INSTRUCTURE INC
Form 10-Q
August 02, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

OR

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

Commission file number: 001-37629

Instructure, Inc.

(Exact name of registrant as specified in its charter)

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

6330 South 3000 East, Suite 700

Salt Lake City, UT 84121

(Address of principal executive offices, including zip code)

(800) 203-6755

(Registrant’s telephone number, including area code)

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

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

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

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

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

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

As of July 28, 2017, there were 29,400,779 shares of the registrant’s common stock outstanding.

Instructure, Inc.

Quarterly Report on Form 10-Q

For the Quarter Ended June 30, 2017

INDEX

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

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements
INSTRUCTURE, INC.

Consolidated Balance Sheets

(in thousands)

	June 30, 2017 (unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 25,744	$ 44,539
Short-term marketable securities	—	23,895
Accounts receivable—net of allowance of $274 and $241 at June 30, 2017 and December 31, 2016, respectively	72,970	18,072
Prepaid expenses	7,721	5,434
Other current assets	886	936
Total current assets	107,321	92,876
Property and equipment, net	18,913	14,733
Goodwill	989	989
Intangible assets, net	802	760
Noncurrent prepaid expenses	978	984
Other assets	1,051	994
Total assets	$ 130,054	$ 111,336
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	$ 4,850	$ 5,374
Accrued liabilities	13,303	10,905
Deferred rent	832	773
Deferred revenue	103,018	72,747
Total current liabilities	122,003	89,799
Deferred revenue, net of current portion	4,130	3,144
Deferred rent, net of current portion	7,899	8,372
Warrant liability	108	25
Other long-term liabilities	32	32
Total liabilities	134,172	101,372
Stockholders' equity (deficit):		
Common stock	3	3
Additional paid-in capital	218,328	206,442
Accumulated other comprehensive loss	—	(12)

Accumulated deficit	(222,449)	(196,469)
Total stockholders’ equity (deficit)	(4,118)	9,964
Total liabilities and stockholders’ equity (deficit)	$ 130,054	$ 111,336

See accompanying notes.

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INSTRUCTURE, INC.

Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue:				
Subscription and support	$32,650	$22,416	$63,163	$42,993
Professional services and other	5,394	3,474	8,860	6,196
Total revenue	38,044	25,890	72,023	49,189
Cost of revenue:				
Subscription and support	7,967	5,586	15,072	11,023
Professional services and other	3,026	2,049	5,537	3,961
Total cost of revenue	10,993	7,635	20,609	14,984
Gross profit	27,051	18,255	51,414	34,205
Operating expenses:				
Sales and marketing	21,314	18,038	40,300	34,201
Research and development	11,057	8,730	22,239	16,535
General and administrative	7,621	6,003	14,607	11,739
Total operating expenses	39,992	32,771	77,146	62,475
Loss from operations	(12,941)	(14,516)	(25,732)	(28,270)
Other income (expense):				
Interest income	39	61	115	132
Interest expense	(4)	(12)	(18)	(23)
Change in fair value of warrant liability	(76)	—	(83)	62
Other income (expense), net	91	(56)	127	(131)
Total other income (expense), net	50	(7)	141	40
Loss before income taxes	(12,891)	(14,523)	(25,591)	(28,230)
Income tax expense	(105)	(67)	(136)	(99)
Net loss	$(12,996)	$(14,590)	$(25,727)	$(28,329)
Net loss per common share, basic and diluted	$(0.45)	$(0.53)	$(0.89)	$(1.03)
Weighted average common shares used in computing basic and diluted net loss per common share	29,090	27,610	28,909	27,456

See accompanying notes.

INSTRUCTURE, INC.

Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net loss	$(12,996)	$(14,590)	$(25,727)	$(28,329)
Other comprehensive loss:				
Net change in unrealized gains (losses) on marketable securities	2	—	—	—
Comprehensive loss	$(12,994)	$(14,590)	$(25,727)	$(28,329)

See accompanying notes.

INSTRUCTURE, INC.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30, 2017	2016
Operating Activities:		
Net loss	$(25,727)	$(28,329)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property and equipment	2,693	1,886
Amortization of intangible assets	259	164
Amortization of deferred financing costs	16	23
Change in fair value of warrant liability	83	(62)
Stock-based compensation	7,440	4,897
Other	(66)	(47)
Changes in assets and liabilities:		
Accounts receivable, net	(55,105)	(31,978)
Prepaid expenses and other assets	(2,280)	133
Accounts payable and accrued liabilities	2,198	1,697
Deferred revenue	31,257	23,794
Deferred rent	(414)	(240)
Other liabilities	—	(330)
Net cash used in operating activities	(39,646)	(28,392)
Investing Activities:		
Purchases of property and equipment	(6,955)	(3,410)
Purchases of intangible assets	(301)	(296)
Proceeds from sale of property and equipment	38	18
Maturities of marketable securities	23,900	325
Net cash provided by (used in) investing activities	16,682	(3,363)
Financing Activities:		
Proceeds from issuance of common stock from employee equity plans	4,316	3,311
Shares repurchased for tax withholdings on vesting of restricted stock	(123)	—
Payments for financing costs	(24)	—
Net cash provided by financing activities	4,169	3,311
Net decrease in cash and cash equivalents	(18,795)	(28,444)
Cash and cash equivalents, beginning of period	44,539	90,471
Cash and cash equivalents, end of period	$25,744	$62,027
Supplemental cash flow disclosure:		
Cash paid for taxes	$175	$31
Non-cash investing and financing activities:		
Capital expenditures incurred but not yet paid	$210	$54
Issuance of common stock for exercise of common stock warrant	$—	$244
Vesting of common stock subject to repurchase	$—	$7

See accompanying notes.

INSTRUCTURE, INC.

Notes to Unaudited Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Organization

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

Basis of Presentation

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

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

Marketable Securities

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

Use of Estimates

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

Liability for Common Stock Warrants

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

Recent Accounting Pronouncements

Adopted accounting pronouncements

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

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

Issued accounting pronouncements

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

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

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

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

We have substantially completed our evaluation of the impact of the new standard on our accounting policies. We are currently in the system implementation stage of adopting the new standard. We have assigned internal resources in addition to the engagement of third party service providers to assist in the implementation of identified system requirements to enable timely and accurate reporting under the new standard.

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

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

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

2. Net Loss Per Share

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

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Net loss	$(12,996)	$(14,590)	$(25,727)	$(28,329)
Denominator:				
Weighted-average common shares outstanding—basic	29,090	27,625	28,909	27,481
Less: Weighted-average common stock subject to repurchase	—	(15)	—	(25)
Total weighted-average common shares outstanding—basic	29,090	27,610	28,909	27,456
Dilutive effect of share equivalents resulting from stock options, restricted stock units, common stock warrants and common stock subject to repurchase	—	—	—	—
Weighted-average common shares outstanding-diluted	29,090	27,610	28,909	27,456
Net loss per common share, basic and diluted	$(0.45)	$(0.53)	$(0.89)	$(1.03)

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

	As of June 30,	
	2017	2016
Options to purchase common stock	2,784	3,556
Common stock warrants	17	17
Common stock subject to repurchase	—	9
Restricted stock units	1,629	952
Total	4,430	4,534

3. Property and Equipment

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

	June 30,	December 31,

	2017	2016
Computer and office equipment	$4,765	$ 3,918
Purchased software	1,071	1,074
Capitalized software development costs	11,370	6,947
Furniture and fixtures	2,976	2,701
Leasehold improvements and other	10,455	9,413
Total property and equipment	30,637	24,053
Less accumulated depreciation and amortization	(11,724)	(9,320)
Total	$18,913	$ 14,733

Accumulated amortization for capitalized software development costs was $3,263,000 and $2,355,000 at June 30, 2017 and December 31, 2016, respectively. Amortization expense for capitalized software development costs was $521,000 and $303,000 for the three months ended June 30, 2017 and 2016, respectively and $1,006,000 and $578,000 for the six months ended June 30, 2017 and 2016, respectively. Amortization expense for capitalized software development costs is recorded within cost of revenue on the consolidated statements of operations.

4. Goodwill and Intangible Assets

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

Intangible assets consisted of the following (in thousands):

	Average Remaining Useful Life	June 30, 2017	December 31, 2016
Domain names	12 Months	$1,268	$ 1,268
Tradenames and trademarks	2 Months	120	109
Software	28 Months	611	321
Capitalized learning content	55 Months	400	400
Accumulated amortization		(1,597)	(1,338)
Total		$802	$ 760

Amortization expense for intangible assets was $117,000 and $86,000 for the three months ended June 30, 2017 and 2016, respectively and $259,000 and $164,000 for the six months ended June 30, 2017 and 2016, respectively.

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

Years Ending December 31,	Amortization Expense
Remainder of 2017	$ 143
2018	285
2019	216
2020	94
2021	64
Total	$ 802

5. Segment Information and Geographic Data

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
United States				