

ENVESTNET, INC.
Form 10-Q
August 10, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2015

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

Commission file number 001-34835

Envestnet, Inc.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

20-1409613
(I.R.S Employer
Identification No.)

35 East Wacker Drive, Suite 2400, Chicago, IL
(Address of principal executive offices)

60601
(Zip Code)

Registrant's telephone number, including area code:

(312) 827-2800

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 (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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of August 1, 2015, 35,617,271 shares of the common stock with a par value of \$0.005 per share were outstanding.

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Table of Contents**Envestnet, Inc.****Condensed Consolidated Balance Sheets****(in thousands, except share information)****(unaudited)**

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$ 198,927	\$ 209,754
Fees and other receivable, net	29,232	20,345
Deferred tax assets, net	4,635	4,654
Prepaid expenses and other current assets	20,653	7,242
Total current assets	253,447	241,995
Property and equipment, net	18,283	16,629
Internally developed software, net	7,999	7,023
Intangible assets, net	67,911	58,654
Goodwill	126,367	104,976
Deferred tax assets, net		565
Other non-current assets	11,621	9,516
Total assets	\$ 485,628	\$ 439,358
Liabilities and Equity		
Current liabilities:		
Accrued expenses	\$ 48,451	\$ 48,247
Accounts payable	6,402	4,869
Contingent consideration	7,422	6,405
Deferred revenue	7,872	5,159
Total current liabilities	70,147	64,680
Convertible notes	147,627	145,203
Contingent consideration	5,194	7,462
Deferred revenue	11,893	6,954
Deferred rent	4,122	3,588
Lease incentive	5,253	5,550
Deferred tax liabilities, net	224	
Other non-current liabilities	2,100	2,430
Total liabilities	246,560	235,867
Commitments and contingencies		
Redeemable units in ERS, LLC	1,500	1,500
Equity:		
Stockholders' equity:		
Preferred stock, par value \$0.005, 50,000,000 shares authorized		
Common stock, par value \$0.005, 500,000,000 shares authorized; 47,513,468 and 46,345,376 shares issued as of June 30, 2015 and December 31, 2014, respectively; 35,593,544 and 34,544,653 shares outstanding as of June 30, 2015 and December 31, 2014, respectively	238	232

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Additional paid-in capital	270,967	233,888
Accumulated deficit	(14,396)	(19,443)
Treasury stock at cost, 11,919,924 and 11,800,723 shares as of June 30, 2015 and December 31, 2014, respectively	(19,797)	(13,242)
Total stockholders' equity	237,012	201,435
Non-controlling interest	556	556
Total equity	237,568	201,991
Total liabilities and equity	\$ 485,628	\$ 439,358

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

Table of Contents**Investnet, Inc.****Condensed Consolidated Statements of Operations****(in thousands, except share and per share information)****(unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues:				
Assets under management or administration	\$ 83,819	\$ 70,727	\$ 164,896	\$ 137,808
Licensing and professional services	18,844	14,102	34,221	25,560
Total revenues	102,663	84,829	199,117	163,368
Operating expenses:				
Cost of revenues	42,486	37,955	81,181	72,392
Compensation and benefits	31,956	25,157	63,491	48,616
General and administration	15,512	12,936	29,721	25,086
Depreciation and amortization	5,725	4,615	11,058	9,037
Restructuring charges	518		518	
Total operating expenses	96,197	80,663	185,969	155,131
Income from operations	6,466	4,166	13,148	8,237
Other income (expense)	(2,251)	1,839	(4,454)	1,920
Income before income tax provision	4,215	6,005	8,694	10,157
Income tax provision	1,679	2,355	3,647	3,639
Net income	2,536	3,650	5,047	6,518
Add: Net loss attributable to non-controlling interest		69		195
Net income attributable to Investnet, Inc.	\$ 2,536	\$ 3,719	\$ 5,047	\$ 6,713
Net income per share attributable to Investnet, Inc.:				
Basic	\$ 0.07	\$ 0.11	\$ 0.14	\$ 0.20
Diluted	\$ 0.07	\$ 0.10	\$ 0.13	\$ 0.18
Weighted average common shares outstanding:				
Basic	35,776,125	34,547,277	35,463,623	34,332,759
Diluted	37,654,074	36,805,758	37,504,028	36,726,121

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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Envestnet, Inc.

Condensed Consolidated Statement of Equity

(in thousands, except share information)

(unaudited)

	Common Stock		Treasury Stock		Additional Paid-in Capital	Accumulated Deficit	Non-controlling Interest	Total Equity
	Shares	Amount	Common Shares	Amount				
Balance, December 31, 2014	46,345,376	\$ 232	(11,800,723)	\$ (13,242)	\$ 233,888	\$ (19,443)	\$ 556	\$ 201,991
Exercise of stock options	686,516	3			5,906			5,909
Issuance of common stock for:								
vesting of restricted stock	358,166	2						2
acquisition of business	123,410	1			8,929			8,930
Stock-based compensation expense					6,749			6,749
Excess tax benefits from stock-based compensation expense					15,495			15,495
Purchase of treasury stock for stock-based minimum tax withholdings			(119,201)	(6,555)				(6,555)
Net income						5,047		5,047
Balance, June 30, 2015	47,513,468	\$ 238	(11,919,924)	\$ (19,797)	\$ 270,967	\$ (14,396)	\$ 556	\$ 237,568

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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Envestnet, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2015	2014
OPERATING ACTIVITIES:		
Net income	\$ 5,047	\$ 6,518
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,058	9,037
Deferred rent and lease incentive	219	1,123
Provision for doubtful accounts	37	
Deferred income taxes	808	
Stock-based compensation	6,749	5,767
Excess tax benefits from stock-based compensation	(15,495)	(3,203)
Interest expense	4,697	
Accretion on contingent consideration	651	824
Fair market value adjustment on contingent consideration	(1,902)	(460)
Changes in operating assets and liabilities, net of acquisitions:		
Fees receivable	(8,825)	(5,009)
Prepaid expenses and other current assets	2,090	2,455
Other non-current assets	(1,244)	(1,136)
Accrued expenses	(6,323)	(1,559)
Accounts payable	1,439	1,200
Deferred revenue	5,978	2,190
Other non-current liabilities	(330)	144
Net cash provided by operating activities	4,654	17,891
INVESTING ACTIVITIES:		
Purchase of property and equipment	(4,912)	(4,841)
Capitalization of internally developed software	(2,208)	(1,651)
Investment in private company	(1,500)	
Acquisition of businesses, net of cash acquired	(21,712)	
Net cash used in investing activities	(30,332)	(6,492)
FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	5,909	1,615
Purchase of treasury stock for stock-based minimum tax withholdings	(6,555)	(1,695)
Excess tax benefits from stock-based compensation expense	15,495	3,203
Issuance of restricted stock	2	
Net cash provided by financing activities	14,851	3,123
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(10,827)	14,522
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	209,754	49,942
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 198,927	\$ 64,464

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Supplemental disclosure of cash flow information - cash paid during the period for income taxes, net of refunds	\$	791	\$	18
Supplemental disclosure of cash flow information - cash paid during the period for interest		1,634		
Supplemental disclosure of non-cash operating, investing and financing activities:				
Leasehold improvements funded by lease incentive		36		
Settlement of contingent consideration liability upon issuance of ERS, LLC membership interest				158
Stock and stock options issued in acquisition of business		8,930		
Purchase of fixed assets included in accounts payable		126		
Purchase liabilities included in accrued expenses		3,520		

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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Investnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

1. Organization and Description of Business

Investnet, Inc. (Investnet) and its subsidiaries (collectively, the Company) provide open-architecture wealth management services and technology to independent financial advisors and financial institutions. These services and related technology are provided via Investnet's wealth management software, Investnet | PMC®, Investnet | Tamarac , Vantage Reporting Solution , Investnet | WMS and Investnet | Placemark .

Investnet's wealth management software is a platform of integrated, internet-based technology applications and related services that provide portfolio diagnostics, proposal generation, investment model management, rebalancing and trading, portfolio performance reporting and monitoring solutions, billing, and back-office and middle-office operations and administration.

The Company's investment consulting group, Investnet | PMC, provides investment manager due diligence and research, a full spectrum of investment offerings supported by both proprietary and third-party research and manager selection, and overlay portfolio management services.

Investnet | Tamarac provides leading portfolio accounting, rebalancing, trading, performance reporting and client relationship management software, principally to high-end registered investment advisers (RIAs).

Vantage Reporting Solution software aggregates and manages investment data, provides performance reporting and benchmarking, giving advisors an in-depth view of clients' various investments, empowering advisors to give holistic, personalized advice.

Investnet | WMS offers financial institutions access to an integrated wealth platform, which helps construct and manage sophisticated portfolio solutions across an entire account life cycle, particularly in the area of unified managed account trading. Investnet | WMS's Overlay Portfolio Management console helps wealth managers efficiently build customized client portfolios that consider both proprietary and open-architecture investment solutions.

Investnet | Placemark develops unified managed account (UMA) programs and other portfolio management outsourcing solutions, including patented portfolio overlay and tax optimization services, for banks, full service broker-dealers and RIA firms.

Through these platform and service offerings, the Company provides open-architecture support for a wide range of investment products (separately managed accounts, multi-manager accounts, mutual funds, exchange-traded funds, stock baskets, alternative investments, and other fee-based investment solutions) from Envestnet | PMC and other leading investment providers via multiple custodians, and also account administration and reporting services.

Envestnet operates six RIAs and a registered broker-dealer. The RIAs are registered with the Securities and Exchange Commission (SEC). The broker-dealer is registered with the SEC, all 50 states and the District of Columbia and is a member of the Financial Industry Regulatory Authority (FINRA).

2. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company as of June 30, 2015 and for the three and six months ended June 30, 2015 and 2014 have not been audited by an independent registered public accounting firm. These unaudited condensed consolidated financial statements have been prepared on the same basis as our audited consolidated financial statements for the year ended December 31, 2014 and reflect all normal recurring adjustments which are, in the opinion of management, necessary to present fairly the Company's financial position as of June 30, 2015 and the results of operations, equity and cash flows for the periods presented herein. The unaudited condensed consolidated balance sheet as of December 31, 2014 was derived from the Company's audited financial statements for the year ended December 31, 2014 but does not include all disclosures, including notes required by accounting principles generally accepted in the United States of America (GAAP). The results of operations for the three and six months ended June 30, 2015 are not necessarily indicative of the operating results to be expected for other interim periods or for the full fiscal year.

The unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, filed with the SEC on March 2, 2015.

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Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

The preparation of these unaudited condensed consolidated financial statements requires management to make estimates and assumptions related to the reporting of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Significant areas requiring the use of management estimates relate to estimating uncollectible receivables, revenue recognition, costs capitalized for internally developed software, valuations and assumptions used for impairment testing of goodwill, intangible and other long-lived assets, fair value of stock and stock options issued, fair value of contingent consideration, realization of deferred tax assets, uncertain tax positions and assumptions used to allocate purchase prices in business combinations. Actual results could differ materially from these estimates under different assumptions or conditions.

Recent Accounting Pronouncements - In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers.

The original effective date for ASU 2014-09 would have required the Company to adopt beginning in its first quarter of 2017. In July 2015, the FASB voted to amend ASU 2014-09 by approving a one-year deferral of the effective date as well as providing the option to early adopt the standard on the original effective date. Accordingly, the Company may adopt the standard in either its first quarter of 2017 or 2018. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company is currently evaluating the timing of its adoption and the impact of adopting the new revenue standard on its condensed consolidated financial statements.

3. Business Acquisitions

Upside Holdings, Inc.

On February 24, 2015, Envestnet, Inc. (the Company) acquired all of the stock of Upside Holdings, Inc. (including its subsidiaries Upside) for consideration totaling \$3,040, subject to certain post-closing adjustments.

Upside is a technology company that is registered as an Internet Investment Adviser under Rule 203A-2(f) of the Investment Advisers Act of 1940 (Advisers Act). Upside helps financial advisors compete against other digital advisors, or robo advisors, by leveraging technology and algorithms to advise, manage, and serve clients who want personalized investment services.

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The Company acquired Upside to integrate its technology within the Company's unified wealth management platform, which will allow advisors to compete more aggressively to engage their clients online and reach a new class of investors. The goodwill arising from the acquisition represents the advantage of this integrated technology, the expected synergistic benefits of the transaction and the knowledge and experience of the workforce in place. The goodwill is not deductible for income tax purposes.

As a result of the acquisition of Upside, the Company provided for the future grant of unvested restricted stock awards to Upside employees at the end of each year in 2015, 2016 and 2017 upon Upside meeting certain performance conditions and then a subsequent two year service condition (Note 13). If 100 percent of the awards are earned for 2015, 2016 and 2017, the maximum number of shares that could be granted for 2015, 2016 and 2017 equals 22,064, 44,128 and 66,192 shares of common stock, respectively. The Company has determined the payments to be categorized as compensation expense. As of June 30, 2015, no amounts have been recognized as it is currently estimated that the performance targets will not be attained in 2015.

The consideration transferred in the acquisition was as follows:

Upfront consideration	\$	2,425
Purchase liabilities		615
Working capital settlement		(385)
Cash acquired		(14)
	\$	2,641

Table of Contents**Envestnet, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****(in thousands, except share and per share amounts)**

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

Total tangible assets acquired	\$	6
Total liabilities assumed		(404)
Identifiable intangible assets		1,450
Goodwill		1,589
Total net assets acquired	\$	2,641

The estimated useful life and amortization method of the intangible asset acquired is as follows:

	Amount	Weighted Average Useful Life in Years	Amortization Method
Proprietary technology	\$ 1,450	4	Straight-line

The results of Upside's operations are included in the condensed consolidated statement of operations beginning February 24, 2015, and are not considered material to the Company's results of operations.

For the three and six months ended June 30, 2015, acquisition related costs for Upside totaled \$15 and \$217 and are included in general and administration expenses.

Oltis Software LLC

On May 6, 2015, the Company acquired all of the issued and outstanding membership interests of Oltis Software LLC (d/b/a Finance Logix®), an Arizona limited liability company (Finance Logix). Finance Logix provides financial planning and wealth management software solutions to banks, broker-dealers and RIAs.

The Company paid upfront consideration of \$20,595 in cash, purchase liabilities of \$2,905, 123,410 in shares of Envestnet common stock with a fair value of \$6,388 and 123,410 stock options to acquire Envestnet common stock at \$52.67 per share with an estimated fair value of \$2,542.

The Company acquired Finance Logix to integrate its technology within the Company's unified wealth management platform, which will allow advisors to offer financial planning that flows seamlessly into portfolio construction and ongoing management on a single platform. Finance Logix allows us to deliver that capability and increase the breadth of our platform and the functionality gap between our platform and competing platforms. The goodwill arising from the acquisition represents cross-selling opportunities, the expected synergistic benefits of the transaction and the knowledge and experience of the workforce in place. The goodwill is deductible for income tax purposes.

In connection with the acquisition of Finance Logix, the Company is required to pay the former owner of Finance Logix future payments in a mix of cash, stock and stock options, based on Finance Logix meeting annual net revenue targets of \$5,000, \$10,000 and \$16,000 for calendar years 2015, 2016 and 2017, respectively, with lower payments for performance below the three yearly targets and a higher payment in 2017 for performance above the target. The Company has preliminarily determined the first payment related to the 2015 target to be categorized as compensation expense and the payments, if any, related to 2016 and 2017 targets, to be categorized as contingent consideration. The Company did not record compensation expense as of June 30, 2015 and preliminarily did not record a contingent consideration liability as of the date of acquisition as payment is not expected to occur at this time.

Changes to the estimated fair value of the contingent consideration, if any, will be recognized in earnings of the Company.

Table of Contents**Investnet, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****(in thousands, except share and per share amounts)**

As of June 30, 2015, the Company has not finalized the opening balance sheet (including taxes), contingent consideration, nor has the Company finalized its valuation of Finance Logix's intangible assets and/or goodwill associated with the transaction as well as the fair value of acquired deferred revenue. The Company expects to finalize the valuation of the intangible assets and deferred revenue, and complete the acquisition accounting as soon as practicable but no later than March 31, 2016.

The preliminary estimated consideration transferred in the acquisition was as follows:

Cash consideration	\$	20,595
Stock and stock option consideration		8,930
Purchase liabilities		2,905
Cash acquired		(909)
	\$	31,521

The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

Total tangible assets acquired	\$	99
Total liabilities assumed		(2,880)
Identifiable intangible assets		14,500
Goodwill		19,802
Total net assets acquired	\$	31,521

A summary of intangible assets acquired, estimated useful lives and amortization method is as follows:

	Amount	Weighted Average Useful Life in Years	Amortization Method
Customer list	\$ 12,500	12	Accelerated
Proprietary technology	2,000	4	Straight-line
Total	\$ 14,500		

The results of Finance Logix's operations are included in the condensed consolidated statement of operations beginning May 6, 2015. Finance Logix's revenues and net loss for the three and six month periods ended June 30, 2015 totaled \$472 and \$328, respectively. The net loss includes estimated acquired intangible asset amortization of \$329.

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For the three and six months ended June 30, 2015, acquisition related costs for Finance Logix totaled \$231 and \$375, respectively, and are included in general and administration expenses. The Company may incur additional acquisition related costs during the third quarter of 2015.

Pro forma results for Envestnet, Inc. giving effect to the Placemark and Finance Logix acquisitions

The following pro forma financial information presents the combined results of operations of Envestnet and Finance Logix for the three and six month periods ended June 30, 2015 and Envestnet, Finance Logix, and Placemark for the three and six months ended June 30, 2014. The pro forma financial information presents the results as if the acquisitions had occurred as of the beginning of 2014. The results of Upside are not included in the pro forma financial information presented below as the Upside acquisition was not considered material to the Company's results of operations.

The unaudited pro forma results presented include amortization charges for acquired intangible assets, stock-based compensation expense and the related tax effect on the aforementioned items.

Table of Contents**Investnet, Inc.****Notes to Unaudited Condensed Consolidated Financial Statements****(in thousands, except share and per share amounts)**

Pro forma financial information is presented for informational purposes and is not indicative of the results of operations that would have been achieved if the acquisition had taken place as of the beginning of 2014.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues	102,932	90,982	200,137	175,103
Net income	2,300	2,575	4,565	4,350
Net income per share:				
Basic	0.06	0.07	0.13	0.13
Diluted	0.06	0.07	0.12	0.12

4. Property and Equipment

	Estimated Useful Life	June 30, 2015	December 31, 2014
Cost:			
Office furniture and fixtures	5-7 years	\$ 4,869	\$ 4,993
Computer equipment and software	3 years	22,459	18,540
Other office equipment	5 years	124	144
Leasehold improvements	Shorter of the lease term or useful life of the asset	11,378	10,805
		38,830	34,482
Less accumulated depreciation and amortization		(20,547)	(17,853)
Property and equipment, net		\$ 18,283	\$ 16,629

During the three and six months ended June 30, 2015, the Company retired fully depreciated property and equipment that were no longer in service with cost and accumulated depreciation amounts of \$564.

Depreciation and amortization expense was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014

Depreciation and amortization expense	\$	1,658	\$	1,553	\$	3,133	\$	3,042
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5. Internally Developed Software

Internally developed software consists of the following:

	Estimated Useful Life	June 30, 2015	December 31, 2014
Internally developed software	5 years	\$ 21,785	\$ 19,577
Less accumulated amortization		(13,786)	(12,554)
Internally developed software, net		\$ 7,999	\$ 7,023

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Envestnet, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

(in thousands, except share and per share amounts)

Amortization expense was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Amortization expense	\$ 632	\$ 508	\$ 1,232	\$ 997

6. Goodwill and Intangible Assets

Changes in the carrying amount of goodwill were as follows:

Balance at December 31, 2014	\$ 104,976
Upside acquisition	