software solutions by adding new core functionality, Value+ services and other improvements to address the evolving needs of our customers, as well as to develop new products for adjacent markets and new verticals;
- our continued strategic efforts to identify acquisition targets that enhance the depth or functionality of our software solutions or Value+ services, or that enable our expansion into adjacent markets or new vertical markets;
- our customer service organization to deepen our relationships with our customers, assist our customers in achieving success through the use of our software solutions, and promote customer retention;
- our sales and marketing organization, including expansion of our direct sales organization and marketing programs, to increase the size of our customer base, increase adoption and utilization of new and existing Value+ services by our new and existing customers, and enter adjacent markets and new verticals;
- maintaining and expanding our technology infrastructure and operational support, including data center operations, to promote the security and availability of our software solutions, and support our growth;
- our general and administrative functions, including hiring additional finance, IT, human resources, legal and administrative personnel, to support our growth and assist us in achieving and maintaining compliance with public company reporting and compliance obligations; and
- the expansion of our existing facilities, including leasing and building out additional office space, to support our growth and strategic development.

As a result of our continuing investments to grow our business in these and other areas, we expect our expenses to increase significantly, and we may not be consistently profitable. Even if we are successful in growing our customer base and increasing revenue from new and existing customers, we may not be able to generate additional revenue in an amount that is sufficient to cover our expenses. We may incur significant losses in a particular period for a number of reasons, and may experience significant fluctuations in our operating results from period to period, including as a result of the other risks and uncertainties described elsewhere in this Quarterly Report. We cannot assure you that we will continue to achieve profitability in the near term or that we will sustain profitability over any particular period of time. Any additional operating losses will have a negative impact on our stockholders' equity.

We have acquired, and may in the future acquire, other companies or technologies, which could divert our management's attention, result in additional dilution to our stockholders and otherwise disrupt our operations.

We have acquired, and may in the future acquire, other companies or technologies to complement or expand our software solutions, optimize our technical capabilities, enhance our ability to compete in our targeted verticals, provide an opportunity to expand into an adjacent market or new vertical, or otherwise offer growth or strategic opportunities. For example, we acquired substantially all of the assets of WegoWise in 2018, and completed the acquisition of Dynasty in 2019. The pursuit of acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated.

We have limited experience acquiring other businesses. We may not be able to integrate acquired assets, technologies, personnel and operations successfully or achieve the anticipated synergies or other benefits from the acquired business due to a

37

Table of Contents

number of risks associated with acquisitions, including:

the aggregate cost, whether in cash or equity securities, to acquire the business;

difficulties integrating the assets, technologies, personnel or operations of the acquired business in a cost-effective manner;

difficulties and additional expenses associated with supporting legacy products and services of the acquired business;

difficulties converting the customers of the acquired business to our software solutions and contract terms;

diversion of management's attention from our business to address acquisition and integration challenges, as well as post-acquisition disputes;

adverse effects on our existing business relationships with customers and strategic partners as a result of the acquisition;

cultural challenges associated with integrating employees from the acquired organization into our company;

the loss of key employees;

use of resources that are needed in other parts of our business;

use of substantial portions of our available cash resources to consummate the acquisition or pay acquisition-related expenses; and

unanticipated costs or liabilities associated with the acquisition.

If an acquisition fails to meet our expectations in terms of its contribution to our overall business strategy or operating results, or if the costs of acquiring or integrating the acquired business exceed our estimates, our business, operating results and financial condition may suffer. In addition, acquisitions could result in the issuance of equity securities, which would result in immediate dilution to our stockholders or, the incurrence of debt, which could impose debt service obligations and restrictions on our ability to operate our business. Furthermore, a significant portion of the purchase price of companies we may acquire could be allocated to goodwill and other intangible assets, which must be assessed for impairment. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our operating results based on this impairment assessment process, which could adversely affect our operating results.

Actual or perceived security vulnerabilities in our software solutions, breaches of our security controls or other unauthorized access to our customers' data could result in liability or reputational harm to us, or cause us to lose customers, any of which could harm our business and operating results.

In providing our software solutions, we store and transmit large amounts of our customers' data, including sensitive and proprietary data. Our software solutions are typically the system of record, system of engagement and, increasingly, the system of intelligence for all or a portion of our customers' businesses, and the data processed through our software solutions is critical to their businesses. Cyber-attacks and other malicious Internet-based activities continue on a regular basis, as evidenced by the recent targeting of a number of high profile companies and organizations. As our business grows, the number of users of our software solutions, as well as the amount of information we store, is increasing, and our brands are becoming more widely recognized. We believe these factors combine to make us an even greater target for this type of malicious activity. Techniques used to sabotage, or to obtain unauthorized access to, systems or networks change frequently and generally are not recognized until launched against a target. Therefore, despite our significant efforts to keep our systems and networks protected and up to date, we may be unable to anticipate these techniques, react in a timely manner, or implement adequate preventive measures, any of which may expose us to a risk of loss, litigation and potential liability. In addition, some of our third-party partners also collect information from transactions with our customers, and these third parties are subject to similar threats of cyber-attacks and other malicious Internet-based activities.

If our security measures, or the security measures of our third-party partners, are breached as a result of negligence, wrongdoing or malicious activity on the part of our employees, our partners' employees, our customers' employees, or any third party, or as a result of any error, product defect or otherwise, and this results in the disruption of the confidentiality, availability or integrity of our customers' data, we could incur liability to our customers and to individuals or organizations whose information was being stored by our customers, as well as, for example, fines from payment processing networks and/or regulatory action by governmental bodies. If we experience a widespread security breach, we cannot be certain that our insurance coverage will be sufficient to compensate us for liabilities

actually incurred or that insurance will continue to be available to us on reasonable terms, or at all. In addition, any breaches of our security controls or other unauthorized access to our customers' data could result in

38

Table of Contents

reputational damage, adversely affect our ability to attract new customers and cause existing customers to reduce or discontinue the use of our software solutions, any of which could harm our business and operating results.

Furthermore, the perception by our current or potential customers that our software solutions could be vulnerable to security breaches, even in the absence of a particular problem or threat, could reduce market acceptance of our software solutions and cause us to lose customers.

Service outages due to malicious activities or performance problems associated with our technology infrastructure could harm our reputation, adversely affect our ability to attract new customers and cause us to lose existing customers.

We have experienced significant growth in the number of users and the amount of data that our technology infrastructure supports, and we expect this growth to continue. We seek to maintain sufficient excess capacity in our technology infrastructure to meet the needs of all of our customers, including to facilitate the expansion of existing customer deployments and the provisioning of new customer deployments. In addition, we need to properly manage our technology infrastructure in order to support version control, changes in hardware and software parameters, and the evolution of our software solutions. However, the provision of new hosting infrastructure requires significant lead-time.

We have experienced, and may in the future experience, website disruptions, service outages and other performance problems with our technology infrastructure. These problems may be caused by a variety of factors, including infrastructure changes, power or network outages, fire, flood or other natural disasters affecting our data centers, human or software errors, viruses, security breaches, fraud or other malicious activity, spikes in customer usage and distributed denial of service attacks. In some instances, we may not be able to identify the cause or causes of these service outages and performance problems within an acceptable period of time. If our technology infrastructure fails to keep pace with the increased number of users and amount of data, or if we are unable to avoid service outages and performance problems, or to resolve them quickly, this could adversely affect our ability to attract new customers, result in the loss of existing customers and harm our reputation, any or all of which could adversely affect our business and operating results.

Errors, defects or other disruptions in our software solutions could harm our reputation, cause us to lose customers, and result in significant expenditures to correct the problem.

Our customers use our software solutions to manage critical aspects of their businesses, and any errors, defects or other disruptions in the performance of our software solutions may result in loss of or damage to our customers' data and disruption to our customers' businesses, which could harm our reputation. We provide continuous updates to our software solutions and, while our software updates undergo extensive testing prior to their release, these updates may contain undetected errors when first introduced. In the past, we have discovered errors, failures, vulnerabilities and bugs in our software updates after they have been released, and similar problems may arise in the future. Real or perceived errors, failures, vulnerabilities or bugs in our software solutions could result in negative publicity, reputational harm, loss of customers, delay in market acceptance of our software solutions, loss of competitive position, withholding or delay of payment to us, claims by customers for losses sustained by them and potential litigation. In any such event, we may be required to expend additional resources in order to help correct the problem or, in order to address customer service or reputational concerns, we may choose to expend additional resources to take corrective action even where not required. The costs incurred in correcting any material errors, defects or other disruptions could be substantial and there may not be any corresponding increase in revenue to offset these costs. In addition, we may not carry insurance sufficient to compensate us for any losses that may result from claims arising from errors, defects or other disruptions in our software solutions.

We face a number of risks in our electronic payment services business that could adversely affect our business or operating results.

In our electronic payments services business, we facilitate the processing of both inbound and outbound payments for our customers. These payments are settled through our sponsoring clearing bank, card payment processors, and other third-party electronic payment services providers that we may contract with from time to time. Our electronic payment services subject us to a number of risks, including, but not limited to:

liability for customer costs related to disputed or fraudulent transactions if those costs exceed the amount of the customer reserves we have during the clearing period or after payments have been settled to our customers;
electronic processing limits on the amounts that any single electronic payment services provider, or collectively all of our electronic payment services providers, will underwrite;
our reliance on sponsoring clearing banks, card payment processors and other electronic payment providers to process electronic transactions;
failure by us, our electronic payment services providers or our customers to adhere to applicable laws, regulations

Table of Contents

and standards that apply to the provision of electronic payment services; continually evolving laws and regulations governing money transmission and anti-money laundering, the application or interpretation of which is not clear in some jurisdictions; incidences of fraud, security breaches, errors, defects, failures, vulnerabilities or bugs in our electronic payment services business, or our failure to comply with required external audit standards; and our inability to increase our fees when our electronic payment services providers increase their transaction processing fees, or to increase our fees in a sufficient amount to maintain our existing margins.

If any of these risks related to our electronic payment services were to materialize, our business or operating results could be negatively affected. Although we attempt to structure and adapt our electronic payment services to comply with complex and evolving laws, regulations and standards, our underwriting efforts do not guarantee compliance. In the event that we are found to be in violation of our legal, regulatory or contractual requirements, we may be subject to monetary fines or penalties, cease and desist orders, mandatory product changes, or other liabilities that could have an adverse effect on our operating results.

Additionally, with respect to the processing of electronic payment transactions by our third-party electronic payment services providers, we are exposed to financial risk. Electronic payment transactions between our customer and another user may be returned for various reasons such as insufficient funds or stop payment orders. If we or our electronic payment services provider is unable to collect such amounts from the customer's account (such as if the customer is illegitimate, or if the customer refuses or is unable to reimburse us for the amounts charged back), we bear the ultimate risk of loss for the transaction amount. While we have not experienced material losses resulting from amounts charged back in the past, there can be no assurance that we will not experience these types of significant losses in the future.

In addition to the risks associated with our electronic payment services, there is an overarching risk stemming from the potential widespread adoption of quickly evolving financial technology products, including, for example, blockchain or other distributed ledger technologies, that could materially impact the manner in which payments are processed and the regulatory framework applicable to such payments. The adoption of disruptive financial technologies could significantly reduce the volume of our electronic payment services business or change the transaction costs associated with or potential revenue derived from those payments, thereby reducing our revenue and increasing our associated expenses, which could materially impact our business, financial condition, operating results and, ultimately, our stock price.

Evolution and expansion of our electronic payment services may subject us to additional risks and regulatory requirements.

The evolution and expansion of our electronic payment services may subject us to additional risks and regulatory requirements, including without limitation laws and regulations governing money transmission and anti-money laundering. These requirements vary throughout the markets in which we operate, and several jurisdictions lack clarity with respect to the application and interpretation of these rules. Our efforts to comply with these rules could require significant management time and effort, as well as significant expenditures, and will not guarantee our compliance with all regulatory requirements, especially given that the applicable regulatory frameworks are constantly changing and subject to evolving interpretation. While we maintain a compliance program focused on applicable laws and regulations throughout our applicable industries, there is no guarantee that we will not be subject to fines, penalties or other regulatory actions in one or more jurisdictions, or be required to adjust our business practices to accommodate future regulatory requirements.

We face a number of risks in our tenant screening services business that could adversely affect our business or operating results.

Our tenant screening services business is subject to a number of complex laws that are subject to varying interpretations, including the Fair Credit Reporting Act ("FCRA") and the related regulations. The FCRA has recently been the subject of multiple class-based litigation proceedings, as well as numerous regulatory inquiries and enforcement actions. In addition, entities such as the Federal Trade Commission ("FTC") and the Consumer Financial Protection Bureau ("CFPB") have the authority to promulgate rules and regulations that may impact our customers

and our business. Although we attempt to structure and adapt our tenant screening services to comply with these laws and regulations, we may from time to time be found to be in violation of them. Further, regardless of our compliance with applicable laws and regulations, we may from time to time be subject to regulatory inquiries enforcement actions, class-based litigation or indemnity demands.

As we have previously announced, we are in the process of settling a class action lawsuit related to alleged violations of the FCRA. In addition, and as also previously announced, we received a Civil Investigative Demand ("CID") from the FTC in December 2018 requesting certain information relating to our compliance with the FCRA in connection with our tenant screening services business. Due to the large number of tenant screening transactions in which we participate, our potential liability in an

Table of Contents

enforcement action or a class action lawsuit could be significant, especially given that certain applicable laws and regulations provide for fines or penalties on a per occurrence basis. The existence of any such enforcement action or class action lawsuit, whether meritorious or not, may adversely affect our ability to attract customers, result in the loss of existing customers, harm our reputation and cause us to incur defense costs or other expenses. Any of the foregoing events may negatively affect our business, financial condition, operating results and, ultimately, our stock price. We use third-party service providers for important electronic payment and tenant screening services, and their failure to fulfill their contractual obligations could harm our reputation, disrupt our business and adversely affect our operating results.

We use third-party electronic payment services providers to enable us to provide electronic payment services to our customers, and third-party tenant screening services providers to enable us to provide tenant screening services, such as background and credit checks, to our customers. We rely on these service providers to provide us with accurate and timely information, and we have significantly less control over our electronic payment and tenant screening services than if we were to maintain and operate them ourselves. In some cases, functions necessary to our business are performed on proprietary third-party systems and software to which we have no access. We also generally do not have long-term contracts with these service providers. In addition, some of these service providers compete with us directly or indirectly in the markets we serve. The failure of these service providers to provide us with accurate and timely information, to fulfill their contractual obligations of us, or to renew their contracts with us, could result in direct liability to us, harm our reputation, result in significant disruptions to our business, and adversely affect our operating results.

Privacy and data security laws and regulations could impose additional costs on us and reduce the demand for our software solutions.

Our customers store and transmit a significant amount of personal or identifying information through our technology platform. Privacy and data security have become significant issues in the United States and in other jurisdictions where we may offer our software solutions. The regulatory framework relating to privacy and data security worldwide is rapidly evolving and is likely to remain uncertain for the foreseeable future. Federal, state and foreign government bodies and agencies have in the past adopted, and may in the future adopt, laws and regulations regarding the collection, use, processing, storage and disclosure of personal or identifying information obtained from customers and other individuals. In addition to government regulation, privacy advocates and industry groups may propose various self-regulatory standards that may legally or contractually apply to our business. Because the interpretation and application of many privacy and data security laws, regulations and applicable industry standards are uncertain, it is possible that these laws, regulations and standards may be interpreted and applied in a manner inconsistent with our existing privacy and data management practices. As we expand into new jurisdictions or verticals, we will need to understand and comply with various new requirements applicable in those jurisdictions or verticals.

To the extent applicable to our business or the businesses of our customers, these laws, regulations and industry standards could have negative effects on our business, including by increasing our costs and operating expenses, and/or delaying or impeding our deployment of new or existing core functionality or Value+ services. Compliance with these laws, regulations and industry standards requires significant management time and attention, and failure to comply could result in negative publicity, subject us to fines or penalties, or result in demands that we modify or cease existing business practices. In addition, the costs of compliance with, and other burdens imposed by, such laws, regulations and industry standards may adversely affect our customers' ability or desire to collect, use, process and store personal information using our software solutions, which could reduce overall demand for them. Even the perception of privacy and data security concerns, whether or not valid, may inhibit market acceptance of our software solutions in certain verticals. Furthermore, privacy and data security concerns may cause our customers' clients, vendors, employees and other industry participants to resist providing the personal information necessary to allow our customers to use our applications effectively. Any of these outcomes could adversely affect our business and operating results.

The markets in which we participate are intensely competitive and, if we do not compete effectively, our business could be harmed.

The overall market for business management software is global, highly competitive and continually evolving in response to a number of factors, including changes in technology, operational requirements, and laws and regulations. Although relatively early in its development, the market for cloud-based business management software is also highly competitive and subject to similar market factors.

While we focus on providing industry-specific, cloud-based business management software solutions in our targeted verticals, we compete with other vertical cloud-based solution providers, as well as with horizontal cloud-based solution providers that provide broad cloud-based solutions across multiple verticals. Our competitors include established vertical software vendors, as well as newer entrants in the market. We also face competition from numerous cloud-based solution providers that focus almost exclusively on one or more point solutions. Continued consolidation among cloud-based providers could lead to significantly increased competition.

Table of Contents

Although the domain expertise required to successfully develop, market and sell cloud-based business management software solutions in the real estate and legal verticals may hinder new entrants that are unable to invest the necessary resources to develop and deploy cloud-based solutions with the same level of functionality as ours, many of our competitors and potential competitors are larger and have greater name recognition, longer operating histories, and significantly greater resources than we do. As a result, our competitors may be able to respond more quickly and effectively to new or changing opportunities, technologies, operational requirements and industry standards. Some of these competitors may have more established customer relationships or strategic partnerships with third parties that enhance their products and services. Other competitors may offer products or services that address one or a number of business functions on a standalone basis at lower prices or bundled as part of a broader product sale, or with greater depth than our software solutions. In addition, our current and potential competitors may develop, market and sell new technologies with comparable functionality to our software solutions, which could cause us to lose customers, slow the rate of growth of new customers and cause us to decrease our prices in order to remain competitive. For all of these reasons, we may not be able to compete effectively against our current and future competitors, which could harm our business.

Business management software for SMBs is a relatively new and developing market and, if the market is smaller than we estimate or develops more slowly than we expect, our operating results could be adversely affected.

We provide cloud-based business management software for SMBs in the real estate and legal markets and, as part of our business strategy, we will assess entry into new markets. While the overall market for cloud-based business management software is rapidly growing, it is not as mature as the market for legacy on-premise software applications. In addition, when compared to larger enterprises, SMBs have not historically purchased enterprise resource planning or other enterprise-wide software systems to manage their businesses due to the cost and complexity of implementing such systems, which generally did not address their industry-specific needs. Furthermore, a number of widely adopted cloud-based solutions have not traditionally targeted SMBs. As a result, many SMBs still run their businesses using manual processes and disparate software systems that are not web-optimized, while others may have invested substantial resources to integrate a variety of point solutions into their organizations to address one or more specific business needs and, therefore, may be reluctant to migrate to a vertical cloud-based solution designed to apply to their entire business. Our success will depend, in part, on the widespread adoption by SMBs of cloud computing in general and of cloud-based business management software in particular.

The market for industry-specific, cloud-based business management software for SMBs, both generally, and specifically within the real estate and legal markets, is evolving and, in comparison to the overall market for cloud-based solutions, is relatively small. The continued expansion of this market depends on numerous factors, including:

the cost and perceived value associated with cloud-based business management software relative to on-premise software applications and disparate point solutions;

the ability of cloud-based solution providers to offer SMBs the functionality they need to operate and grow their businesses;

the willingness of SMBs to transition from their existing software systems, or otherwise alter their existing businesses practices, to migrate their businesses to a vertical cloud-based business management software solution; and
the ability of cloud-based solution providers to address security, privacy, availability and other concerns.

If cloud-based business management software does not achieve widespread market acceptance among SMBs, our revenue may increase at a slower rate than we expect and may even decline, which could adversely affect our operating results. In addition, it is difficult to estimate the rate at which SMBs will be willing to transition to vertical cloud-based business management software in any particular period, which makes it difficult to estimate the overall size and growth rate of the market for cloud-based business management software for SMBs at any given point in time or to forecast growth in our revenue or market share.

Our estimates of market opportunity are subject to significant uncertainty and, even if the markets in which we compete meet or exceed our size estimates, we could fail to increase our revenue or market share.

Market opportunity estimates are subject to significant uncertainty and are based on assumptions and estimates, including our internal analysis and industry experience. Assessing the market for industry-specific, cloud-based

business management software is particularly difficult due to a number of factors, including limited available information and rapid evolution of the market. If we had made different assumptions, our estimates of market opportunity could be materially different.

In addition, even if the markets in which we compete meet or exceed our size estimates, our software solutions could fail to gain market acceptance and our business may not grow in line with our forecasts, or at all, which would have a material adverse impact on our financial condition and operating results.

Table of Contents

If we are unable to introduce successful enhancements, including new and innovative core functionality and Value+ services for our existing markets and verticals, or new products for adjacent markets or additional verticals, our operating results could be adversely affected.

The software industry in general, and our targeted verticals in particular, are characterized by rapid technological advances, changing industry standards, evolving customer requirements and intense competition. Our ability to attract new customers, increase revenue from our existing customers, and expand into adjacent markets or new verticals depends, in part, on our ability to enhance the functionality of our existing software solutions by introducing new and innovative core functionality and Value+ services that keep pace with technological developments, and provide functionality that addresses the evolving business needs of our customers. In addition, our growth over the long term depends, in part, on our ability to introduce new products for adjacent markets and additional verticals that we identify through our market validation process. Market acceptance of our current and future software solutions will depend on numerous factors, including:

- the unique functionality and ease of use of our software solutions and the extent to which our software solutions meet the business needs of our customers;
- the perceived benefits and security of our cloud-based business management software solutions relative to on-premise software applications or other competitive products;
- the pricing of our software solutions relative to competitive products;
- perceptions about the security, privacy and availability of our software solutions relative to competitive products;
- time-to-market of the updates and enhancements to our core functionality, Value+ services and new products; and
- perceptions about the quality and responsiveness of our customer service organization.

If we are unable to successfully enhance the functionality of our existing software solutions, including our core solutions and Value+ services, and develop or acquire new products that gain market acceptance in adjacent markets and additional verticals, our revenue may increase at a slower rate than we expect and may even decline, which could adversely affect our operating results.

Our business depends substantially on existing customers renewing their subscriptions with us and expanding their use of our Value+ services, and a decline in customer renewal rates, or failure to convince existing customers to adopt and utilize our Value+ services, could adversely impact our operating results.

In order for us to maintain or increase our revenue and improve our operating results, it is important that our existing customers continue to pay subscription fees for the use of our core solutions, which tend to incrementally rise over time, as well as increase their adoption and utilization of our Value+ services. Our customers have no obligation to renew their subscriptions with us upon expiration of their subscription periods, which typically range from one month to one year. We cannot assure you that our customers will renew their subscriptions with us. In addition, our law firm customers that start their accounts using a 10-day free trial have no obligation to begin a paid subscription.

Furthermore, although a significant portion of our revenue growth has historically resulted from the adoption and utilization of our Value+ services by our existing customers, we cannot assure you that our existing customers will continue to broaden their adoption and utilization of our Value+ services, or use our Value+ services at all. If our existing customers do not renew their subscriptions and increase their adoption and utilization of our existing or newly developed Value+ services, our revenue may increase at a slower rate than we expect and may even decline, which could adversely impact our financial condition and operating results.

Word-of-mouth referrals represent a significant source of new customers for us and provide us with an opportunity to cost-effectively market and sell our software solutions. The loss of our existing customers could have a significant impact on our reputation in our targeted verticals and our ability to acquire new customers cost-effectively. A reduction in the number of our existing customers, even if offset by an increase in new customers, could have the impact of reducing our revenue and operating margins.

In an effort to retain our customers and to expand our customers' adoption and utilization of our Value+ services, we may choose to use increasingly costly sales and marketing efforts. In addition, we may make significant investments in research and product development to introduce Value+ services that ultimately are not broadly adopted by our customers. In either of those cases, we could incur significantly increased costs without a corresponding

increase in revenue. Furthermore, we may fail to identify Value+ services that our customers need for their businesses, in which case we could miss opportunities to increase our revenue.

Table of Contents

Pricing pressure may cause us to change our pricing model, which could hurt our renewal rates and our ability to attract new customers, as well as our ability to increase adoption and usage of our Value+ services, which could adversely affect our operating results.

As the markets for our existing software solutions mature, or as current and future competitors introduce new products or services that compete with ours, we may experience pricing pressure and be unable to renew our subscription agreements with existing customers or increase adoption and usage of our Value+ services, or attract new customers at prices that are consistent with our current pricing model and operating budget. If this were to occur, it is possible that we would have to change our pricing model, offer pricing incentives, or generally reduce our prices, which may adversely affect our revenue even if adoption and utilization remain constant. In addition, many of our customers are smaller companies or firms, which are typically more cost sensitive than larger enterprises. Changes to our pricing model could harm our customer retention rates and our ability to attract new customers, whether in connection with our core solutions or our Value+ services, which could adversely affect our operating results.

We expect to continue to derive a significant portion of our revenue from our property manager customers, and factors resulting in a loss of these customers could adversely affect our operating results.

Historically, more than 90% of our revenue has been derived from APM, and we expect that our property manager customers will continue to account for a significant portion of our revenue for the foreseeable future. We could lose property manager customers as a result of numerous factors, including:

the expiration and non-renewal of subscriptions or termination of subscription agreements;

the introduction of competitive products or technologies;

our failure to provide updates and enhancements to our core functionality and Value+ services, and to introduce new Value+ services to our customers;

changes in pricing policies by us or our competitors;

acquisitions or consolidations within the property management industry;

bankruptcies or other financial difficulties facing our customers; and

conditions or trends that are specific to the property management industry such as the economic factors that impact the rental market.

The loss of a significant number of our property manager customers, or the loss of even a small number of our larger property manager customers, could cause our revenue to increase at a slower rate than we expect or even decline. In addition, even if we are able to retain our property manager customers, we may be unable to grow revenue from these property manager customers by increasing their adoption and utilization of our Value+ services. Any of these outcomes could adversely affect our operating results.

Our quarterly results may fluctuate significantly and period-to-period comparisons of our results may not be meaningful.

Our quarterly results, including the levels of our revenue, costs, operating expenses, and operating margins, may fluctuate significantly in the future, and period-to-period comparisons of our results may not be meaningful.

Accordingly, the results of any one quarter should not be relied upon as an indication of our future performance. In addition, our quarterly results may not fully reflect the underlying performance of our business. Factors that may cause fluctuations in our quarterly results include, but are not limited to:

our ability to retain our existing customers, and to expand adoption and utilization of our core solutions and Value+ services by our existing customers;

our ability to attract new customers, the type of customers we are able to attract, the size and needs of their businesses, and the cost of acquiring these customers;

the mix of our core solutions and Value+ services sold during the period;

the timing and impact of security breaches, service outages or other performance problems with our technology infrastructure and software solutions;

Table of Contents

variations in the timing of sales of our core solutions and Value+ services as a result of trends impacting the verticals in which we sell our software solutions;
the timing and market acceptance of new core functionality, Value+ services and other products introduced by us and our competitors;
changes in our pricing policies or those of our competitors;
 the timing of our recognition of revenue;
the amount and timing of costs and operating expenses related to the maintenance and expansion of our business, infrastructure and operations;
the amount and timing of costs and operating expenses associated with assessing or entering adjacent markets or new verticals;
the amount and timing of costs and operating expenses related to the development or acquisition of businesses, services, technologies or intellectual property rights, and potential future charges for impairment of goodwill from these acquisitions;
the timing and costs associated with legal proceedings, enforcement actions, regulatory inquiries or similar matters;
changes in the competitive dynamics of our industry, including consolidation among competitors, strategic partners or customers;
loss of our executive officers or other key employees;
industry conditions and trends that are specific to the verticals in which we sell or intend to sell our software solutions; and
general economic and market conditions.

Our focus on managing our business towards the achievement of long-term growth, rather than the realization of short-term financial or business metrics, may serve to exacerbate the fluctuations in our quarterly results, which could result in downward pressure on the market price of our Class A common stock. In addition, fluctuations in quarterly results may negatively impact the value of our Class A common stock, regardless of whether they impact or reflect the overall performance of our business. Furthermore, if our quarterly results fall below the expectations of investors or any securities analysts who follow our stock, or below any financial guidance we may provide, the price of our Class A common stock could decline substantially.

Our corporate culture has contributed to our success and, if we cannot continue to foster this culture as we grow, we could lose the passion, creativity, teamwork, focus and innovation fostered by our culture.

We believe that our culture has been and will continue to be a key contributor to our success. If we do not continue to develop our corporate culture or maintain our core values as we grow and evolve, we may be unable to foster the passion, creativity, teamwork, focus and innovation we believe we need to support our growth. Any failure to preserve our culture could negatively affect our ability to recruit and retain personnel and to effectively focus on and pursue our strategic objectives. Moreover, liquidity available to our employee security holders could lead to disparities of wealth among our employees, which could adversely impact relations among employees and our culture in general. As we grow and mature as a public company, we may find it difficult to maintain our corporate culture.

If we lose key members of our management team, our business may be harmed.

Our success and future growth depend, in part, upon the continued services of our executive officers and other key employees. From time to time, there may be changes in our executive officers or other key employees resulting from the hiring or departure of these personnel, which may disrupt our business. Our executive officers and other key employees are generally employed on an at-will basis, which means that these personnel could terminate their employment with us at any time. Additionally, the equity awards held by many of our executive officers and other key employees are close to fully vested, and these employees may not have sufficient financial incentive to stay with us. The loss of one or more of our executive officers or other key employees, or the failure by our executive team to work effectively with our employees and lead our company, could have an adverse effect on our business.

Table of Contents

We depend on highly skilled personnel and, if we are unable to retain or hire additional qualified personnel, we may not be able to achieve our strategic objectives.

To execute our growth plan and achieve our strategic objectives, we must continue to attract and retain highly qualified and motivated personnel across our organization. In particular, in order to continue to enhance our software solutions, add new and innovative core functionality and Value+ services, as well as develop new products, it will be critical for us to increase the size of our research and product development organization, including hiring highly skilled software engineers. Competition for software engineers is intense within our industry and there continues to be upward pressure on the compensation paid to these professionals. In addition, in order for us to achieve broader market acceptance of our software solutions, grow our customer base, and pursue adjacent markets and new verticals, we will need to continue to increase the size of our sales and marketing and customer service organizations.

Identifying and recruiting qualified personnel training them in the use of our software solutions and ensuring they are well-equipped to provide great service to our customers requires a significant investment of time and resources, and it can be particularly difficult to retain these individuals.

Many of the companies with which we compete for experienced personnel have greater name recognition and financial resources than we have. If we hire employees from competitors or other companies, their former employers may attempt to assert that we or these employees have breached their legal obligations, resulting in a diversion of our time and resources. In addition, our headquarters are located in Santa Barbara, California, which is not generally recognized as a prominent commercial center, and it is challenging to attract qualified professionals due to our geographic location. As a result, we may have even greater difficulty hiring and retaining skilled personnel than our competitors. If we are unable to attract and retain the personnel necessary to execute our growth plan, we may be unable to achieve our strategic objectives and our operating results may suffer.

In addition, prospective and existing employees often consider the value of the equity awards they receive in connection with their employment. If the perceived value of our equity awards declines, or if the price of our Class A common stock experiences significant volatility, this may adversely affect our ability to recruit and retain highly skilled employees. If we fail to attract new personnel or to retain and motivate our current personnel, we may not be able to achieve our strategic objectives.

Our growth depends in part on the success of our strategic relationships with third parties, and if we are unsuccessful in establishing or maintaining these relationships, our ability to compete in the market place or grow our revenue could be impaired.

In order to grow our business, we anticipate that we will continue to depend on our relationships with third parties, including our data center operators, electronic payment, tenant screening and insurance services providers, and other third parties that support delivery of our software solutions. Identifying partners, negotiating agreements and maintaining relationships requires significant time and resources. Our competitors may be more effective than us in cost-effectively building relationships with third parties that enhance their products and services, allow them to provide more competitive pricing, or offer other benefits to their customers. In addition, acquisitions of our partners by our competitors could result in a decrease in the number of current and potential strategic partners willing to establish or maintain relationships with us, and could increase the price at which products or services are available to us. If we are unsuccessful in establishing or maintaining our relationships with third parties, our ability to compete in the marketplace or to grow our revenue could be impaired, which could negatively impact our operating results. Even if we are successful, we cannot assure you that these relationships will result in increased customer adoption and usage of our software solutions or improved operating results. Furthermore, if our partners fail to perform as expected, we may be subjected to litigation, our reputation may be harmed, and our business and operating results could be adversely affected.

We depend on data centers and computing infrastructure operated by third parties and any disruption in these operations could adversely affect our operating results.

We currently serve our customers through a combination of our own servers located in third-party data center facilities, and servers and data centers operated by Amazon and other third parties. While we control and have access to our own servers and the other components of our network that are located in our third-party data centers, we do not control the operation of any of these third-party data center facilities. The owners of our data center facilities have no

obligation to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew these agreements on commercially reasonable terms, or if one of our third-party data center operators is acquired, we may be required to transfer our servers and other infrastructure to new data center facilities, and we may incur significant costs and possible service interruptions in connection with doing so. Further, our third-party data center providers could experience significant outages outside of our control that could adversely affect our business. Problems faced by our third-party data center operators, or with any of the service providers with whom we or they contract, could adversely affect the experience of our customers. Our third-party data center operators could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy, faced by our third-party data center operators, or any of the service providers with whom we or they contract, may have negative effects on our business. Additionally,

Table of Contents

if our data centers are unable to keep up with our growing needs for capacity or any spikes in customer demand, this could have an adverse effect on our business. Any changes in third-party service levels at our data centers could result in loss of or damage to our customers' stored information and service interruptions, which could harm our reputation. These issues could also cause us to lose customers, harm our ability to attract new customers, and subject us to potential liability, any of which could adversely affect our operating results.

Our systems are not yet fully redundant and, although the redundancies we do have in place will permit us to respond, at least to some degree, to service outages, our third-party data centers are vulnerable in the event of failure. We do not yet have adequate structure or systems in place to recover from a data center's severe impairment or total destruction, and recovery from the total destruction or severe impairment of any of our third-party data centers could be difficult or may not be possible at all.

Our platform must integrate with a variety of devices, operating systems and browsers that are developed by others, and if we are unable to ensure that our software solutions interoperate with such devices, operating systems and browsers, our software solutions may become less competitive, and our operating results may be harmed.

We offer our software solutions across a variety of operating systems and through the Internet. We are dependent on the interoperability of our platform with third-party devices, desktop and mobile operating systems, as well as web browsers that we do not control. Any changes in such devices, systems or web browsers that degrade the functionality of our software solutions or give preferential treatment to competitive services could adversely affect adoption and usage of our software solutions. In addition, in order to deliver high quality software solutions, we will need to continuously enhance and modify our functionality to keep pace with changes in Internet-related hardware, mobile operating systems such as iOS and Android, browsers and other software, communication, network and database technologies. We may not be successful in developing enhancements and modifications that operate effectively with these devices, operating systems, web browsers and other technologies or in bringing them to market in a timely manner. Furthermore, uncertainties regarding the timing or nature of new network platforms or technologies, and modifications to existing platforms or technologies, could increase our research and product development expenses. In the event that it is difficult for our customers to access and use our software solutions, our software solutions may become less competitive, and our operating results could be adversely affected.

If our property manager customers stop requiring residents to provide proof of legal liability to landlord insurance, if insurance premiums decline or if insureds experience greater than expected losses, our operating results could be harmed.

We generate revenue by offering legal liability to landlord insurance through a wholly owned subsidiary. Some of our property manager customers require residents to provide proof of legal liability to landlord insurance and offer to enroll residents in their legal liability to landlord insurance policy. If demand for rental housing declines, or if our property manager customers believe that it may decline, these customers may reduce their rental rates and stop requiring residents to provide proof of legal liability to landlord insurance in order to reduce the overall cost of renting and make their rental offerings more competitive. If our property manager customers stop requiring residents to provide proof of legal liability to landlord insurance or elect to enroll residents in insurance programs offered by competing providers, or if insurance premiums otherwise decline, our revenues from insurance services could be adversely affected.

Additionally, our legal liability to landlord insurance policies are underwritten by us, and we are required by our insurance partner to maintain a reserve to cover potential claims under the policies. While our policies have a limit of \$100,000 per occurrence, there is no limit on the dollar amount of claims that could be made against us in any particular period or in the aggregate. In the event that claims by the insureds increase unexpectedly, our reserve may not be sufficient to cover our resulting liability under the policies. To the extent we are required to pay out amounts to insureds that are significantly higher than our current reserves, this could have a material adverse effect on our operating results.

Our insurance business is subject to state governmental regulation, which could limit the growth of our insurance business and impose additional costs on us.

Our insurance-related wholly owned subsidiaries and third-party service providers maintain licenses with a number of individual state departments of insurance. Collectively, we are subject to state governmental regulation and

supervision in connection with the operation of our insurance business, which includes both our legal liability to landlord insurance and renters' insurance businesses. This state governmental supervision could limit the growth of our insurance business by increasing the costs of regulatory compliance, limiting or restricting the products or services we provide or the methods by which we provide them, and subjecting us to the possibility of regulatory actions or proceedings. Our continued ability to maintain these insurance licenses in the jurisdictions in which we are licensed depends on our compliance with the rules and regulations promulgated from time to time by the regulatory authorities in each of these jurisdictions. Furthermore, state insurance departments conduct periodic examinations, audits and investigations of the affairs of insurance companies and agencies, any of which could result in the expenditure of significant management time or financial resources.

Table of Contents

In all jurisdictions, the applicable laws and regulations are subject to amendment and interpretation by regulatory authorities. Generally, such authorities are vested with relatively broad discretion to grant, renew and revoke licenses and approvals and to implement and interpret rules and regulations. Accordingly, we may be precluded or temporarily suspended from carrying on some or all of the activities of our insurance business or otherwise be fined or penalized in a given jurisdiction. No assurances can be given that our insurance business can continue to be conducted in any given jurisdiction as it has been conducted in the past or that we will be able to expand our insurance business in the future.

If we are unable to enter new verticals, or if our software solution for any new vertical fails to achieve market acceptance, our operating results could be adversely affected and we may be required to reconsider our growth strategy.

Our growth strategy is dependent, in part, on our ability to expand into new verticals, beyond the real estate and legal markets. However, we may be unable to identify new verticals that meet our criteria for selecting industries that cloud-based solutions are ideally suited to address. In addition, our market validation process may not support entry into selected verticals due to our perception of the overall market opportunity or of the willingness of market participants within those verticals to adopt our software solutions. Further, instead of pursuing new verticals, we may prefer for various reasons to pursue alternative growth strategies, such as entry into markets that are adjacent to the markets in which we currently participate within our existing verticals, or the development of additional products or services for our existing markets.

Even if we choose to enter new verticals, our market validation process does not guarantee our success. We may be unable to develop a software solution for a new vertical or, in the event that we enter a new vertical by way of a strategic acquisition, we may be unable to leverage the acquired software solution in time to take advantage of the identified market opportunity, and any delay in our time-to-market could expose us to additional competition or other factors that could impede our success. In addition, any software solution we develop or acquire for a new vertical may not provide the functionality required by potential customers and, as a result, may not achieve widespread market acceptance within the new vertical. To the extent we choose to enter new verticals, whether organically or via strategic acquisition, we may invest significant resources to develop and expand the functionality of our software solutions to meet the needs of customers in those verticals, which investments will occur in advance of our realization of revenue from them.

In addition, while we expedited our entry into the legal vertical through the acquisition of MyCase in 2012, our practice and case management solution is in an earlier stage of development than APM, our property management solution, and we are at an earlier stage in the process of expanding the core functionality and Value+ services associated with our legal software. We face significant competition in the legal market from both vertical software vendors and cloud-based solution providers that offer one or more point solutions. There can be no assurance that we will be able to achieve market acceptance for our legal software at or near the levels achieved by our property management software. The success of our vertical market strategy depends, in part, on our ability to continue to significantly increase the number and size of our law firm customers and the revenue derived from them, and our failure to achieve these objectives could have an adverse impact on our operating results.

All of our revenues are generated by sales to customers in our targeted verticals, and factors that adversely affect the applicable industry could also adversely affect us.

Currently, all of our sales are to customers in the real estate market and, to a lesser extent, the legal market. Demand for our software solutions could be affected by factors that are unique to and adversely affect our targeted verticals. In particular, the real estate and legal markets are highly regulated, subject to intense competition and impacted by changes in general economic and market conditions. For example, changes in applicable laws and regulations could significantly impact the software functionality demanded by our customers and require us to expend significant resources to ensure our software solutions continue to meet their evolving needs. In addition, other industry-specific factors, such as industry consolidation or the introduction of competing or disruptive technology, could lead to a significant reduction in the number of customers that use our software solutions within a particular vertical or the Value+ services demanded by these customers. Further, if the real estate or legal markets decline, our customers may decide not to renew their subscriptions or they may cease using our Value+ services in order to reduce costs to remain

competitive. As a result, our ability to generate revenue from our real estate and legal market customers could be adversely affected by specific factors that affect the real estate or legal markets.

In addition to the foregoing risks associated with our targeted verticals themselves, there is an overarching risk stemming from potential widespread adoption of quickly evolving financial or other disruptive technology products that could significantly impact our targeted verticals, even if that technology is not specifically designed to apply directly to our targeted verticals. The adoption of these new technologies could significantly reduce the volume or demand of customers in our targeted verticals, thereby reducing our revenue, which could materially impact our business, financial condition, operating results and, ultimately, our stock price.

Table of Contents

If we are unable to increase sales of our software solutions to larger customers while mitigating the risks associated with serving such customers, our business and operating results may suffer.

While we plan to continue to market and sell our software solutions to smaller companies or firms, our growth strategy is dependent, in part, upon increasing sales of our software solutions to larger customers within the real estate and legal markets. Sales to larger customers may involve risks that are not present, or are present to a lesser extent, in sales to smaller businesses. As we seek to increase our sales to larger customers, we may invest considerably greater amounts of time and financial resources in our sales and marketing efforts. In addition, we may face longer sales cycles and experience less predictability and greater competition in completing some of our sales than we have in selling our software solutions to smaller businesses. Although we generally have not configured our software solutions or negotiated our pricing for specific customers, which has historically resulted in reduced upfront selling costs, our ability to successfully sell our software solutions to larger customers may be dependent, in part, on our ability to develop functionality, or to implement pricing policies, that are unique to particular customers. It may also be dependent on our ability to attract and retain sales personnel with experience selling to larger organizations. Also, because security breaches or other performance problems with respect to larger customers may result in greater economic harm to these customers and more adverse publicity, there is increased financial and reputational risk associated with serving such customers. If we are unable to increase sales of our software solutions to larger customers, while mitigating the risks associated with serving such customers, our business and operating results may suffer.

If we are unable to deliver effective customer service, it could harm our relationships with our existing customers and adversely affect our ability to attract new customers.

Our business depends, in part, on our ability to satisfy our customers, both by providing software solutions that address their business needs, and by providing onboarding services and ongoing customer service, which contributes to retaining customers and increasing adoption and utilization of our Value+ services by our existing customers. Once our software solutions are deployed, our customers depend on our customer service organization to resolve technical issues relating to their use of our solutions. We may be unable to respond quickly to accommodate short-term increases in customer demand for support services or may otherwise encounter a customer issue that is difficult to resolve. If a customer is not satisfied with the quality or responsiveness of our customer service, we could incur additional costs to address the situation. As we do not separately charge our customers for support services, increased demand for our support services would increase costs without corresponding revenue, which could adversely affect our operating results. In addition, regardless of the quality or responsiveness of our customer service efforts, a customer that is not satisfied with an outcome may choose to terminate, or not to renew, their relationship with us.

Our sales process is highly dependent on the ease of use of our software solutions, our reputation and positive recommendations from our existing customers. Any failure to maintain high-quality or responsive customer service, or a market perception that we do not maintain high-quality or responsive customer service, could harm our reputation, cause us to lose customers and adversely impact our ability to sell our software solutions to prospective customers.

Our software solutions address functions within the heavily regulated real estate and legal markets, and our customers' failure to comply with applicable laws and regulations could subject us to litigation.

We sell our software solutions to customers within the real estate market and, to a lesser extent, the legal market. Our customers use our software solutions for business activities that are subject to a number of laws and regulations, including without limitation federal, state and local real property laws and legal ethics rules. Any failure by our customers to comply with laws and regulations applicable to their businesses could result in fines, penalties or claims for substantial damages against our customers. To the extent our customers believe that our software solutions or our customer service organization caused or contributed to such failures, our customers may make claims for damages against us, regardless of whether we are responsible for the failure. As a result, we may be subject to lawsuits that, even if unsuccessful, could divert our resources and our management's attention and adversely affect our business, and our insurance coverage may not be sufficient to cover such claims against us.

If we are unable to maintain and promote our brands, or to do so in a cost-effective manner, our ability to maintain and expand our customer base will be impaired, and our operating results could be adversely affected.

We believe that maintaining and promoting our brands is critical to achieving widespread awareness and acceptance of our software solutions, and maintaining and expanding our customer base. We also believe that the importance of brand recognition will increase as competition in our targeted verticals increases. If we do not continue to build awareness of our brands, we could be placed at a competitive disadvantage as compared to companies whose brands are, or become, more recognizable than ours. Maintaining and promoting our brands will depend, in part, on our ability to continue to provide new and innovative core functionality and Value+ services and best-in-class customer service, as well as the effectiveness of our sales and marketing efforts. If we fail to deliver products and functionality that address our customers' business needs, or if we fail to meet our customers' expectations for customer service, it could weaken our brands and harm our reputation. Additionally, the actions of third parties which are out of our control may affect our brands and reputation if customers do not have a positive experience using the services

Table of Contents

of our third-party partners that support our software solutions. Maintaining and enhancing our brands may require us to make substantial investments, and these investments may not result in commensurate increases in our revenue. If we fail to successfully maintain and promote our brands, or if we make investments that are not offset by increased revenue, our operating results could be adversely affected.

Failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brands, which could harm our business.

We currently rely on patent, trademark, copyright and trade secret laws, trade secret protection and confidentiality or license agreements with our employees, customers, partners and others to protect our intellectual property rights. Our success and ability to compete depend, in part, on our ability to continue to protect our intellectual property, including our proprietary technology and our brands. If we are unable to protect our proprietary rights adequately, our competitors could use the intellectual property we have developed to enhance their own products and services, which could harm our business.

In order to monitor and protect our intellectual property rights, we may be required to expend significant resources. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming and distracting to management, and could result in the impairment or loss of portions of our intellectual property or require us to pay costly royalties. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability of our intellectual property rights. Accordingly, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property. Our failure to secure, protect and enforce our intellectual property rights could adversely affect our business and operating results.

We may be sued by third parties for alleged infringement of their proprietary rights, which could cause us to incur significant expenses and require us to pay substantial damages.

There is considerable patent, trademark, copyright, trade secret and other intellectual property development activity in our industry. Our success depends, in part, on our not infringing upon the intellectual property rights of others. Our competitors, as well as a number of other entities and individuals, may legally own or claim to own intellectual property relating to our technology or software solutions, including without limitation technology we develop and build internally and that which we acquire. From time to time, our competitors or other third parties may claim that we are infringing upon their intellectual property rights. However, we may be unaware of the intellectual property rights that others may claim cover some or all of our technology or software solutions. Any claims or litigation, regardless of merit, could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages, settlement costs or ongoing royalty payments, require that we comply with other unfavorable license and other terms, or prevent us from offering our software solutions in their current form. Even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the attention of our management and key personnel from our business operations and harm our operating results.

We have incurred and will continue to incur significant costs as a result of operating as a public company, and our management is required to devote substantial time to compliance with legal requirements and corporate governance initiatives.

As a public company, we have incurred and expect to continue to incur significant legal, accounting, compliance and other expenses. We are subject to the reporting requirements of the Exchange Act, the listing requirements of the NASDAQ Global Market, and other applicable securities rules and regulations. Compliance with these rules and regulations will continue to increase our legal and financial compliance costs, make some activities more difficult, time-consuming or costly, and increase demand on our systems and resources, particularly now that we are no longer an “emerging growth company” as defined in the JOBS Act.

For example, the Exchange Act requires that we publicly file annual, quarterly and current reports with respect to our business and operating results, and the Sarbanes-Oxley Act of 2002, or SOX, requires that we maintain effective

disclosure controls and procedures and internal control over financial reporting. In order to meet these requirements, significant resources and management oversight will be required. As a result, management's attention may be diverted from other business concerns, which could harm our business and operating results.

Because we are no longer an "emerging growth company," we are subject to, among other things, the requirement under Section 404 of SOX to obtain an attestation report on internal control over financial reporting from our independent registered public accounting firm, enhanced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and the requirement to hold a nonbinding advisory vote on executive compensation. Compliance with these additional requirements will only further increase our legal and financial compliance costs.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure requirements are creating uncertainty for public companies, increasing legal and financial compliance costs, and making some activities more

Table of Contents

difficult and time consuming. These laws, regulations and standards are subject to varying interpretations and their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to governance practices. We intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies, regulatory authorities may initiate legal proceedings against us, which could result in a material adverse impact on our business.

Compliance with the requirements of Section 404 of SOX will be costly and divert management resources, and we and our independent registered public accounting firm may be unable to conclude that our internal control over financial reporting is effective.

Pursuant to Section 404 of SOX, we are required to furnish an annual report by our management on our internal control over financial reporting. Because we are no longer an "emerging growth company," we are required to include in our Annual Report an attestation report on internal control over financial reporting issued by our independent registered public accounting firm. To achieve and maintain compliance with Section 404, we have been and will continue to be engaged in a process to document and evaluate our internal control over financial reporting, which will be costly and result in a diversion of management resources. In this regard, we will need to continue to dedicate internal resources, potentially engage outside consultants and adopt a detailed work plan to assess and document the adequacy of internal control over financial reporting, continue steps to improve control processes as appropriate, validate through testing that controls are functioning as documented, and implement a continuous reporting and improvement process for internal control over financial reporting.

Despite our efforts, there is a risk that in the future neither we nor our independent registered public accounting firm will be able to conclude that our internal control over financial reporting is effective as required by Section 404. If this were to occur, we could be subject to investigations or enforcement actions by the SEC or other regulatory authorities, stockholder lawsuits or other adverse actions, any of which could require us to incur defense costs, pay fines, settlements or judgments, or incur other costs or expenses. Furthermore, investor perceptions of our business may suffer if deficiencies are found, which could cause a decline in the market price of our Class A common stock.

Irrespective of our compliance with Section 404, any failure of our internal control over financial reporting could have a material adverse effect on our stated results of operations and harm our reputation. If we are unable to implement these requirements effectively, it could harm our business, and could result in an adverse opinion on our internal control over financial reporting from our independent registered public accounting firm.

Because we recognize revenue from subscriptions for our software solutions over the term of each subscription agreement, downturns or upturns in new business may not be immediately reflected in our operating results.

We recognize revenue from customers ratably over the term of each subscription agreement, which typically ranges from one month to one year. As a result, some of the revenue we report in each period is derived from the recognition of deferred revenue relating to subscription agreements entered into during previous periods. Consequently, a decline in new or renewed subscriptions in any one period may not be reflected in our revenue results for that period.

However, any such decline will negatively affect our revenue in future quarters. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription period. Accordingly, the effect of downturns or upturns in our sales, the market acceptance of our software solutions, and potential changes in our customer retention rates, may not be apparent in our operating results until future periods.

Because our invoicing is generally for periods less than one year, our revenue growth is heavily dependent on new subscription sales, consumption of our usage-based Value+ services and renewals of our subscription services in the

current year.

Our growth is heavily dependent on subscription sales, adoption and consumption of our usage-based Value+ services and renewals of our subscription services in the current year. We offer our core solutions and Value+ subscription services to customers pursuant to subscription agreements with relatively short terms, typically ranging 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. We do not currently intend to extend the typical terms of our subscription agreements with any regularity, or to invoice our customers less frequently, and we expect that we will continue to depend on current-year sales and renewals to drive our growth.

51

Table of Contents

Our software solutions contain both third-party and open source software, which may pose risks to our proprietary source code and/or introduce security vulnerabilities, and could have a negative impact on our business and operating results.

We use open source software in our software solutions and expect to continue to do so in the future. The terms of many open source licenses to which we are subject have not been interpreted by United States or foreign courts, and there is a risk that open source licenses could be construed in a manner that imposes unanticipated conditions, restrictions or costs on our ability to provide or distribute our software solutions. Additionally, we may from time to time face claims from third parties alleging ownership of, or demanding release of, the open source software or of derivative works that we developed using such software, which could include our proprietary source code, or otherwise seeking to enforce the terms of the applicable open source license. These claims could result in litigation, which could be costly for us to defend, and could require us to make our source code freely available, purchase a costly license or cease offering the implicated core functionality and Value+ services unless and until we can re-engineer them to avoid infringement. This re-engineering process could require significant additional research and product development resources, and we may not be able to complete it successfully or in a timely manner. In addition to risks related to license requirements, usage of certain open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or controls on the origin of software. These risks could be difficult to eliminate or manage, and could have a negative impact on our business and operating results.

We also use third-party commercial software in our software solutions and expect to continue to do so in the future. Third-party commercial software is developed outside of our direct control, and may introduce security vulnerabilities that may be difficult to anticipate or mitigate. Further, there is no guarantee that third-party software developers will continue active work on the third-party software that we use. Should development of in-use third-party software cease, significant engineering effort may be required to create an in-house solution. These risks could also be difficult to eliminate or manage, and could have a negative impact on our business and operating results.

Changes in laws and regulations related to the Internet or changes in the Internet infrastructure itself may diminish the demand for our software solutions, and could have a negative impact on our business.

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication and business services. Federal, state or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting the use of the Internet as a commercial medium. Changes in these laws or regulations, including laws impacting net neutrality, could decrease the demand for our software solutions and services and/or increase our cost of doing business, or require us to modify our software solutions to comply with or otherwise address any new or changed laws or regulations.

In addition, government agencies or private organizations may begin to impose taxes, fees or other charges for accessing the Internet, or for the commerce conducted via the Internet. These laws or charges could limit the growth of Internet-related commerce or communications generally, result in reductions in the demand for Internet-based business services such as ours, and cause us to incur significant expenses.

The use of the Internet in general could be adversely affected by delays in the development or adoption of new standards and protocols to handle increased demands of Internet activity, accessibility, reliability, security, cost, ease of use and quality of service. In addition, the use of the Internet as a medium for commerce, communication and business services may have been, and may continue to be, adversely affected by concerns regarding network outages, software errors, viruses, security breaches, fraud or other malicious activity. If the use of the Internet is adversely affected by these issues, demand for our software solutions could decrease.

Financing agreements that we are party to or may become party to may contain operating and financial covenants that restrict our business and financing activities. Failure to comply with these covenants, or other restrictions, could result in default under these agreements.

Our existing credit agreement with Wells Fargo as administrative agent, and the lenders that are parties thereto, which we refer to as the Second Amendment of our Original Credit Agreement, contains certain operating and financial restrictions and covenants, including limitations on dividends, dispositions, mergers or consolidations, incurrence of indebtedness and liens, and other corporate activities. These restrictions and covenants, as well as those contained in any future financing agreements that we may enter into, may restrict our ability to finance our operations, and to engage in, expand or otherwise pursue our business activities and strategic objectives. Our ability to comply with these covenants may be affected by events beyond our control, and breaches of these covenants could result in a default under the Second Amendment of our Original Credit Agreement and any future financing agreements that we may enter into. If not waived, defaults could cause any outstanding indebtedness under the Second Amendment of our Original Credit Agreement and any future financing agreements that we may enter into to become immediately due and payable.

Table of Contents

We may require additional capital to support our operations or the growth of our business, and we cannot be certain that this capital will be available on favorable terms when required, or at all.

We may need additional capital to grow our business and meet our strategic objectives. Our ability to obtain additional capital, if and when required, will depend on numerous factors, including investor and lender demand, our historical and forecasted financial and operating performance, our market position, and the overall condition of the capital markets. We cannot guarantee that additional financing will be available to us on favorable terms when required, or at all. In addition, if we raise additional funds through the issuance of equity securities, those securities may have powers, preferences or rights senior to the rights of our Class A common stock, and our existing stockholders may experience immediate dilution. If we raise additional funds through the issuance of debt securities, we may incur interest expense or other costs to service the indebtedness, we may be required to encumber certain assets, and we may become subject to restrictions on our ability to conduct business, any of which could negatively impact our operating results. Furthermore, if we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support the growth of our business and the achievement of our strategic objectives could be significantly impaired and our operating results may be harmed.

Our ability to use our net operating loss carryforwards and certain other tax attributes may be limited.

As of December 31, 2018, the date of our most recent audited financial statements, we had federal net operating loss carryforwards of approximately \$57.7 million and state net operating loss carryforwards of approximately \$41.2 million, which begin to expire in 2031 and 2023, respectively. We also had federal and state research and development credit carryforwards of \$7.4 million and \$7.5 million, respectively. The federal credits carryforwards will begin to expire in 2031, while the majority of state credit carryforwards apply indefinitely. Under Section 382 of the Internal Revenue Code of 1986, as amended, if a corporation undergoes an “ownership change,” the corporation’s ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes, such as research tax credits, to offset its post-change income and taxes may be limited. In general, an “ownership change” occurs if there is a cumulative change in our ownership by “5% shareholders” that exceeds 50% over a rolling three-year period. Similar rules may apply under state tax laws. It is possible that our existing net operating loss and/or credit carryforwards may be subject to limitations arising from previous ownership changes, and future issuances of our stock could cause an ownership change. Furthermore, our ability to utilize net operating loss and/or credit carryforwards of companies that we have acquired or may acquire in the future may be subject to limitations. Any such limitations on our ability to use our net operating loss carryforwards and other tax assets could adversely impact our business, financial condition and operating results.

Tax laws or regulations could be enacted or changed and existing tax laws or regulations could be applied to us or to our customers in a manner that could increase the costs of our software solutions and adversely impact our operating results.

The application of federal, state, local and foreign tax laws to services provided electronically is continuously evolving. New income, sales, use or other tax laws, statutes, rules, regulations or ordinances could be enacted or amended at any time, possibly with retroactive effect, and could be applied solely or disproportionately to services provided over the Internet. These enactments or amendments could adversely affect our sales activity due to the inherent cost increase the taxes would represent and could ultimately result in a negative impact on our operating results.

In addition, existing tax laws, statutes, rules, regulations or ordinances could be interpreted, modified or applied adversely to us, possibly with retroactive effect, which could require us or our customers to pay additional tax amounts, as well as require us or our customers to pay fines or penalties, as well as interest on past amounts. If we are unsuccessful in collecting such taxes due from our customers, we could be held liable for such costs, thereby adversely impacting our operating results.

We may be subject to additional tax liabilities.

We are subject to income, sales, use, value added and other taxes in the United States and other jurisdictions in which we conduct business, and such laws and rates vary by jurisdiction. Certain jurisdictions in which we do not collect sales, use, value added or other taxes on our sales may assert that such taxes are applicable, which could result in tax assessments, penalties and interest, and we may be required to pay or collect such taxes in the future. If we receive an adverse determination as a result of an audit or related litigation, or we unilaterally determine that we have misinterpreted provisions of the tax regulations to which we are subject, there could be a material effect on our tax provision, net income or cash flows in the period or periods for which that determination is made.

Because our long-term growth strategy involves expansion of our sales to customers outside the United States, our business will be susceptible to the risks associated with international operations.

A component of our growth strategy involves the expansion of our international operations and worldwide customer base. To date, we have realized an immaterial amount of revenue from customers outside the United States. Operating in international

Table of Contents

markets will require significant resources and management attention and will subject us to regulatory, economic, geographic and political risks that are different from those in the United States. Because of our limited experience with international operations and significant differences between the United States and international markets, our international expansion efforts may not be successful in creating demand for our software solutions outside of the United States or in effectively selling our software solutions in any international markets we may enter. If we invest substantial time and resources to expand our international operations and are unable to do so successfully, our business and operating results could suffer.

Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.

Generally accepted accounting principles in the United States, are subject to interpretation by the Financial Accounting Standards Board, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant impact on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

Risks Related to Our Class A Common Stock

The market price of our Class A common stock may be volatile or may decline regardless of our operating performance, which could result in substantial losses for our stockholders.

The market price of our Class A common stock has been, and is likely to continue to be, highly volatile, and fluctuations in the price of our Class A common stock could cause you to lose all or part of your investment. For example, from March 31, 2018 to March 31, 2019, the share price of our Class A common stock on the NASDAQ Global Market fluctuated between \$38.90 and \$91.48.

There are numerous factors that could cause fluctuations in the market price of our Class A common stock, including: volatility in the trading volume of our Class A common stock;

price and volume fluctuations in the overall stock market;

volatility in the market prices and trading volumes of securities issued by software companies;

changes in operating performance and stock market valuations of software companies generally, and of companies that sell cloud-based solutions within our targeted verticals in particular;

sales of shares of our Class A common stock by us or our stockholders, or perceptions that such sales may occur;

any future announcements to repurchase our Class A common stock, and any actual share repurchases that we may undertake from time to time;

failure of securities analysts to maintain coverage of us, changes in financial estimates by securities analysts who follow us, or our failure to meet these estimates or the expectations of investors;

the guidance we may provide to the public, any changes in that guidance, and our performance relative to that guidance;

announcements by us or our competitors of new products or services;

public reaction to our press releases, filings with the SEC and other public announcements;

rumors and market speculation involving us or other software companies;

actual or anticipated changes in our operating results or fluctuations in our operating results;

actual or anticipated developments in our business, our competitors' businesses or the competitive landscape generally;

legal proceedings, enforcement actions or regulatory inquiries relating to us or our competitors;

developments or disputes concerning our intellectual property or other proprietary rights;

announced or completed acquisitions of businesses or technologies by us or our competitors;

Table of Contents

new laws or regulations or new interpretations of existing laws or regulations applicable to our business or the industries in which we operate;
changes in accounting standards, policies, guidelines, interpretations or principles;
changes in our management; and
general economic conditions and trends, including slow or negative growth of our markets.

In addition, in the past, following periods of volatility in the overall market and the market price of a particular company's securities, securities class action litigation has often been instituted against these companies. If instituted against us, any such litigation, regardless of its merit or final outcome, could result in substantial costs and a diversion of our management's attention, thereby adversely affecting our operating results and, potentially, the price of our Class A common stock.

The dual class structure of our common stock has the effect of concentrating voting control with a limited number of stockholders, including our executive officers, directors and principal stockholders, which will limit your ability to influence corporate matters.

Our Class B common stock has 10 votes per share, and our Class A common stock has one vote per share. At December 31, 2018, the holders of the outstanding shares of our Class B common stock, including our executive officers, directors, and principal stockholders, collectively hold approximately 92% of the combined voting power of our outstanding capital stock. Because of the 10-to-1 voting ratio between our Class B common stock and Class A common stock, the holders of our Class B common stock collectively control a majority of the combined voting power of our outstanding capital stock and therefore are able to exercise significant influence and control over the establishment and implementation of our future business plans and strategic objectives, as well as to control all matters submitted to our stockholders for approval. These persons may manage our business in ways with which you disagree and which may be adverse to your interests. This concentrated control may also have the effect of delaying, deterring or preventing a change-in-control transaction, depriving our stockholders of an opportunity to receive a premium for their capital stock or negatively affecting the market price of our Class A common stock.

Transfers by holders of our Class B common stock will generally result in those shares converting to Class A common stock, subject to limited exceptions. The conversion of our Class B common stock to Class A common stock will have the effect, over time, of increasing the relative voting power of the holders of our Class B common stock who retain their shares over the long term.

We cannot predict the impact that our capital structure may have on our stock price.

S&P Dow Jones, a provider of widely followed stock indices, has announced that companies with multiple classes of stock, will not be eligible for inclusion in certain of their indices. As a result, our Class A common stock will not be eligible for those stock indices. Additionally, FTSE Russell, another provider of widely followed stock indices, requires new constituents of its indices to have at least five percent of their voting rights in the hands of public stockholders. At March 31, 2019, the holders of the outstanding shares of our Class B common stock, including our executive officers, directors, and principal stockholders, collectively hold approximately 92% of the combined voting power of our outstanding capital stock. Many investment funds are precluded from investing in companies that are not included in such indices, and these funds would be unable to purchase our Class A common stock. We cannot assure you that other stock indices will not take a similar approach in the future. Exclusion from indices could make our Class A common stock less attractive to investors and, as a result, the market price of our Class A common stock could be adversely affected.

In addition, several shareholder advisory firms have announced their opposition to the use of multiple class structures. As a result, the dual class structure of our common stock may cause shareholder advisory firms to publish negative commentary about our corporate governance practices or otherwise seek to cause us to change our capital structure.

Any actions or publications by shareholder advisory firms critical of our corporate governance practices or capital structure could also adversely affect the value of our Class A common stock.

Share repurchases could increase the volatility of the trading price of our common stock and diminish our cash reserves, and we cannot guarantee that our share repurchase program will enhance long-term stockholder value.

In October 2018, our Board of Directors adopted a \$30.0 million Share Repurchase Program relating to our outstanding shares of our Class A common stock. In February 2019, our Board of Directors adopted a \$100.0 million Share Repurchase Program relating to our outstanding shares of our Class A common stock, which is inclusive of, and not in addition to, the remaining

Table of Contents

availability under the October 2018 authorization. Although our Board of Directors has authorized the Repurchase Program, it does not obligate us to repurchase any specific dollar amount or number of shares, there is no expiration date for the Repurchase Program, and the Repurchase Program may be modified, suspended or terminated at any time and for any reason. The timing and actual number of shares repurchased under the Repurchase Program will depend on a variety of factors, including the acquisition price of the shares, our liquidity position, general market and economic conditions, legal and regulatory requirements and other considerations. Our ability to repurchase shares may also be limited by restrictive covenants in our existing credit agreement or in future borrowing arrangements we may enter into from time to time.

Repurchases of our shares could increase the volatility of the trading price of our shares, which could have a negative impact on the trading price of our shares. Similarly, the future announcement of the termination or suspension of the Repurchase Program, or our decision not to utilize the full authorized repurchase amount under the Repurchase Program, could result in a decrease in the trading price of our shares. In addition, the Repurchase Program could have the impact of diminishing our cash reserves, which may impact our ability to finance our growth, complete acquisitions and execute our strategic plan. There can be no assurance that any share repurchases we do elect to make will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased our shares. Although our share repurchase program is intended to enhance long-term stockholder value, we cannot guarantee that it will do so and short-term stock price fluctuations could reduce the effectiveness of the Repurchase Program.

Anti-takeover provisions contained in our amended and restated certificate of incorporation and amended and restated bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could have the effect of rendering more difficult hostile takeovers, change-in-control transactions or changes in our board of directors or management. Among other things, these provisions:

- authorize the issuance of preferred stock with powers, preferences and rights that may be senior to our common stock, which can be created and issued by our board of directors without prior stockholder approval;
- provide for the adoption of a staggered board of directors whereby our board is divided into three classes, each of which has a different three-year term;
- provide that the number of directors will be fixed by our board of directors;
- prohibit our stockholders from filling vacancies on our board of directors;
- provide for the removal of a director only for cause and then only by the affirmative vote of the holders of a majority of the combined voting power of our outstanding capital stock;
- prohibit stockholders from calling special stockholder meetings;
- prohibit stockholders from acting by written consent without holding a meeting of stockholders;
- require the vote of at least two-thirds of the combined voting power of our outstanding capital stock to approve amendments to our certificate of incorporation or bylaws;
- require advance written notice of stockholder proposals and director nominations;
- provide for a dual-class common stock structure, as discussed above; and
- require the approval of the holders of at least a majority of the outstanding shares of our Class B common stock, voting as a separate class, prior to consummating a change-in-control transaction.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which may delay, deter or prevent a change-in-control transaction. Section 203 imposes certain restrictions on mergers, business combinations and other transactions between us and holders of 15% or more of our common stock.

Any provision of Delaware law, our amended and restated certificate of incorporation, or our amended and restated bylaws, that has the effect of rendering more difficult, delaying, deterring or preventing a change-in-control transaction could limit the opportunity for our stockholders to receive a premium for their shares of our capital stock,

and could also affect the price that some investors are willing to pay for our Class A common stock.

56

Table of Contents

Future sales of shares of our Class A common stock, or the perception that these sales could occur, could depress the market price of our Class A common stock.

Sales of a substantial number of shares of our Class A common stock in the public market, or the perception that these sales might occur, could cause the market price of our Class A common stock to decline or make it more difficult for you to sell your Class A common stock at a time and price that you deem appropriate, and could impair our ability to raise capital through the sale of additional equity securities. We are unable to predict the effect that sales, or the perception that our shares may be available for sale, will have on the prevailing market price of our Class A common stock.

At March 31, 2019, we had an aggregate of 1.4 million options outstanding that, if fully exercised, would result in the issuance of additional shares of Class A common stock or Class B common stock, as applicable. Our Class B common stock converts into Class A common stock on a one-for-one basis. In addition, at March 31, 2019, we had 0.7 million restricted stock units, or RSUs, outstanding which, if fully vested and settled in shares, would result in the issuance of additional shares of Class A common stock. All of the shares of Class A common stock issuable upon the exercise of options (or upon conversion of shares of Class B common stock issued upon the exercise of options), or upon the vesting and settlement of RSUs, have been registered for public resale under the Securities Act. Accordingly, these shares will be able to be freely sold in the public market upon issuance.

Certain holders of our Class A common stock and Class B common stock have rights, subject to certain conditions, to require us to file registration statements for the public resale of such shares (in the case of Class B common stock, the Class A common stock issuable upon conversion of such shares) or to include such shares in registration statements that we may file for us or other stockholders. Any sales of securities by these stockholders could have a material adverse effect on the market price of our Class A common stock.

If securities or industry analysts do not publish or cease publishing research or reports about us, our business, our market or our competitors, or if they adversely change their recommendations regarding our Class A common stock, the market price and trading volume of our Class A common stock could decline.

The trading market for our Class A common stock is influenced, to some extent, by the research and reports that securities or industry analysts publish about us, our business, our market or our competitors. If any of the analysts who cover us adversely change their recommendations regarding our Class A common stock or provide more favorable recommendations about our competitors, the market price of our Class A common stock may decline. If any of the analysts who cover us were to cease coverage of us or fail to publish reports on us regularly, visibility of our company in the financial markets could decrease, which in turn could cause the market price or trading volume of our Class A common stock to decline.

We do not expect to declare any dividends in the foreseeable future.

We have never declared or paid any cash dividends on our existing common stock. We do not anticipate declaring or paying any cash dividends to holders of our Class A common stock in the foreseeable future and intend to retain all future earnings for use in the growth of our business. In addition, the terms of our Credit Agreement restrict our ability to pay dividends. Consequently, investors may need to rely on sales of our Class A common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors should not purchase our Class A common stock with the expectation of receiving cash dividends.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents

Item 6. Exhibits

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

58

Table of Contents

SIGNATURES

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

AppFolio, Inc.

Date: May 2, 2019 By: /s/ Ida Kane

Ida Kane
Chief Financial Officer
(Principal Financial and Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description of Document
31.1	<u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.</u>
32.1*	<u>Certifications of Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

* The certifications attached as Exhibit 32.1 accompany this Quarterly Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed “filed” by the registrant for purposes of Section 18 of the Exchange Act, and are not to be incorporated by reference into any of the registrant’s filings under the Securities Act or the Exchange Act, whether made before or after the date of this Quarterly Report, irrespective of any general incorporation language contained in any such filing.