

CHEGG, INC  
Form 10-Q  
November 07, 2016  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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 001-36180

CHEGG, INC.

(Exact name of registrant as specified in its charter)

Delaware 20-3237489  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)  
3990 Freedom Circle  
Santa Clara, CA, 95054  
(Address of principal executive offices)  
(408) 855-5700  
(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 (Exchange Act) 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, 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

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(Do not check if a smaller reporting company)

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

As of October 31, 2016, the Registrant had 91,347,606 outstanding shares of Common Stock.

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Unless the context requires otherwise, the words “we,” “us,” “our,” “Company,” and “Chegg” refer to Chegg, Inc. and its subsidiaries taken as a whole.

“Chegg,” “Chegg.com,” “Chegg Study,” “Chegg for Good,” “Student Hub,” “internships.com,” “ResearchReady,” “InstaEDU,” “EasyBib” and “#1 In Textbook Rentals,” are some of our trademarks used in this Quarterly Report on Form 10-Q. Solely for convenience, our trademarks, trade names, and service marks referred to in this Quarterly Report on Form 10-Q appear without the ®, ™ and SM symbols, but those references are not intended to indicate, in any way, that we will not assert, to the fullest extent under applicable law, our rights to these trademarks and trade names. Other trademarks appearing in this Quarterly Report on Form 10-Q are the property of their respective holders.

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NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained in this Quarterly Report on Form 10-Q other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans, and our objectives for future operations, are forward-looking statements. The words “believe,” “may,” “will,” “estimate,” “continue,” “anticipate,” “intend,” “project,” “endeavor,” “expect,” “plans to,” “if,” “future,” and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties, and assumptions, including those described in Part II, Item 1A, “Risk Factors” in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, 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 results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the future events and trends discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

## CHEGG, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except for number of shares and par value)

|  | September 30,<br>2016<br>(unaudited) | December 31,<br>2015<br>* |
|--|--------------------------------------|---------------------------|
| Assets   |                                      |                           |
| Current assets   |                                      |                           |
| Cash and cash equivalents  | \$ 90,213                            | \$ 67,029                 |
| Short-term investments   | —                                    | 17,800                    |
| Accounts receivable, net of allowance for doubtful accounts of \$390 and \$378 at September 30, 2016 and December 31, 2015, respectively   | 9,481                                | 13,157                    |
| Prepaid expenses   | 4,018                                | 3,117                     |
| Other current assets   | 35,570                               | 31,732                    |
| Total current assets   | 139,282                              | 132,835                   |
| Long-term investments  | —                                    | 4,229                     |
| Textbook library, net  | 3,956                                | 29,728                    |
| Property and equipment, net  | 30,766                               | 19,971                    |
| Goodwill   | 114,980                              | 91,301                    |
| Intangible assets, net   | 21,659                               | 8,865                     |
| Other assets   | 5,565                                | 4,427                     |
| Total assets   | \$ 316,208                           | \$ 291,356                |
| Liabilities and stockholders' equity   |                                      |                           |
| Current liabilities  |                                      |                           |
| Accounts payable   | \$ 7,992                             | \$ 5,860                  |
| Deferred revenue   | 30,004                               | 14,971                    |
| Accrued liabilities  | 59,034                               | 35,280                    |
| Total current liabilities  | 97,030                               | 56,111                    |
| Long-term liabilities  |                                      |                           |
| Total other long-term liabilities  | 4,075                                | 4,170                     |
| Total liabilities  | 101,105                              | 60,281                    |
| Commitments and contingencies (Note 8)   |                                      |                           |
| Stockholders' equity:  |                                      |                           |
| Preferred stock, \$0.001 par value – 10,000,000 shares authorized, no shares issued and outstanding  | —                                    | —                         |
| Common stock, \$0.001 par value 400,000,000 shares authorized; 91,113,230 and 88,099,983 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively |                                      | 88                        |
| Additional paid-in capital   | 584,999                              | 560,242                   |
| Accumulated other comprehensive loss   | (148                                 | ) (172                    |
| Accumulated deficit  | (369,839                             | ) (329,083                |
| Total stockholders' equity   | 215,103                              | 231,075                   |
| Total liabilities and stockholders' equity   | \$ 316,208                           | \$ 291,356                |

\* Derived from audited consolidated financial statements as of and for the year ended December 31, 2015.

See Notes to Condensed Consolidated Financial Statements.



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CHEGG, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2016                                | 2015       | 2016                               | 2015       |
| Net revenues:   |                                     |            |                                    |            |
| Rental  | \$5,511                             | \$22,703   | \$32,081                           | \$93,199   |
| Services  | 49,765                              | 33,358     | 126,795                            | 94,001     |
| Sales   | 16,067                              | 25,225     | 32,157                             | 46,019     |
| Total net revenues  | 71,343                              | 81,286     | 191,033                            | 233,219    |
| Cost of revenues:   |                                     |            |                                    |            |
| Rental  | 7,646                               | 27,080     | 26,505                             | 86,873     |
| Services  | 12,884                              | 10,377     | 38,691                             | 32,189     |
| Sales   | 18,169                              | 24,263     | 33,833                             | 44,407     |
| Total cost of revenues  | 38,699                              | 61,720     | 99,029                             | 163,469    |
| Gross profit  | 32,644                              | 19,566     | 92,004                             | 69,750     |
| Operating expenses:   |                                     |            |                                    |            |
| Technology and development  | 16,241                              | 15,664     | 49,232                             | 45,076     |
| Sales and marketing   | 15,256                              | 16,211     | 41,449                             | 49,985     |
| General and administrative  | 13,905                              | 12,060     | 41,140                             | 35,780     |
| Restructuring (credits) charges   | (100 )                              | 342        | (298 )                             | 3,320      |
| Loss (gain) on liquidation of textbooks                                       | 2,673                               | (909 )     | (523 )                             | (2,649 )   |
| Total operating expenses  | 47,975                              | 43,368     | 131,000                            | 131,512    |
| Loss from operations  | (15,331 )                           | (23,802 )  | (38,996 )                          | (61,762 )  |
| Interest expense and other (expense) income, net:                             |                                     |            |                                    |            |
| Interest expense, net   | (30 )                               | (61 )      | (151 )                             | (182 )     |
| Other (expense) income, net   | (148 )                              | 85         | (146 )                             | 217        |
| Total interest expense and other (expense) income, net                        | (178 )                              | 24         | (297 )                             | 35         |
| Loss before provision for income taxes  | (15,509 )                           | (23,778 )  | (39,293 )                          | (61,727 )  |
| Provision for income taxes  | 554                                 | 389        | 1,463                              | 1,113      |
| Net loss  | \$(16,063)                          | \$(24,167) | \$(40,756)                         | \$(62,840) |
| Net loss per share, basic and diluted   | \$(0.17 )                           | \$(0.28 )  | \$(0.45 )                          | \$(0.73 )  |
| Weighted average shares used to compute net loss per share, basic and diluted | 91,059                              | 87,706     | 90,201                             | 86,419     |

See Notes to Condensed Consolidated Financial Statements.

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CHEGG, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2016                                | 2015       | 2016                               | 2015       |
| Net loss   | \$(16,063)                          | \$(24,167) | \$(40,756)                         | \$(62,840) |
| Other comprehensive (loss) income:                             |                                     |            |                                    |            |
| Change in unrealized gain on available for sale investments    | —                                   | 16         | 25                                 | 21         |
| Change in foreign currency translation adjustments, net of tax | 35                                  | (119 )     | (1 )                               | (97 )      |
| Other comprehensive (loss) income                              | 35                                  | (103 )     | 24                                 | (76 )      |
| Total comprehensive loss                                       | \$(16,028)                          | \$(24,270) | \$(40,732)                         | \$(62,916) |

See Notes to Condensed Consolidated Financial Statements.



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CHEGG, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2016                               | 2015       |
| Cash flows from operating activities  |                                    |            |
| Net loss  | \$(40,756)                         | \$(62,840) |
| Adjustments to reconcile net loss to net cash used in operating activities: |                                    |            |
| Textbook library depreciation expense                                       | 8,903                              | 36,838     |
| Other depreciation and amortization expense                                 | 10,001                             | 9,180      |
| Share-based compensation expense  | 32,701                             | 31,784     |
| Gain on liquidation of textbooks  | (523                               | ) (2,649   |
| Loss from write-offs of textbooks   | 896                                | 4,534      |
| Other non-cash items  | 106                                | 790        |
| Change in assets and liabilities, net of acquisition of business:           |                                    |            |
| Accounts receivable   | 312                                | (399       |
| Prepaid expenses and other current assets                                   | (4,712                             | ) (32,503  |
| Other assets  | 284                                | (204       |
| Accounts payable  | 2,713                              | 1,977      |
| Deferred revenue  | 14,896                             | 21,490     |
| Accrued liabilities   | 5,997                              | 10,310     |
| Other liabilities   | (92                                | ) (194     |
| Net cash provided by operating activities                                   | 30,726                             | 18,114     |
| Cash flows from investing activities  |                                    |            |
| Purchases of textbooks  | (795                               | ) (32,226  |
| Proceeds from liquidations of textbooks                                     | 23,873                             | 34,230     |
| Purchases of marketable securities  | (7,633                             | ) (19,975  |
| Proceeds from sale of marketable securities                                 | 22,830                             | 350        |
| Maturities of marketable securities   | 6,844                              | 29,989     |
| Purchases of property and equipment   | (17,834                            | ) (5,884   |
| Acquisition of business, net of cash acquired                               | (25,864                            | ) —        |
| Purchase of strategic equity investment                                     | (1,020                             | ) (2,019   |
| Net cash provided by investing activities                                   | 401                                | 4,465      |
| Cash flows from financing activities  |                                    |            |
| Common stock issued under stock plans, net                                  | 1,114                              | 12,588     |
| Payment of taxes related to the net share settlement of RSUs                | (9,057                             | ) (8,080   |
| Repurchase of common stock  | —                                  | (2,263     |
| Net cash (used in) provided by financing activities                         | (7,943                             | ) 2,245    |
| Net increase in cash and cash equivalents                                   | 23,184                             | 24,824     |
| Cash and cash equivalents, beginning of period                              | 67,029                             | 56,117     |
| Cash and cash equivalents, end of period                                    | \$90,213                           | \$80,941   |
| Supplemental cash flow data:  |                                    |            |
| Cash paid during the period for:  |                                    |            |
| Interest  | \$47                               | \$76       |
| Income taxes  | \$831                              | \$686      |
| Non-cash investing and financing activities:                                |                                    |            |

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|  |          |       |
|--|----------|-------|
| Accrued purchases of long-lived assets                     | \$1,517  | \$999 |
| Issuance of common stock related to prior acquisition      | \$—      | \$825 |
| Accrued deferred cash consideration related to acquisition | \$16,650 | \$—   |

See Notes to Condensed Consolidated Financial Statements.

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CHEGG, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Background and Basis of Presentation

Company and Background

Chegg, Inc. (Chegg, the Company, we, us, or our), headquartered in Santa Clara, California, was incorporated as a Delaware corporation on July 29, 2005. Chegg is the leading student-first connected learning platform, empowering students to take control of their education to save time, save money, and get smarter. We help students study more effectively for college admissions exams, find the right college to accomplish their goals, get better grades and test scores while in school, and find internships that allow them to gain valuable skills to help them enter the workforce after college. Our connected learning platform offers products and services that help students transition from high school to college to career, with a view toward improving student outcomes and the overall return on investment in education.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of September 30, 2016, the condensed consolidated statements of operations and the condensed consolidated statements of comprehensive loss for the three and nine months ended September 30, 2016 and 2015, the condensed consolidated statements of cash flows for the nine months ended September 30, 2016 and 2015, and the related footnote disclosures are unaudited. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, including normal recurring adjustments, necessary to present fairly our financial position as of September 30, 2016, our results of operations for the three and nine months ended September 30, 2016 and 2015, and cash flows for the nine months ended September 30, 2016 and 2015. Our results of operations for the three and nine months ended September 30, 2016 and cash flows for the nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year.

We operate in a single segment. Our fiscal year ends on December 31 and in this report we refer to the year ended December 31, 2015 as 2015.

The condensed consolidated financial statements and related financial information should be read in conjunction with the audited consolidated financial statements and the related notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2015 (the Annual Report on Form 10-K) filed with the U.S. Securities and Exchange Commission (SEC).

There have been no material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report on Form 10-K.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States (U.S. GAAP) requires management to make estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities; the disclosure of contingent liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the reporting periods. Significant estimates, assumptions, and judgments are used for, but not limited to: revenue recognition, recoverability of accounts receivable, determination of the useful lives and salvage value assigned to our textbook library, restructuring charges, share-based compensation expense including estimated forfeitures, accounting for income taxes, useful lives assigned to long-lived assets for

depreciation and amortization, impairment of goodwill and long-lived assets, and the valuation of acquired tangible and intangible assets. We base our estimates on historical experience, knowledge of current business conditions, and various other factors we believe to be reasonable under the circumstances. These estimates are based on management's knowledge about current events and expectations about actions we may undertake in the future. Actual results could differ from these estimates, and such differences could be material to our financial position and results of operations.

#### Recent Accounting Pronouncements

Except for the 2016 accounting pronouncements, which are described below, there have been no material changes to recent accounting pronouncements as compared to recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2015.

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In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). ASU 2016-15 provides for specific guidance on eight cash flow issues where the previously U.S. GAAP was either unclear or did not include specific guidance. The guidance requires a retrospective application and is effective for annual periods after December 15, 2017, with earlier application permitted as of the beginning of an interim or annual reporting period. We have elected to early adopt this standard which did not result in any changes to the presentation of our condensed consolidated statements of cash flows for the nine months ended September 30, 2016 and 2015.

In May 2016, the FASB issued ASU No. 2016-12 Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. ASU 2016-12 provides for improvements and practical expedients for specific areas of Topic 606. In April 2016, the FASB issued ASU No. 2016-10 Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing. ASU 2016-10 provides for clarification of two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance. In March 2016, the FASB issued ASU No. 2016-08 Revenue from Contracts with Customers (Topic 606) - Principal versus Agent Considerations (Reporting Revenue Gross versus Net). ASU No. 2016-08 requires an entity to determine whether the nature of its promise to provide goods or services to a customer is performed in a principal or agent capacity and to recognize revenue in a gross or net manner based on its principal/agent designation.

ASUs 2016-12, 2016-10 and 2016-08 allow for companies to choose to apply the standard retrospectively to each prior reporting period presented (full retrospective application) or retrospectively with the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings of the annual reporting period that includes the date of initial application (modified retrospective application). Each guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. We plan to adopt the guidance starting in the first quarter of 2018. We are currently in the process of evaluating these guidance updates and have not yet determined the impact on our condensed consolidated financial statements.

In March 2016 the FASB issued ASU No. 2016-09 Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 provides for simplification involving several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. In addition to these simplifications, ASU 2016-09 also eliminates the guidance in Topic 718 that was indefinitely deferred shortly after the issuance of FASB Statement No. 123 (revised 2004), Share-Based Payment. Early adoption is permitted and the application of the guidance is different for each update included within ASU 2016-09. The guidance is effective for annual periods after December 15, 2016, and we are currently in the process of evaluating the impact of this new guidance.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires an entity to recognize a right-of-use asset and lease liability for all leases with terms of more than 12 months. Recognition, measurement, and presentation of expenses will depend on classification as a finance or operating lease. The amendments in this update also require certain quantitative and qualitative disclosures about leasing arrangements. Early adoption is permitted, and the guidance requires a modified retrospective adoption. The guidance is effective for annual periods after December 15, 2018, and we are currently in the process of evaluating the impact of this new guidance.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 requires all financial assets and liabilities not accounted for under the equity method to be measured at fair value with the changes in fair value recognized in net income. The amendments in this update also require an entity to separately present in other comprehensive income the

portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendments in this update supersede the requirement to disclose the methods and significant assumptions used in calculating the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet for public business entities. Early adoption is not permitted except for the comprehensive income presentation requirement, and the updated guidance requires a prospective application with a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The guidance is effective for annual periods after December 15, 2017, and we are currently in the process of evaluating the impact of this new guidance.

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## Note 2. Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during 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 shares of common stock, including stock options, warrants, restricted stock units (RSUs), and performance-based restricted stock units (PSUs), to the extent dilutive. Basic and diluted net loss per share was the same for each period presented as the inclusion of all potential common shares outstanding would have been anti-dilutive.

The following table sets forth the computation of historical basic and diluted net loss per share (in thousands, except per share amounts):

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2016                                | 2015       | 2016                               | 2015       |
| Numerator:   |                                     |            |                                    |            |
| Net loss   | \$(16,063)                          | \$(24,167) | \$(40,756)                         | \$(62,840) |
| Denominator:   |                                     |            |                                    |            |
| Weighted average common shares used to compute net loss per share, basic and diluted | 91,059                              | 87,706     | 90,201                             | 86,419     |
| Net loss per share, basic and diluted  | \$(0.17 )                           | \$(0.28 )  | \$(0.45 )                          | \$(0.73 )  |

The following potential weighted-average shares of common stock outstanding were excluded from the computation of diluted net loss per share because including them would have been anti-dilutive (in thousands):

|                                   | Three<br>Months<br>Ended<br>September<br>30, |       | Nine Months<br>Ended<br>September<br>30, |        |
|-----------------------------------|--|-------|--|--------|
|                                   | 2016   | 2015  | 2016                                     | 2015   |
| Options to purchase common stock  | 10,420                                       | 8,156 | 10,917                                   | 11,744 |
| RSUs and PSUs                     | 624  | 317   | 1,797                                    | 159    |
| Employee stock purchase plan      | —  | 6     | —  | 14     |
| Warrants to purchase common stock | 200  | 200   | 200                                      | 335    |
| Total common stock equivalents    | 11,244                                       | 8,679 | 12,914                                   | 12,252 |

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## Note 3. Cash and Cash Equivalents, Investments and Restricted Cash

The following table shows our cash and cash equivalents, restricted cash and investments' adjusted cost, unrealized gain (loss) and fair value as of September 30, 2016 and December 31, 2015 (in thousands):

|                                 | September 30, 2016 |                                  |               | December 31, 2015 |                                  |               |
|---------------------------------|--------------------|----------------------------------|---------------|-------------------|----------------------------------|---------------|
|                                 | Cost               | Net<br>Unrealized<br>Gain/(Loss) | Fair<br>Value | Cost              | Net<br>Unrealized<br>Gain/(Loss) | Fair<br>Value |
| Cash and cash equivalents:      |                    |                                  |               |                   |                                  |               |
| Cash                            | \$88,935           | \$                               | —\$88,935     | \$52,905          | \$                               | \$52,905      |
| Money market funds              | 1,278              | —                                | 1,278         | 6,672             | —                                | 6,672         |
| Commercial paper                | —                  | —                                | —             | 5,453             | —                                | 5,453         |
| Corporate securities            | —                  | —                                | —             | 600               | (1)                              | 599           |
| Agency bond                     | —                  | —                                | —             | 1,400             | —                                | 1,400         |
| Total cash and cash equivalents | \$90,213           | \$                               | —\$90,213     | \$67,030          | \$(1)                            | \$67,029      |
| Short-term investments:         |                    |                                  |               |                   |                                  |               |
| Commercial paper                | \$—                | \$                               | —\$—          | \$3,746           | \$                               | \$3,746       |
| Corporate securities            | —                  | —                                | —             | 10,572            | (12)                             | 10,560        |
| Agency bonds                    | —                  | —                                | —             | 3,494             | —                                | 3,494         |
| Total short-term investments    | \$—                | \$                               | —\$—          | \$17,812          | \$(12)                           | \$17,800      |
| Long-term investments:          |                    |                                  |               |                   |                                  |               |
| Corporate securities            | \$—                | \$                               | —\$—          | \$3,241           | \$(10)                           | \$3,231       |
| Agency bond                     | —                  | —                                | —             | 1,001             | (3)                              | 998           |
| Long-term corporate securities  | \$—                | \$                               | —\$—          | \$4,242           | \$(13)                           | \$4,229       |
| Short-term restricted cash      | \$—                | \$                               | —\$—          | \$300             | \$                               | \$300         |
| Long-term restricted cash       | 84                 | —                                | 84            | 478               | —                                | 478           |
| Total restricted cash           | \$84               | \$                               | —\$84         | \$778             | \$                               | \$778         |

The amortized cost and fair value of available-for-sale investments as of September 30, 2016 was \$1.3 million, respectively, and consist of money market fund deposits which are not due at a single maturity date.

As of September 30, 2016, we did not carry a balance of short-term or long-term investments. Our investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of preserving capital and maintaining liquidity. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment, we review factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates and our intent to sell or whether it is more likely than not it will be required to sell, and the investment before recovery of the investment's cost basis. During the nine months ended September 30, 2016, we did not recognize any impairment charges.

## Strategic Investment

During the three months ended September 30, 2016 and 2015, we invested \$1.0 million and \$2.0 million, respectively, in a third party to expand our customer reach. Our total investment of \$3.0 million is included in other assets on our condensed consolidated balance sheet. We did not record other-than-temporary impairment charges on this investment during the three and nine months ended September 30, 2016 and 2015, respectively, as there were no significant



identified events or changes in circumstances that would be considered an indicator for impairment.

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## Note 4. Fair Value Measurement

We have established a fair value hierarchy used to determine the fair value of our financial instruments as follows:

Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.

Level 3—Inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value; the inputs require significant management judgment or estimation.

A financial instrument's classification within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Financial instruments measured and recorded at fair value on a recurring basis as of September 30, 2016 and December 31, 2015 are classified based on the valuation technique level in the tables below (in thousands):

|  | September 30, 2016 |   |   |
|--|--------------------|---|---|
|  | Total              | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |
| Assets:  |                    |   |   |
| Cash equivalents:                                |                    |   |   |
| Money market funds                               | \$1,278            | \$ 1,278  | \$ —  |
| Total assets measured and recorded at fair value | \$1,278            | \$ 1,278  | \$ —  |

|                         | December 31, 2015 |   |   |
|-------------------------|-------------------|---|---|
|                         | Total             | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |
| Assets:                 |                   |   |   |
| Cash equivalents:       |                   |   |   |
| Money market funds      | \$6,672           | \$ 6,672  | \$ —  |
| Commercial paper        | 5,453             | —   | 5,453   |
| Corporate securities    | 599               | —   | 599   |
| Agency bond             | 1,400             | —   | 1,400   |
| Short-term investments: |                   |   |   |
| Commercial paper        | 3,746             | —   | 3,746   |
| Corporate securities    | 10,560            | —   | 10,560  |
| Agency bonds            | 3,494             | —   | 3,494   |
| Long-term investments:  |                   |   |   |

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|  |          |          |           |
|--|----------|----------|-----------|
| Corporate securities                             | 3,231    | —        | 3,231     |
| Agency bond                                      | 998      | —        | 998       |
| Total assets measured and recorded at fair value | \$36,153 | \$ 6,672 | \$ 29,481 |

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We value our marketable securities based on quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. We classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models such as discounted cash flow techniques.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while we believe our valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

## Note 5. Acquisition

In May 2016, we acquired all of the outstanding interests of Imagine Easy Solutions, LLC (Imagine Easy), a privately held online learning company based in New York that provides a portfolio of online writing tools. We anticipate this acquisition to enhance our ability to acquire new students, increase the value of our platform to our existing students, and have a meaningful and positive impact on their outcomes. The total fair value of the purchase consideration was \$42.3 million. The purchase consideration included deferred cash consideration of \$17.0 million, of which the present value of \$16.7 million was recorded as accrued liabilities on our condensed consolidated balance sheet as of September 30, 2016. We will accrete into the deferred cash consideration of \$17.0 million until it is paid to the sellers in April 2017. During the three and nine months ended September 30, 2016, we recorded accretion expense of \$0.2 million and \$0.3 million, respectively, through other expense on the condensed consolidated statement of operations. Further, the consideration included an escrow and a hold-back amount of \$4.2 million and \$0.5 million, respectively, for general representations and warranties and potential post-closing adjustments. The escrow amount will be released in July 2017, and the hold-back amount was released during the third quarter of 2016.

The acquisition date fair value of the purchase consideration for the above transaction consisted of the following (in thousands):

|   |          |
|---|----------|
| Initial cash consideration                | \$21,023 |
| Net working capital adjustment            | 200      |
| Fair value of deferred cash consideration | 16,374   |
| Escrow                                    | 4,200    |
| Hold-back                                 | 500      |
| Fair value of purchase consideration      | \$42,297 |

Included in the purchase agreement are additional contingent payments of up to \$18.0 million, of which \$3.0 million relates to the achievement of performance conditions for the fiscal year ended 2016. These payments will be made over the next three years, subject to continued employment of the sellers, and will be expensed ratably as technology and development and general and administrative expense on our condensed consolidated statements of operations. These contingent payments may be settled by us, at our sole discretion, either in cash or shares of our common stock. We have accrued \$2.5 million as of September 30, 2016 for these contingent payments which is included within accrued liabilities on our condensed consolidated balance sheet.

The fair value of the intangible assets acquired was determined under the acquisition method of accounting for business combinations. The excess of purchase consideration paid over the fair value of identifiable assets acquired was recorded as goodwill. Goodwill is primarily attributable to the potential for future product offerings as well as our expanded student reach. The amounts recorded for goodwill are expected to be deductible for tax purposes.



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The following table presents the total purchase price allocation recorded in our condensed consolidated balance sheets as of the acquisition date (in thousands):

|                                    |          |
|------------------------------------|----------|
| Cash                               | \$59     |
| Accounts receivable                | 2,610    |
| Favorable lease acquired           | 300      |
| Other acquired assets              | 212      |
| Acquired intangible assets:        |          |
| Trade names                        | 1,800    |
| Domain names                       | 1,100    |
| Advertiser relationships           | 6,600    |
| User base                          | 410      |
| Non-compete agreements             | 500      |
| Developed technology               | 5,600    |
| Total acquired intangible assets   | 16,010   |
| Total identifiable assets acquired | 19,191   |
| Liabilities assumed                | (573 )   |
| Net identifiable assets acquired   | 18,618   |
| Goodwill                           | 23,679   |
| Total purchase consideration       | \$42,297 |

During the nine months ended September 30, 2016, we incurred \$1.0 million of acquisition-related expenses associated with the acquisition of Imagine Easy which have been included in general and administrative expenses in our condensed consolidated statements of operations.

The pro forma results of operations of the above acquisition have not been presented as the financial impact to our condensed consolidated statements of operations is not material.

## Note 6. Goodwill and Intangible Assets

Goodwill consists of the following (in thousands):

|                             | September 30, 2016 | December 31, 2015 |
|-----------------------------|--------------------|-------------------|
| Beginning balance           | \$ 91,301          | \$ 91,301         |
| Addition due to acquisition | 23,679             | —                 |
| Ending balance              | \$ 114,980         | \$ 91,301         |

Intangible assets as of September 30, 2016 and December 31, 2015 consist of the following (in thousands, except weighted-average amortization period):

|                           | September 30, 2016                               | December 31, 2015 | Net Carrying Amount      |          |
|---------------------------|--|-------------------|--------------------------|----------|
|                           | Weighted-Average Amortization Period (in months) | Carrying Amount   | Accumulated Amortization |          |
| Developed technologies    | 60   | \$ 15,017         | \$ (7,779 )              | \$ 7,238 |
| Customer lists            | 47   | 9,830             | (3,192 )                 | 6,638    |
| Trade names               | 48   | 5,243             | (1,661 )                 | 3,582    |
| Non-compete agreements    | 30   | 1,720             | (1,177 )                 | 543      |
| Master service agreements | 21   | 1,030             | (972 )                   | 58       |

|                             |   |          |              |          |
|-----------------------------|---|----------|--------------|----------|
| Indefinite-lived trade name | — | 3,600    | —            | 3,600    |
| Total intangible assets     |   | \$36,440 | \$ (14,781 ) | \$21,659 |

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|                             | December 31, 2015                               |   |                           |
|-----------------------------|---|---|---------------------------|
|                             | Weighted-Average                                |   |                           |
|                             | Amortization<br>Period<br>(in Amount<br>months) | Carrying<br>Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
| Developed technologies      | 52 \$9,417                                      | \$ (6,702 )                             | \$ 2,715                  |
| Customer lists              | 20 2,820  | (2,239 )                                | 581                       |
| Trade names                 | 48 2,343  | (920 )                                  | 1,423                     |
| Non-compete agreements      | 28 1,220  | (832 )                                  | 388                       |
| Master service agreements   | 21 1,030  | (872 )                                  | 158                       |
| Indefinite-lived trade name | — 3,600   | —                                       | 3,600                     |
| Total intangible assets     | \$ 20,430                                       | \$ (11,565 )                            | \$ 8,865                  |

During the three and nine months ended September 30, 2016, amortization expense related to our acquired intangible assets totaled approximately \$1.4 million and \$3.2 million, respectively. During the three and nine months ended September 30, 2015, amortization expense related to our acquired intangible assets totaled approximately \$1.1 million and \$4.1 million, respectively.

As of September 30, 2016, the estimated future amortization expense related to our finite-lived intangible assets is as follows (in thousands):

|                                |           |
|--------------------------------|-----------|
| Remaining three months of 2016 | \$ 1,376  |
| 2017                           | 5,153     |
| 2018                           | 4,255     |
| 2019                           | 3,433     |
| 2020                           | 2,153     |
| Thereafter                     | 1,689     |
| Total                          | \$ 18,059 |

## Note 7. Debt Obligations

In September 2016, we entered into a revolving line of credit with an aggregate principal amount of \$30.0 million (the Line of Credit) with an accordion feature that, subject to the lender's discretion, allows us to borrow up to a total of \$50.0 million. This new line of credit replaces the previous line of credit that expired in August 2016. The Line of Credit matures September 2019 and requires us to repay the outstanding balance upon maturity. We will pay a fee equal to 0.25% per year on the average daily unused amount of the Line of Credit and a base interest rate equal to the LIBOR. In addition, we will pay a fee for each issued letter of credit which will be determined based on our current leverage ratio at the time the letter of credit is issued. If our leverage ratio is less than 1.00%, we will pay a fee equal to 1.50% per year and if our leverage ratio is greater than or equal to 1.00%, we will pay a fee equal to 2.50% per year. Our leverage ratio is a ratio of all obligations owed to the bank divided by our consolidated EBITDA. EBITDA for the purposes of calculating our leverage ratio is defined as net profit (loss) before tax, plus interest expense, plus non-cash stock compensation (net of capitalized interest expense), depreciation expense, amortization expense and other non-cash expenses (assuming there are no future cash costs), plus expenses incurred in connection with permitted acquisitions (including without limitation accrued acquisition-related contingent expenses) in an amount not to exceed \$6.0 million per calendar year, plus non-recurring expenses in an amount not to exceed \$2.0 million per calendar year. We must maintain financial covenants under the Line of Credit as follows: (1) maintain a balance of unrestricted cash at the Bank of not less than \$30.0 million at all times, other than the three months ending March 31, 2017 and June 30, 2017, and not less than \$25.0 million during the three months ending March 31, 2017 and June 30,



2017; and (2) achieve EBITDA, on a trailing 12 month basis, of not less than (i) \$25.0 million for the period of time from September 30, 2016 through June 30, 2017, (ii) \$30.0 million for the period of time from September 30, 2017 through June 30, 2018, and (iii) \$35.0 million for the period of time from September 30, 2018 through the maturity of the Line of Credit.

As of December 31, 2015, we had a revolving credit facility with an aggregate principal amount of \$30.0 million (the Revolving Credit Facility) with an accordion feature that, subject to certain financial criteria, allowed us to borrow up to a total of \$65.0 million beginning the quarter ended December 31, 2015. The Revolving Credit Facility carried, at our election, a base

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interest rate of the greater of the Federal Funds Rate plus 0.5% or one-month LIBOR plus 1% or a LIBOR based interest rate plus additional interest of up to 4.5% depending on our leverage ratio. The Revolving Credit Facility expired in August 2016.

As of September 30, 2016, we were in compliance with the financial covenants of the Line of Credit. Further, we had no amounts outstanding and were able to borrow up to \$30.0 million under the Line of Credit.

Note 8. Commitments and Contingencies

We lease our office and warehouse facilities under operating leases, which expire at various dates through 2021. Our primary operating lease commitments at September 30, 2016 related to our headquarters in Santa Clara, California, our office in San Francisco, California, and our warehouse facility in Shepherdsville, Kentucky. We recognize rent expense on a straight-line basis over the lease period. Where leases contain escalation clauses, rent abatements, or concessions, such as rent holidays and landlord or tenant incentives or allowances, we apply them in the determination of straight-line rent expense over the lease term. As a result of our strategic partnership with Ingram and the exit of our Kentucky warehouse during 2015, we have subleased substantially all of our warehouse in Kentucky and we expect this sublease agreement to generate \$0.2 million of sublease income per month through the end of the lease term in November 2016. Rental expense, net of sublease income, was approximately \$0.5 million and \$1.4 million in the three and nine months ended September 30, 2016, respectively, and \$0.6 million and \$2.0 million in the three and nine months ended September 30, 2015, respectively.

From time to time, third parties may assert patent infringement claims against us in the form of letters, litigation, or other forms of communication. In addition, we may from time to time be subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights, and other intellectual property rights; employment claims; and general contract or other claims. We may also, from time to time, be subject to various legal or government claims, disputes, or investigations. Such matters may include, but not be limited to, claims, disputes, or investigations related to warranty, refund, breach of contract, employment, intellectual property, government regulation, or compliance or other matters.

In July 2010, the Kentucky Tax Authority issued a property tax assessment of approximately \$1.0 million related to our textbook library located in our Kentucky warehouse for the 2009 and 2010 tax years under audit. In March 2011, we filed a protest with the Kentucky Board of Tax Appeals that was rejected in March 2012. In September 2012, we filed a complaint seeking declaratory rights against the Commonwealth of Kentucky in the Bullitt Circuit Court of Kentucky, and that case was subsequently dismissed in favor of administration remedies with the Kentucky Tax Authority. We received a final Notice of Tax due in October 2012 from the Kentucky Tax Authority, and we appealed this notice in November 2012 with the Kentucky Board of Tax Appeals. In May 2013, we presented an Offer in Judgment to the Kentucky Tax Authority of approximately \$150,000, excluding tax and penalties, an amount that we have accrued for the two years under audit. We accrued this amount as of December 31, 2012. We appealed to the Kentucky Board of Tax Appeals in July 2013, and the Board issued a ruling in favor of the Kentucky Department of Revenue in January 2014 maintaining the property tax assessment. In February 2014, we filed an appeal to the Franklin Circuit Court in Kentucky, and in June 2014 the Circuit Court held in abeyance our motion to appeal. In October 2014 the Franklin Circuit Court in Kentucky issued its opinion and order reversing the Board of Tax Appeal's decision, setting aside the Kentucky Department of Revenue's tax assessments against us and further vacating all penalties and interest. The Kentucky Department of Revenue has appealed the Circuit Court ruling. On March 4, 2016, the Kentucky Court of Appeals ruled unanimously in our favor, affirming our position that no property tax was owed on the textbooks. The Kentucky Department of Revenue petitioned the Kentucky Supreme Court for a discretionary review, which was denied in September 2016. The case was determined in our favor with no property tax due related to our textbook library.

We are not aware of any other pending legal matters or claims, individually or in the aggregate, that are expected to have a material adverse impact on our consolidated financial position, results of operations, or cash flows. However, our determination of whether a claim will proceed to litigation cannot be made with certainty, nor can the results of litigation be predicted with certainty. Nevertheless, defending any of these actions, regardless of the outcome, may be costly, time consuming, distract management personnel, and have a negative effect on our business. An adverse outcome in any of these actions, including a judgment or settlement, may cause a material adverse effect on our future business, operating results, and/or financial condition.

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## Note 9. Guarantees and Indemnifications

We have agreed to indemnify our directors and officers for certain events or occurrences, subject to certain limits, while such persons are or were serving at our request in such capacity. We may terminate the indemnification agreements with these persons upon termination of employment, but termination will not affect claims for indemnification related to events occurring prior to the effective date of termination. We have a directors' and officers' insurance policy that limits our potential exposure up to the limits of our insurance coverage. In addition, we also have other indemnification agreements with various vendors against certain claims, liabilities, losses, and damages. The maximum amount of potential future indemnification is unlimited.

We believe the fair value of these indemnification agreements is minimal. We have not recorded any liabilities for these agreements as of September 30, 2016.

## Note 10. Stockholders' Equity

## Share-based Compensation

Total share-based compensation expense recorded for employees and non-employees, is as follows (in thousands):

|  | Three Months<br>Ended<br>September 30, |         | Nine Months<br>Ended<br>September 30, |          |
|--|--|---------|---------------------------------------|----------|
|  | 2016                                   | 2015    | 2016                                  | 2015     |
| Cost of revenues                       | \$46                                   | \$103   | \$115                                 | \$318    |
| Technology and development             | 3,449                                  | 3,464   | 11,207                                | 9,444    |
| Sales and marketing                    | 1,605                                  | 126     | 5,456                                 | 6,214    |
| General and administrative             | 5,110                                  | 5,240   | 15,923                                | 15,808   |
| Total share-based compensation expense | \$10,210                               | \$8,933 | \$32,701                              | \$31,784 |

There was no capitalized share-based compensation expense as of September 30, 2016 or 2015.

## Fair Value of Restricted Stock Units (RSUs) and of Performance-Based Restricted Stock Units (PSUs)

RSUs and PSUs are converted into shares of our common stock upon vesting on a one-for-one basis. Vesting of RSUs is subject to the employee's continuing service to us, while vesting of PSUs is subject to our achievement of specified corporate financial performance objectives in addition to the employee's continuing service to us. The compensation expense related to RSUs and PSUs is determined using the fair value of our common stock on the date of grant, and the expense is recognized on a straight-line basis over the vesting period. RSUs are typically fully vested at the end of three or four years while PSUs vest subject to the achievement of performance objectives and if achieved, typically vest over two to three years. We assess the achievement of performance objectives on a quarterly basis and adjust our share-based payment expense as appropriate.

## Fair Value of 2013 Employee Stock Purchase Plan (2013 ESPP)

Under the 2013 ESPP, rights to purchase shares are generally granted during the second and fourth quarter of each year. We estimate the fair value of rights granted under the 2013 ESPP at the date of grant using the Black-Scholes-Merton option-pricing model.

## Stock Option Activity

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During the nine months ended September 30, 2016 and 2015, we granted 232,700 and 165,456 stock option awards, respectively, at a weighted average grant date fair value of \$2.58 and \$3.63, respectively, solely to members of our board of directors. We did not grant stock option awards during the three months ended September 30, 2016 and 2015.

As of September 30, 2016, our total unrecognized compensation expense for stock option awards granted to employees, officers, directors, and consultants was approximately \$2.9 million, which will be recognized over a weighted-average vesting period of approximately 0.8 years.

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## RSU and PSU Activity

|                               | RSUs and<br>PSUs Outstanding | Weighted<br>Average<br>Grant Date<br>Fair Value |
|-------------------------------|------------------------------|---|
| Balance at December 31, 2015  | 13,270,650                   | \$ 6.38   |
| Granted                       | 9,620,354                    | 4.44  |
| Released                      | (4,558,359)                  | 6.48  |
| Canceled                      | (3,931,959)                  | 6.09  |
| Balance at September 30, 2016 | 14,400,686                   | \$ 5.13   |

## 2015 PSU Grant

In February 2015, we granted PSUs under the 2013 Equity Incentive Plan (2013 Plan) to certain of our key employees (the February 2015 grants). The PSUs entitle the employees to receive a certain number of shares of our common stock based on our satisfaction of certain financial and strategic performance targets during 2015 (the 2015 Performance Period) and 2016 (the 2016 Performance Period). Based on the achievement of the performance conditions during the 2015 Performance Period for the February 2015 grants, the final settlement met the minimum threshold for the 2015 Performance Period based on a specified objective formula approved by the Compensation Committee of the Board of Directors (the Compensation Committee). The PSUs related to the 2015 Performance Period vest annually over a one or three year period depending on the employee, with the initial vesting occurring in February 2016. In March 2016, the financial and strategic performance targets were set by the Compensation Committee for the 2016 Performance Period for the February 2015 grants. The PSUs related to the 2016 Performance Period vest over a one year period with vesting occurring in March 2017.

During the nine months ended September 30, 2016, the Compensation Committee approved a modification of the performance targets related to the 2015 Performance Period of the February 2015 grants for 26 employees. As a result of the modification, we recorded an expense of \$1.5 million during the nine months ended September 30, 2016.

The number of shares underlying the PSUs granted during the nine months ended September 30, 2015 totaled 2,300,824 shares and had a weighted average grant date fair value of \$6.59 per share. During the nine months ended September 30, 2016, 688,464 shares were released relating to the 2015 Performance Period. As of September 30, 2016, we expect a significant portion of the remaining PSUs related to the 2016 Performance Period to vest.

## 2016 PSU Grants

In March 2016, we granted PSUs under the 2013 Plan to certain of our key executives. The PSUs entitle the executives to receive a certain number of shares of our common stock based on our satisfaction of certain financial and strategic performance targets during 2016. Based on the achievement of the performance conditions during 2016 for the March 2016 grants, the final settlement will range between zero and 100% of the maximum shares underlying the PSU awards based on a specified objective formula approved by the Compensation Committee. If earned, these PSUs will vest over a three year period depending on the employee, with the initial vesting occurring in March 2018.

The number of shares underlying the PSUs granted during the nine months ended September 30, 2016 totaled 2,377,842 shares and had a weighted average grant date fair value of \$4.32 per share. As of September 30, 2016, we expect a significant portion of these PSUs to vest.

As of September 30, 2016, we had a total of approximately \$40.0 million of unrecognized compensation costs related to RSUs and PSUs that are expected to be recognized over the remaining weighted average period of 2.0 years.

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## Note 11. Income Taxes

We recorded an income tax provision of approximately \$0.6 million and \$1.5 million for the three and nine months ended September 30, 2016, respectively, and an income tax provision of approximately \$0.4 million and \$1.1 million for the three and nine months ended September 30, 2015, respectively. The income tax provision for the three and nine months ended September 30, 2016 was primarily due to state and foreign income tax expense and federal tax expense related to tax amortization of acquired indefinite lived intangible assets. The income tax provision for the three and nine months ended September 30, 2015 was primarily due to state and foreign income tax expense and federal tax expense related to the tax amortization of acquired goodwill.

## Note 12. Restructuring (Credits) Charges

The following table summarizes the activity related to the accrual for restructuring charges (in thousands):

|                               | Workforce<br>Reduction<br>Costs | Lease<br>Termination<br>and Other<br>Costs | Total   |
|-------------------------------|---------------------------------|--|---------|
| Balance at January 1, 2015    | \$ —                            | \$ —                                       | \$—     |
| Restructuring charges         | 1,885                           | 2,983                                      | 4,868   |
| Cash payments                 | (1,830)                         | (675 )                                     | (2,505) |
| Write-offs                    | —                               | (317 )                                     | (317 )  |
| Other                         | —                               | 472  | 472     |
| Balance at December 31, 2015  | 55                              | 2,463                                      | 2,518   |
| Restructuring credits         | —                               | (298 )                                     | (298 )  |
| Cash payments                 | (55 )                           | (1,564 )                                   | (1,619) |
| Balance at September 30, 2016 | \$ —                            | \$ 601                                     | \$601   |

## 2015 Restructuring Plan

Restructuring charges recorded in 2015 were related to our exits from our print coupon business and our Kentucky warehouse. As a result of our strategic partnership with Ingram, we successfully exited our warehouse facilities during 2015. Restructuring credits of \$0.3 million recorded during the three and nine months ended September 30, 2016 were primarily related to a partial reversal of previously accrued lease termination costs due to our subtenant leasing additional space. Costs incurred to date related to the lease termination and other costs are expected to be fully paid by 2021.

As of September 30, 2016, the \$0.6 million liability was comprised of a short-term accrual of \$0.5 million included within accrued liabilities and a long-term accrual of \$0.1 million included within other liabilities on the condensed consolidated balance sheets.

## Note 13. Related-Party Transactions

Our Chief Executive Officer is a member of the Board of Directors of Adobe Systems Incorporated (Adobe). During the three and nine months ended September 30, 2016, we had purchases of \$0.7 million and \$2.5 million, respectively, and during the three and nine months ended September 30, 2015, we had purchases of \$1.1 million and \$2.0 million, respectively, of products from Adobe. We had no revenues in the three and nine months ended September 30, 2016 and \$0.1 million in the nine months ended September 30, 2015 from Adobe. We had \$0.7 million and \$0.4 million in payables as of September 30, 2016 and December 31, 2015, respectively, to Adobe. We had no outstanding accounts receivables as of September 30, 2016 and December 31, 2015 from Adobe.



One of our board members is also a member of the Board of Directors of Cengage Learning, Inc. (Cengage). During the three and nine months ended September 30, 2016, we had purchases of \$2.8 million and \$7.2 million, respectively, and during the three and nine months ended September 30, 2015, we had purchases of \$2.9 million and \$9.1 million, respectively, of products from Cengage. We had \$0.6 million in revenues in both the three and nine months ended September 30, 2016 and \$0.1 million in revenues in both the three and nine months ended September 30, 2015 from Cengage. We had an immaterial amount in payables as of September 30, 2016 and December 31, 2015 to Cengage. We had \$0.1 million in outstanding accounts receivables as of September 30, 2016 and no outstanding accounts receivables as of December 31, 2015 from Cengage.

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One of our board members is also a member of the Board of Directors of Groupon, Inc. (Groupon). During the three and nine months ended September 30, 2016, we had purchases of \$0.2 million and \$0.5 million, respectively, and an immaterial amount during the three and nine months ended September 30, 2015 of services from Groupon. We had no revenues in the three and nine months ended September 30, 2016 and September 30, 2015 from Groupon. We had an immaterial amount in payables as of September 30, 2016 and December 31, 2015, respectively, to Groupon. We had no outstanding accounts receivables as of September 30, 2016 and December 31, 2015 from Groupon.

Transactions with the above related parties have been conducted on an arms-length basis, and the terms of our contracts are consistent with our contracts with other independent parties.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion of our financial condition and results of operations in conjunction with our condensed consolidated financial statements and the related notes included in Part I, Item 1, "Financial Statements (unaudited)" of this Quarterly Report on Form 10-Q. In addition to historical consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates, and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. See the "Note about Forward-Looking Statements" for additional information. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Quarterly Report on Form 10-Q, particularly in Part II, Item 1A, "Risk Factors."

### Overview

Chegg is the leading student-first connected learning platform. Our goal is to help students transition from high school to college to career, with a view to improving student outcomes. We help students study more effectively for college admission exams, find the right college to accomplish their goals, get better grades and test scores while in school, and find internships that allow them to gain valuable skills to help them enter the workforce after college. We strive to improve the overall return on investment in education.

We match domestic and international students with colleges, universities, and other academic institutions (collectively referred to as colleges) in the United States. Students get help finding the best fit school for them, and colleges are able to reach the best candidates at a fraction of the cost of traditional marketing. Once in college, we provide a range of products and services to help students save time, save money and get smarter. We offer an extensive print textbook library for rent and sale both on our own and through our strategic partnership with Ingram, which we discuss in more detail below. We also offer eTextbooks for rent and sale. Students can subscribe to our digital services, such as Chegg Study, which provides step-by-step Textbook Solutions and Expert Answers, helping students with their course work. We also have live tutors available to students online, anytime, anywhere through our Chegg Tutors service. We provide access to internships to help students gain skills that are critical to securing their first job. We provide students with an online adaptive test preparation service currently covering the ACT and SAT exams. Finally, we provide a portfolio of online writing tools to help students improve their writing skills.

To deliver services to students, we partner with a variety of third parties. We work with colleges to help shape their incoming classes. We source print textbooks, eTextbooks, and supplemental materials directly or indirectly from thousands of publishers in the United States, including Pearson, Cengage Learning, McGraw Hill, Wiley, and MacMillan. We have a large network of students and professionals who leverage our platform to tutor in their spare time and employers who leverage our platform to post their internships and jobs. In addition, because we have a large student user base, local and national brands partner with us to reach the college and high school demographics.

During the three and nine months ended September 30, 2016, we generated net revenues of \$71.3 million and \$191.0 million, respectively, and in the same periods had net losses of \$16.1 million and \$40.8 million, respectively. During the three and nine months ended September 30, 2015, we generated net revenues of \$81.3 million and \$233.2 million, respectively, and in the same periods had net losses of \$24.2 million and \$62.8 million, respectively. We plan to continue to invest in our long-term growth, particularly further investment in the technology that powers our connected learning platform, the development of additional products and services that serve students, and expanding our strategic partnership with Ingram.

Our strategy for achieving and maintaining profitability is centered upon our ability to utilize Chegg Services to increase student engagement with our connected learning platform. We plan to continue to invest in the expansion of Chegg Services to provide a more compelling and personalized solution and deepen engagement with students. In May 2016, we acquired Imagine Easy Solutions, LLC, a privately held online learning company based in New York that provides a portfolio of online writing tools. We anticipate this acquisition to enhance our ability to acquire new students, increase the value to our

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existing students, and have a meaningful and positive impact on their outcomes. Further, we believe this expanded and deeper penetration of the student demographic will allow us to drive further growth in our enrollment and brand marketing services. In addition, we believe that these investments we have made to achieve our current scale will allow us to drive increased operating margins over time that, together with increased contributions of Chegg Services products, will enable us to accomplish profitability and become cash-flow positive for the long-term. Our ability to accomplish these long-term objectives is subject to numerous risks and uncertainties, including our ability to attract, retain, and increasingly engage the student population, intense competition in our markets, the ability to achieve sufficient contributions to revenue from Chegg Services and other factors described in greater detail in Part II, Item 1A, "Risk Factors."

We have presented revenues for our two product lines, Required Materials and Chegg Services, based on how students view us and the utilization of our products by them. Required Materials includes all products that are essential for students to meet the requirements of their coursework and Chegg Services includes all other products we provide to supplement the requirements and help students with their coursework. Chegg Services also includes our marketing services which help to complete our offering of services to students. More detail on our two product lines is discussed in the next two sections titled "Required Materials" and "Chegg Services."

### Required Materials

Our Required Materials product line includes the rental and sale of print textbooks and eTextbooks as well as the commission we receive from Ingram. Our web-based, multiplatform eTextbook Reader, eTextbooks and supplemental course materials are available from approximately 120 publishers, which we offer as a rental-equivalent solution and for free to students awaiting the arrival of their print textbook rental. This product line has been highly capital intensive due to the resources required to maintain a print textbook rental library. As a result of our strategic partnership with Ingram, we have exited our warehouse facilities in Kentucky and have transitioned our textbook library to Ingram's facilities, which has helped to free up resources historically required by this product line. We will continue to liquidate our print textbook library through the normal course of our operations and expect it to be substantially liquidated at the end of 2016. Until that point, we will continue to rent textbooks and recognize revenues on the textbooks that we own as rental revenues on our consolidated statement of operations through the liquidation period. Once our entire print textbook library has been liquidated, all revenues from print textbook rentals will be commission-based.

We have historically capitalized the investment in our print textbook library and recorded depreciation expense in cost of revenues over its useful life using an estimated liquidation value. During the nine months ended September 30, 2016 and 2015, our purchases of print textbooks, net of proceeds from textbook liquidation, was an inflow of \$23.1 million and \$2.0 million, respectively. We received a net inflow of cash as we continued to liquidate our existing textbook library. This is expected to continue through 2016 as we are no longer purchasing textbooks for rental as a result of our strategic partnership with Ingram.

We use our website to liquidate print textbooks from our print textbook library, which allows us to generate greater recovery on our print textbooks compared to bulk liquidations, while at the same time providing students substantial savings over the retail price of a new book. We are able to adjust what we liquidate based on expected rental demand. We also use our website to source, on behalf of Ingram, both new and used print textbooks for rental or resale from wholesalers, publishers and students. Purchasing used print textbooks allows for a reduction in the investments necessary to maintain the rental catalog while at the same time attracting students to our website by offering more for their textbooks than they could generally get by selling them back to their campus bookstore.

In the aggregate, Required Materials revenues were 58% and 55% of net revenues during the three and nine months ended September 30, 2016, respectively, and 75% and 72% of net revenues during the three and nine months ended

September 30, 2015, respectively.

### Chegg Services

Our Chegg Services are experiencing rapid growth and we expect our partnership with Ingram to accelerate the growth of these offerings by freeing up capital while allowing us to maintain our leadership and brand recognition. Our Chegg Services for students include our connected learning platform, or the Student Hub, our online writing tools service, our test preparation service currently covering the ACT and SAT exams, online tutoring, our Chegg Study service, College Admissions, Scholarship Services, and Internship Services. In addition, we offer enrollment marketing services to colleges, allowing them to reach interested college-bound high school students that use our College Admissions and Scholarship Services. We also work with leading brands, such as Dell, MasterCard, Microsoft, PayPal, Proctor & Gamble, Red Bull, Shutterfly, and Starbucks, to provide students with discounts, promotions, and other products that, based on student feedback, delight them. For example, for Red Bull, we inserted a free can of Red Bull in select textbook rental shipments to students, and Microsoft sponsored a “Free

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Study Week,” which included free access to our Chegg Study service as well as additional free study materials. All of our brand advertising services and the discounts, promotions, and other products provided to students are paid for by the brands.

Students typically pay to access Chegg Services such as Chegg Study on a monthly or annual basis, while colleges subscribe to our enrollment marketing services and brands pay us depending on the nature of the campaign. In the aggregate, Chegg Services revenues were 42% and 45% of net revenues during the three and nine months ended September 30, 2016, respectively, and 25% and 28% of net revenues during the three and nine months ended September 30, 2015, respectively.

### Strategic Partnership with Ingram

We expect our partnership with Ingram to accelerate the growth of Chegg Services products by allowing us to utilize capital otherwise spent on the purchase of print textbooks, and at the same time allowing us to maintain our leading position and high brand recognition through our iconic orange boxes. We entered into a definitive inventory purchase and consignment agreement with Ingram that will allow us to focus exclusively on eTextbooks and Chegg Services. Under the agreement, since May 2015, Ingram has been responsible for all new investments in the print textbook library, fulfillment logistics, and has title and risk of loss related to print textbook rentals. As a result of our strategic partnership with Ingram, our revenues include a commission on the total revenues that we earn from Ingram upon their fulfillment of a rental transaction using print textbooks for which Ingram has title and risk of loss. Additionally, we have ceased making additional investments in our print textbook library during 2015 and expect to rent and liquidate our existing inventory of print textbooks throughout 2016. This new model will allow us to reduce and eventually eliminate the operating expenses we incur to acquire and maintain a print textbook library. As we transition to a fully digital company, we will continue to buy used books on Ingram’s behalf including books through our buyback program and invoice Ingram at cost. We will also continue to provide Ingram with extended payment terms throughout 2016 as we procure print textbooks on behalf of Ingram, before moving to normal payment terms in 2017.

### Seasonality of Our Business

A substantial majority of our revenues are recognized ratably over the term the student rents our print textbooks and eTextbooks or has access to our Chegg Services. Historically, this has generally resulted in our highest revenues in the fourth quarter as it reflects more days of the academic year and our lowest revenues in the second quarter as colleges conclude their academic year for summer and there are fewer days of rentals. The recognition of revenues from our eTextbooks and Chegg Services will continue to follow this trend. As a result of our strategic partnership with Ingram, revenues from Ingram owned print textbook rental transactions will now be higher in the first and third quarters as we recognize a commission on the transaction rather than recognizing the revenues ratably over the term the student rents the textbooks. The variable expenses associated with our shipments of textbooks and marketing activities are highest in the first and third quarters as shipping and other fulfillment costs and marketing expenses are expensed when incurred, generally at the beginning of academic terms. We expect these variable expenses to decrease during 2016 as we have completely transitioned the shipping and fulfillment activities related to textbooks to Ingram. As a result of these factors, the most concentrated periods for our revenues and expenses do not necessarily coincide, and comparisons of our quarterly operating results on a sequential basis may not provide meaningful insight into our overall financial performance. We expect our strategic partnership with Ingram to shift peak revenues in the periods that a student rents a textbook as a result of our revenue sharing agreement such that our revenues will more closely track the academic calendar as our expenses associated with the textbook rental business decrease.

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## Results of Operations

The following table summarizes our historical condensed consolidated statements of operations (in thousands, except percentage of revenues):

|  | Three Months Ended September 30, |        |            | Nine Months Ended September 30, |            |        |            |        |
|--|----------------------------------|--------|------------|---------------------------------|------------|--------|------------|--------|
|  | 2016                             |        | 2015       |                                 | 2016       |        | 2015       |        |
| Net revenues:  |                                  |        |            |                                 |            |        |            |        |
| Rental   | \$5,511                          | 7 %    | \$22,703   | 28 %                            | \$32,081   | 17 %   | \$93,199   | 40 %   |
| Services   | 49,765                           | 70     | 33,358     | 41                              | 126,795    | 66     | 94,001     | 40     |
| Sales  | 16,067                           | 23     | 25,225     | 31                              | 32,157     | 17     | 46,019     | 20     |
| Total net revenues                                     | 71,343                           | 100    | 81,286     | 100                             | 191,033    | 100    | 233,219    | 100    |
| Cost of revenues <sup>(1)</sup> :                      |                                  |        |            |                                 |            |        |            |        |
| Rental   | 7,646                            | 11     | 27,080     | 33                              | 26,505     | 14     | 86,873     | 37     |
| Services   | 12,884                           | 18     | 10,377     | 13                              | 38,691     | 20     | 32,189     | 14     |
| Sales  | 18,169                           | 25     | 24,263     | 30                              | 33,833     | 18     | 44,407     | 19     |
| Total cost of revenues                                 | 38,699                           | 54     | 61,720     | 76                              | 99,029     | 52     | 163,469    | 70     |
| Gross profit   | 32,644                           | 46     | 19,566     | 24                              | 92,004     | 48     | 69,750     | 30     |
| Operating expenses <sup>(1)</sup> :                    |                                  |        |            |                                 |            |        |            |        |
| Technology and development                             | 16,241                           | 23     | 15,664     | 19                              | 49,232     | 26     | 45,076     | 19     |
| Sales and marketing                                    | 15,256                           | 21     | 16,211     | 20                              | 41,449     | 22     | 49,985     | 21     |
| General and administrative                             | 13,905                           | 19     | 12,060     | 15                              | 41,140     | 22     | 35,780     | 15     |
| Restructuring (credits) charges                        | (100 )                           | —      | 342        | —                               | (298 )     | —      | 3,320      | 1      |
| Loss (gain) on liquidation of textbooks                | 2,673                            | 4      | (909 )     | (1 )                            | (523 )     | —      | (2,649 )   | (1 )   |
| Total operating expenses                               | 47,975                           | 67     | 43,368     | 53                              | 131,000    | 70     | 131,512    | 55     |
| Loss from operations                                   | (15,331 )                        | (21 )  | (23,802 )  | (29 )                           | (38,996 )  | (22 )  | (61,762 )  | (25 )  |
| Total interest expense and other (expense) income, net | (178 )                           | —      | 24         | —                               | (297 )     | —      | 35         | —      |
| Loss before provision for income taxes                 | (15,509 )                        | (21 )  | (23,778 )  | (29 )                           | (39,293 )  | (22 )  | (61,727 )  | (25 )  |
| Provision for income taxes                             | 554                              | (1 )   | 389        | —                               | 1,463      | (1 )   | 1,113      | (1 )   |
| Net loss   | \$(16,063)                       | (22 )% | \$(24,167) | (29 )%                          | \$(40,756) | (23 )% | \$(62,840) | (26 )% |

<sup>(1)</sup> Includes share-based compensation expense as follows:

|  |          |         |          |          |
|--|----------|---------|----------|----------|
| Cost of revenues                       | \$46     | \$103   | \$115    | \$318    |
| Technology and development             | 3,449    | 3,464   | 11,207   | 9,444    |
| Sales and marketing                    | 1,605    | 126     | 5,456    | 6,214    |
| General and administrative             | 5,110    | 5,240   | 15,923   | 15,808   |
| Total share-based compensation expense | \$10,210 | \$8,933 | \$32,701 | \$31,784 |

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## Three and Nine Months Ended September 30, 2016 and 2015

## Net Revenues

Net revenues in the three months ended September 30, 2016 decreased \$9.9 million, or 12%, compared to the same period in 2015. In the three months ended September 30, 2016 compared to the same period in 2015, rental revenues decreased \$17.2 million or 76%, while services revenues increased \$16.4 million, or 49%, and sales revenues decreased \$9.2 million, or 36%.

Net revenues in the nine months ended September 30, 2016 decreased \$42.2 million, or 18%, compared to the same period in 2015. In the nine months ended September 30, 2016 compared to the same period in 2015, rental revenues decreased \$61.1 million or 66%, while services revenues increased \$32.8 million, or 35%, and sales revenues decreased \$13.9 million, or 30%.

The decrease in rental revenues during the three and nine months ended September 30, 2016 as compared to the same period in 2015 was due to our strategic partnership with Ingram, which commenced in July 2014. As a result of our strategic partnership, our rental revenues are increasingly classified as services revenues to represent the commission on the total revenues that we earn from Ingram upon their fulfillment of a rental transaction using books for which Ingram has title and risk of loss rather than recognizing rental revenues from transactions using our print textbooks. The increase in services revenues during the three and nine months ended September 30, 2016 as compared to the same periods in 2015 was driven primarily from growth across our other offerings for students, which included increased revenues from our Chegg Study service and our recent acquisition of Imagine Easy, as well as an increase in the commissions earned from Ingram. The decrease in sales revenues during the three and nine months ended September 30, 2016 as compared to the same periods in 2015 was driven primarily from a decrease in textbooks sold on a just in time basis.

The following table sets forth our net revenues for the periods shown for our Required Materials and Chegg Services product lines (in thousands, except percentages):

|                    | Three Months<br>Ended<br>September 30, |          | Change     |       |
|--------------------|--|----------|------------|-------|
|                    | 2016                                   | 2015     | \$         | %     |
| Required Materials | \$41,667                               | \$60,664 | \$(18,997) | (31)% |
| Chegg Services     | 29,676                                 | 20,622   | 9,054      | 44    |
| Total net revenues | \$71,343                               | \$81,286 | \$(9,943)  | (12)% |

|                    | Nine Months<br>Ended<br>September 30, |           | Change     |       |
|--------------------|---------------------------------------|-----------|------------|-------|
|                    | 2016                                  | 2015      | \$         | %     |
| Required Materials | \$105,924                             | \$167,591 | \$(61,667) | (37)% |
| Chegg Services     | 85,109                                | 65,628    | 19,481     | 30    |
| Total net revenues | \$191,033                             | \$233,219 | \$(42,186) | (18)% |

Required Materials revenues decreased \$19.0 million, or 31%, and \$61.7 million, or 37%, in the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015, primarily due to our strategic partnership with Ingram. We expect this to continue to decrease throughout 2016 as our Required Materials revenues are increasingly comprised of a commission earned from Ingram rather than the full revenues from a print textbook



rental transaction. Required Materials revenues represented 58% and 55% of net revenues during the three and nine months ended September 30, 2016, respectively, and 75% and 72% of net revenues during the three and nine months ended September 30, 2015, respectively. Chegg Services revenues increased \$9.1 million, or 44%, and \$19.5 million, or 30%, in the three and nine months ended September 30, 2016, respectively, compared to the same periods in 2015 due to growth in new memberships for our Chegg Study service, partially offset by revenues recognized from our print coupon business that we exited during the three months ended March 31, 2015. Chegg Services revenues represented 42% and 45% of net revenues during the three and nine months ended September 30, 2016, respectively, and 25% and 28% of net revenues during the three and nine months ended September 30, 2015, respectively.

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## Cost of Revenues

The following table sets forth our cost of revenues for the periods shown (in thousands, except percentages):

|                                 | Three Months  |          | Change     |       |
|---------------------------------|---------------|----------|------------|-------|
|                                 | Ended         |          |            |       |
|                                 | September 30, |          |            |       |
|                                 | 2016          | 2015     | \$         | %     |
| Cost of revenues <sup>(1)</sup> | \$38,699      | \$61,720 | \$(23,021) | (37)% |

<sup>(1)</sup> Includes share-based compensation expense of: \$46      \$103      \$(57      ) (55)%

|                                 | Nine Months   |           | Change     |       |
|---------------------------------|---------------|-----------|------------|-------|
|                                 | Ended         |           |            |       |
|                                 | September 30, |           |            |       |
|                                 | 2016          | 2015      | \$         | %     |
| Cost of revenues <sup>(1)</sup> | \$99,029      | \$163,469 | \$(64,440) | (39)% |

<sup>(1)</sup> Includes share-based compensation expense of: \$115      \$318      \$(203      ) (64)%

Cost of revenues in the three months ended September 30, 2016 decreased by \$23.0 million, or 37%, compared to the same period in 2015. The decrease in absolute dollars and as a percentage of revenues for the three months ended September 30, 2016 was primarily due to a decrease in textbook depreciation of \$7.7 million, lower order fulfillment costs of \$7.8 million, lower cost of revenues as a result of lower sales revenue of \$9.5 million, a decrease in write-offs related to our print textbook library of \$0.5 million, and lower warehouse personnel costs of \$0.6 million. These decreases were partially offset by higher content depreciation of \$2.5 million. As a result, gross margins increased to 46% in the three months ended September 30, 2016, from 24% in the three months ended September 30, 2015.

Cost of revenues in the nine months ended September 30, 2016 decreased by \$64.4 million, or 39%, compared to the same period in 2015. The decrease in absolute dollars and as a percentage of revenues for the nine months ended September 30, 2016 was primarily due to a decrease in textbook depreciation of \$27.9 million, lower order fulfillment costs of \$17.6 million, lower cost of revenues as a result of lower sales revenue of \$14.4 million, a decrease in write-offs related to our print textbook library of \$3.6 million, and lower warehouse personnel costs of \$3.4 million. These decreases were partially offset by higher content depreciation of \$3.1 million. As a result, gross margins increased to 48% in the nine months ended September 30, 2016, from 30% in the nine months ended September 30, 2015.

The decreases in cost of revenues for the three and nine months ended September 30, 2016 compared to the same periods in 2015 resulted from Ingram's fulfillment of more print textbook rental orders and the closure of our warehouse in Kentucky. Further, as Ingram increasingly takes the title and risk of loss for the print textbook inventory needed to fulfill all print textbook rentals and sales, we anticipate our total cost of revenues will continue to decrease and our total gross margins will continue to increase.

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## Operating Expenses

The following table sets forth our operating expenses for the periods shown (in thousands, except for percentages):

|   | Three Months Ended |                    | Change  |      |
|---|--------------------|--------------------|---------|------|
|   | September 30, 2016 | September 30, 2015 | \$      | %    |
| Technology and development <sup>(1)</sup> | \$16,241           | \$15,664           | \$577   | 4 %  |
| Sales and marketing <sup>(1)</sup>        | 15,256             | 16,211             | (955 )  | (6 ) |
| General and administrative <sup>(1)</sup> | 13,905             | 12,060             | 1,845   | 15   |
| Restructuring (credits) charges           | (100 )             | 342                | (442 )  | n/m  |
| Loss (gain) on liquidation of textbooks   | 2,673              | (909 )             | 3,582   | n/m  |
|   | \$47,975           | \$43,368           | \$4,607 | 11 % |

<sup>(1)</sup> Includes share-based compensation expense of:

|                                  |          |         |         |      |
|----------------------------------|----------|---------|---------|------|
| Technology and development       | \$3,449  | \$3,464 | \$(15 ) | — %  |
| Sales and marketing              | 1,605    | 126     | 1,479   | n/m  |
| General and administrative       | 5,110    | 5,240   | (130 )  | (2 ) |
| Share-based compensation expense | \$10,164 | \$8,830 | \$1,334 | 15 % |

|   | Nine Months Ended  |                    | Change   |       |
|---|--------------------|--------------------|----------|-------|
|   | September 30, 2016 | September 30, 2015 | \$       | %     |
| Technology and development <sup>(1)</sup> | \$49,232           | \$45,076           | \$4,156  | 9 %   |
| Sales and marketing <sup>(1)</sup>        | 41,449             | 49,985             | (8,536 ) | (17 ) |
| General and administrative <sup>(1)</sup> | 41,140             | 35,780             | 5,360    | 15    |
| Restructuring (credits) charges           | (298 )             | 3,320              | (3,618 ) | n/m   |
| Loss (gain) on liquidation of textbooks   | (523 )             | (2,649 )           | 2,126    | (80 ) |
|   | \$131,000          | \$131,512          | \$(512 ) | — %   |

<sup>(1)</sup> Includes share-based compensation expense of:

|                                  |          |          |         |       |
|----------------------------------|----------|----------|---------|-------|
| Technology and development       | \$11,207 | \$9,444  | \$1,763 | 19 %  |
| Sales and marketing              | 5,456    | 6,214    | (758 )  | (12 ) |
| General and administrative       | 15,923   | 15,808   | 115     | 1     |
| Share-based compensation expense | \$32,586 | \$31,466 | \$1,120 | 4 %   |

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n/m - not meaningful

## Technology and Development

Technology and development expenses during the three months ended September 30, 2016 increased \$0.6 million, or 4%, compared to the same period in 2015. During the three months ended September 30, 2016, our employee-related expenses increased \$0.4 million and our web hosting and software licensing fees increased \$0.6 million compared to the three months ended September 30, 2015. Technology and development as a percentage of net revenues were 23% during the three months ended September 30, 2016 compared to 19% during the same period in 2015.

Technology and development expenses during the nine months ended September 30, 2016 increased \$4.2 million, or 9%, compared to the same period in 2015. During the nine months ended September 30, 2016, our employee-related expenses increased \$1.6 million, our web hosting and software licensing fees increased \$1.3 million, our outside

services expenses increased \$0.5 million and our share-based compensation expense increased \$1.8 million compared to the nine months ended

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September 30, 2015. Technology and development as a percentage of net revenues were 26% during the nine months ended September 30, 2016 compared to 19% during the same period in 2015.

### Sales and Marketing

Sales and marketing expenses during the three months ended September 30, 2016 decreased by \$1.0 million, or 6%, compared to the same period in 2015. The decrease was primarily attributable to lower advertising and marketing expenses of \$2.9 million, partially offset by an increase in share-based compensation expenses of \$1.5 million, compared to the three months ended September 30, 2015. Sales and marketing expenses as a percentage of net revenues were 21% during the three months ended September 30, 2016 compared to 20% during the same period in 2015.

Sales and marketing expenses during the nine months ended September 30, 2016 decreased by \$8.5 million, or 17%, compared to the same period in 2015. The decrease was primarily attributable to decreases in employee-related expenses, advertising and marketing expenses, and share-based compensation expenses of \$1.8 million, \$5.9 million, and \$0.8 million, respectively, compared to the nine months ended September 30, 2015. Sales and marketing expenses as a percentage of net revenues remained flat during the nine months ended September 30, 2016 compared to the same period in 2015.

### General and Administrative

General and administrative expenses in the three months ended September 30, 2016 increased \$1.8 million, or 15%, compared to the same period in 2015. The increase was due to higher employee-related expenses of \$1.6 million compared to the three months ended September 30, 2015. General and administrative expenses as a percentage of net revenues were 19% during the three months ended September 30, 2016 compared to 15% during the same period in 2015.

General and administrative expenses in the nine months ended September 30, 2016 increased \$5.4 million, or 15%, compared to the same period in 2015. The increase was due to higher employee-related expenses, outside services, and professional fees primarily related to our acquisition of Imagine Easy of \$3.3 million, \$0.4 million, and \$0.5 million, respectively, compared to the nine months ended September 30, 2015. General and administrative expenses as a percentage of net revenues were 22% during the nine months ended September 30, 2016 compared to 15% during the same period in 2015.

### Restructuring (Credits) Charges

Restructuring credits of \$0.3 million recorded during the three and nine months ended September 30, 2016 were related to a partial reversal of previously accrued lease termination costs due to our subtenant leasing additional space. Costs incurred to date related to the lease termination and other costs are expected to be fully paid by 2021.

### Loss (gain) on Liquidation of Textbooks

During the three months ended September 30, 2016 and 2015, we had a loss on liquidation of print textbooks of \$2.7 million and gain on liquidation of print textbooks of \$0.9 million, respectively, resulting from proceeds received from liquidation of previously rented print textbooks on our website and through various other liquidation channels.

During the nine months ended September 30, 2016 and 2015, we had a gain on liquidation of print textbooks of \$0.5 million and \$2.6 million, respectively, resulting from proceeds received from liquidation of previously rented print textbooks on our website and through various other liquidation channels.



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## Interest Expense and Other (Expense) Income, Net

The following table sets forth our interest expense and other (expense) income, net, for the periods shown (in thousands, except percentages):

|  | Three Months |        |         |        |
|--|--------------|--------|---------|--------|
|  | Ended        |        | Change  |        |
|  | September    |        |         |        |
|  | 30,          |        |         |        |
|  | 2016         | 2015   | \$      | %      |
| Interest expense, net                                  | \$(30 )      | \$(61) | \$31    | (51 )% |
| Other (expense) income, net                            | (148 )       | 85     | (233 )  | n/m    |
| Total interest expense and other (expense) income, net | \$(178)      | \$24   | \$(202) | n/m    |

|  | Nine Months   |         |         |        |
|--|---------------|---------|---------|--------|
|  | Ended         |         | Change  |        |
|  | September 30, |         |         |        |
|  | 2016          | 2015    | \$      | %      |
| Interest expense, net                        | \$(151)       | \$(182) | \$31    | (17 )% |
| Other (expense) income, net                  | (146 )        | 217     | (363 )  | n/m    |
| Total interest expense and other income, net | \$(297)       | \$35    | \$(332) | n/m    |

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n/m - not meaningful

Interest expense, net decreased slightly during the three and nine months ended September 30, 2016 compared to the same periods in 2015 as a result of entering into our new line of credit in September 2016.

Other (expense) income, net, was a net expense during the three and nine months ended September 30, 2016. The decreases during the three and nine months ended September 30, 2016 compared to the same periods in 2015, respectively, were primarily attributable to the accretion of the deferred cash consideration as a result of our acquisition of Imagine Easy.

## Provision for Income Taxes

The following table sets forth our provision for income taxes for the periods shown (in thousands, except percentages):

|                            | Three     |       |        |      |
|----------------------------|-----------|-------|--------|------|
|                            | Months    |       | Change |      |
|                            | Ended     |       |        |      |
|                            | September |       |        |      |
|                            | 30,       |       |        |      |
|                            | 2016      | 2015  | \$     | %    |
| Provision for income taxes | \$554     | \$389 | \$165  | 42 % |

|                            | Nine Months   |         |        |      |
|----------------------------|---------------|---------|--------|------|
|                            | Ended         |         | Change |      |
|                            | September 30, |         |        |      |
|                            | 2016          | 2015    | \$     | %    |
| Provision for income taxes | \$1,463       | \$1,113 | \$350  | 31 % |

We recorded an income tax provision of approximately \$0.6 million and \$1.5 million for the three and nine months ended September 30, 2016, respectively, and an income tax provision of approximately \$0.4 million and \$1.1 million for the three and nine months ended September 30, 2015, respectively, which was primarily due to state and foreign income tax expense and federal tax expense. The increase during the three and nine months ended September 30, 2016 compared to the same period in 2015 was primarily due to an increase in foreign profits.



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## Liquidity and Capital Resources

As of September 30, 2016, our principal sources of liquidity were cash and cash equivalents totaling \$90.2 million, which were held for working capital purposes. The substantial majority of our net revenues are from e-commerce transactions with students, which are settled immediately through payment processors, as opposed to our accounts payable, which are settled based on contractual payment terms with our suppliers. Our cash equivalents are composed of money market funds. We also have an aggregate principal amount of \$30.0 million available under our Line of Credit with an accordion feature that, subject to the lender's discretion, allows us to borrow up to a total of \$50.0 million. The Line of Credit expires in September 2019. As of September 30, 2016, we were in compliance with the financial covenants of the Line of Credit. Further, we had no amounts outstanding and were able to borrow up to \$30.0 million under the Line of Credit.

As a result of our expanded strategic partnership with Ingram, we will continue to buy used print textbooks on Ingram's behalf and invoice Ingram at cost. We provided Ingram with extended payment terms in 2015 and will continue to do so during 2016 for the purchase of print textbooks, before moving to normal payment terms in 2017. We have a reimbursement balance due from Ingram included within other current assets on the condensed consolidated balance sheet related to the purchase of these textbooks of \$28.7 million and \$28.9 million as of September 30, 2016 and December 31, 2015, respectively. As a result of our strategic partnership with Ingram, we anticipate having significantly more working capital.

During the nine months ended September 30, 2016 and 2015, our proceeds from print textbook liquidations exceeded our investment in print textbooks and resulted in a cash inflow of \$23.1 million and \$2.0 million, respectively, as a result of our strategic partnership with Ingram whereby we no longer make new investments in the print textbook library. Since May 1, 2015, Ingram has been responsible for all new investments in the print textbook library.

As of September 30, 2016, we have incurred cumulative losses of \$369.8 million from our operations, and we expect to incur additional losses in the future. Our operations have been financed primarily by net proceeds from the sales of shares of our convertible preferred stock, through various debt financing activities and our initial public offering (IPO).

We believe that our existing sources of liquidity will be sufficient to fund our operations for at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, our investments in technology and development activities, our acquisition of new products and services, and our sales and marketing activities. To the extent that existing cash, cash equivalents, and cash from operations are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. Additional funds may not be available on terms favorable to us or at all. If adequate funds are not available on acceptable terms, or at all, we may be unable to adequately fund our business plans and it could have a negative effect on our business, operating cash flows, and financial condition.

Most of our cash is held in the United States. As of September 30, 2016, our foreign subsidiaries held an insignificant amount of cash in foreign jurisdictions. We currently do not intend or foresee a need to repatriate these funds. In addition, based on our current and future needs, we believe our current funding and capital resources for our international operations are adequate.

The following table sets forth our cash flows (in thousands):

|  |               |      |
|--|---------------|------|
|  | Nine Months   |      |
|  | Ended         |      |
|  | September 30, |      |
|  | 2016          | 2015 |

Consolidated Statements of Cash Flows Data:

|   |           |          |
|---|-----------|----------|
| Net cash provided by operating activities           | \$30,726  | \$18,114 |
| Net cash provided by investing activities           | \$401     | \$4,465  |
| Net cash (used in) provided by financing activities | \$(7,943) | \$2,245  |

Cash Flows from Operating Activities

Although we incurred net losses during the nine months ended September 30, 2016 and 2015, our net losses were offset by non-cash expenditures such as print textbook library depreciation expense, other depreciation and amortization expense, and share-based compensation expense.

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Net cash provided by operating activities during the nine months ended September 30, 2016 was \$30.7 million. Our net loss of \$40.8 million was reduced by the change in our deferred revenue of \$14.9 million and accrued liabilities of \$6.0 million. Additionally, we had significant non-cash operating expenses including print textbook library depreciation expense of \$8.9 million, other depreciation and amortization expense of \$10.0 million, and share-based compensation expense of \$32.7 million.

Net cash provided by operating activities during the nine months ended September 30, 2015 was \$18.1 million. Our net loss of \$62.8 million was partially offset by significant non-cash operating expenses, including textbook library depreciation expense of \$36.8 million, other depreciation and amortization expense of \$9.2 million, share-based compensation expense of \$31.8 million and loss from write-offs of textbooks of \$4.5 million.

### Cash Flows from Investing Activities

Cash flows from investing activities have been primarily related to the purchase of print textbooks, marketable securities, and property and equipment, offset by proceeds from the maturity of marketable securities and the proceeds from the liquidation of print textbooks.

Net cash provided by investing activities during the nine months ended September 30, 2016 was \$0.4 million and was primarily driven by proceeds from the sale or maturity of marketable securities of \$29.7 million and the proceeds from the liquidation of print textbooks of \$23.9 million partially offset by the acquisition of business of \$25.9 million, purchase of marketable securities of \$7.6 million, purchase of strategic equity investment of \$1.0 million, and purchase of property and equipment of \$17.8 million.

Net cash provided by investing activities during the nine months ended September 30, 2015 was \$4.5 million and was primarily used for the purchases of textbooks of \$32.2 million, purchases of investments of \$20.0 million, purchases of property and equipment of \$5.9 million, and the purchase of a strategic equity investment in a third party of \$2.0 million, offset by proceeds from the sale or maturity of investments of \$30.3 million and proceeds from the liquidation of textbooks of \$34.2 million.

### Cash Flows from Financing Activities

Net cash used in financing activities during the nine months ended September 30, 2016 was \$7.9 million and was related to the payment of \$9.1 million in taxes related to the net share settlement of restricted stock units (RSUs), which became fully vested during the period offset by \$1.1 million for common stock issued pursuant to our ESPP plan.

Net cash provided by financing activities during the nine months ended September 30, 2015 was \$2.2 million and was primarily related to the proceeds from common stock issued under our stock plans totaling \$12.6 million, partially offset by the payment of \$8.1 million in taxes related to the net share settlement of RSUs which became fully vested during the period as well as the repurchase of common stock of \$2.3 million associated with a put option granted in connection with a prior acquisition.

### Contractual Obligations and Other Commitments

As a result of our strategic partnership with Ingram and the exit of our Kentucky warehouse during 2015, we have subleased our warehouse in Kentucky and we expect this sublease agreement to generate \$0.2 million of sublease income per month through the end of the term of our lease in November 2016.

### Off-Balance Sheet Arrangements

Through September 30, 2016, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

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### Critical Accounting Policies, Significant Judgments and Estimates

Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP). The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. These estimates form the basis for judgments we make about the carrying values of our assets and liabilities, which are not readily apparent from other sources. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

There have been no material changes in our critical accounting policies and estimates during the nine months ended September 30, 2016 as compared to the critical accounting policies and estimates disclosed in Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in our Annual Report on Form 10-K for the year ended December 31, 2015.

### Recent Accounting Pronouncements

For relevant recent accounting pronouncements, see Note 1-Background and Basis of Presentation of our accompanying Notes to Condensed Consolidated Financial Statements included in Part I, Item 1, "Financial Statements (unaudited)" of this Quarterly Report on Form 10-Q.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our market risk during the nine months ended September 30, 2016, compared to the disclosures in Part II, Item 7A, “Quantitative and Qualitative Disclosures about Market Risk” contained in our Annual Report on Form 10-K.

### ITEM 4. CONTROLS AND PROCEDURES

#### (a) Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of the end of the period covered by this report.

In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on management’s evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are designed to, and are effective to, provide assurance at a reasonable level that the 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 SEC rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

(b) Changes in Internal Control over Financial Reporting

During the nine months ended September 30, 2016, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during our most recently completed fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, third parties may assert patent infringement claims against us in the form of letters, litigation or other forms of communication. In addition, we may from time to time be subject to other legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights; employment claims; and general contract or other claims. We may also, from time to time be subject to various legal or government claims, disputes, or investigations. Such matters may include, but not be limited to, claims, disputes or investigations related to warranty, refund, breach of contract, employment, intellectual property, government regulation or compliance or other matters.

In July 2010, the Kentucky Tax Authority issued a property tax assessment of approximately \$1.0 million related to our textbook library located in our Kentucky warehouse for the 2009 and 2010 tax years under audit. In March 2011, we filed a protest with the Kentucky Board of Tax Appeals that was rejected in March 2012. In September 2012, we filed a complaint seeking declaratory rights against the Commonwealth of Kentucky in the Bullitt Circuit Court of Kentucky, and that case was subsequently dismissed in favor of administration remedies with the Kentucky Tax Authority. We received a final Notice of Tax due in October 2012 from the Kentucky Tax Authority, and we appealed this notice in November 2012 with the Kentucky Board of Tax Appeals. In May 2013, we presented an Offer in Judgment to the Kentucky Tax Authority of approximately \$150,000, excluding tax and penalties, an amount that we have accrued for the two years under audit. We accrued this amount as of December 31, 2012. We appealed to the Kentucky Board of Tax Appeals in July 2013, and the Board issued a ruling in favor of the Kentucky Department of Revenue in January 2014 maintaining the property tax assessment. In February 2014, we filed an appeal to the Franklin Circuit Court in Kentucky, and in June 2014 the Circuit Court held in abeyance our motion to appeal. In October 2014 the Franklin Circuit Court in Kentucky issued its opinion and order reversing the Board of Tax Appeal's decision, setting aside the Kentucky Department of Revenue's tax assessments against us and further vacating all penalties and interest. The Kentucky Department of Revenue has appealed the Circuit Court ruling. On March 4, 2016, the Kentucky Court of Appeals ruled unanimously in our favor, affirming our position that no property tax was owed on the textbooks. The Kentucky Department of Revenue petitioned the Kentucky Supreme Court for a discretionary review, which was denied in September 2016. The case was determined in our favor with no property tax due related to our textbook library.

We are not aware of any other pending legal matters or claims, individually or in the aggregate, that are expected to have a material adverse impact on our consolidated financial position, results of operations or cash flows. However, our analysis of whether a claim may proceed to litigation cannot be predicted with certainty, nor can the results of litigation be predicted with certainty. Nevertheless, defending any of these actions, regardless of the outcome, may be costly, time consuming, distract management personnel and have a negative effect on our business. An adverse outcome in any of these actions, including a judgment or settlement, may cause a material adverse effect on our future business, operating results and/or financial condition.

ITEM 1A. RISK FACTORS

The risks and uncertainties set forth below, as well as other risks and uncertainties described elsewhere in this Quarterly Report on Form 10-Q including in our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" or in other filings by Chegg with the SEC, could adversely affect our business, financial condition, results of operations and the trading price of our common stock. Additional risks and uncertainties that are not currently known to us or that are not currently believed by us to be material may also harm our business operations and financial results. Because of the following risks and uncertainties, as well as other factors affecting our financial condition and operating results, past financial

performance should not be considered to be a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.



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Risks Related to Our Business and Industry

Our limited operating history, recent business model transition and evolving digital offerings make it difficult to evaluate our current business and future prospects.

Although we began our operations in July 2005, we did not launch our online print textbook rental business until 2007 or begin generating revenues at scale from print textbook rentals until 2010. We began transitioning to a new model for our Required Materials product line in August 2014 through our strategic partnership with Ingram to accelerate our transition away from the more capital intensive aspects of the print textbook rental business. We expect to cease owning a physical textbook library and to be a fully digital company by 2017. We continue to market, use our branding and maintain the customer experience around print textbook rentals, while Ingram funds all new rental textbook inventory, fulfillment, logistics, and has title and risk of loss related to textbook rentals for the textbooks they own. The transition may be disruptive to our operations and may adversely affect our business and results of operations if we are unable to successfully transition these aspects of the print textbook rental business to Ingram. Since July 2010, we also have been focused on expanding our other offerings, in many instances through the acquisition of other companies, to include digital textbooks (eTextbooks), supplemental materials, multiplatform eTextbook Reader software, Chegg Study, Chegg Tutors, Chegg Test Prep, Chegg Writing Tools, College Admissions and Scholarship Services, purchases of used textbooks, internships, careers, college counseling, enrollment marketing services and brand advertising. Our newer products and services, or any other products and services we may introduce or acquire, may not be integrated effectively into our business, achieve or sustain profitability or achieve market acceptance at levels sufficient to justify our investment.

Our ability to fully integrate new products and services into our connected learning platform or achieve satisfactory financial results from them is unproven. Because we have a limited operating history and the market for our products and services, including newly acquired or developed products and services, is rapidly evolving, it is difficult for us to predict our operating results, particularly with respect to our newer offerings, and the ultimate size of the market for our products and services. If the market for a connected learning platform does not develop as we expect, or if we fail to address the needs of this market, our business will be harmed.

We face the risks, expenses and difficulties typically encountered by companies in their early stage of development, including, but not limited to our ability to successfully:

- execute on our relatively new, evolving and unproven business model;
- develop new products and services, both independently and with developers or other third parties;
- attract and retain students and increase their engagement with our connected learning platform and our mobile applications;
- attract and retain colleges, universities and other academic institutions and brands to our marketing services;
- manage the growth of our business, including increasing or unforeseen expenses;
- develop and scale a high performance technology infrastructure to efficiently handle increased usage by students, especially during peak periods prior to each academic term;
- maintain and manage relationships with strategic partners, including Ingram and other distributors, publishers, wholesalers, colleges and brands;
- develop a profitable business model and pricing strategy;
- compete with companies that offer similar services or products;
- expand into adjacent markets;
- navigate the ongoing evolution and uncertain application of regulatory requirements, such as privacy laws, to our business, including our new products and services;
- integrate and realize synergies from businesses that we acquire; and
- expand into foreign markets.

We have encountered and will continue to encounter these risks and if we do not manage them successfully, our business, financial condition, results of operations and prospects may be materially and adversely affected.



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We have a history of losses and we may not achieve or sustain profitability in the future.

We have experienced significant net losses since our incorporation in July 2005, and we may continue to experience net losses in the future. Our net losses for the three months ended September 30, 2016 and 2015 were \$16.1 million and \$24.2 million, respectively, and for the nine months ended September 30, 2016 and 2015 were \$40.8 million and \$62.8 million, respectively. As of September 30, 2016, we had an accumulated deficit of \$369.8 million. We expect to make significant investments in the development and expansion of our business and our cost of revenues and operating expenses may increase. Operating expense may be negatively impacted by the liquidation of our textbook library as we move to a digital revenue model. We may not succeed in increasing our revenues sufficiently to offset these higher expenses, and our efforts to grow the business may prove more expensive than we currently anticipate. We may incur significant losses in the future for a number of reasons, including slowing demand for print textbook rentals and/or our other products and services; increasing competition, particularly for the price of textbooks; decreased spending on education; and other risks described in this Quarterly Report on Form 10-Q. We may encounter unforeseen expenses, challenges, complications and delays and other unknown factors as we pursue our business plan and our business model continues to evolve. While our revenues have grown in recent periods, this growth may not be sustainable and we may not be able to achieve profitability. To achieve profitability, we may need to change our operating infrastructure and scale our operations more efficiently. We also may need to reduce our costs or implement changes in our product offerings to improve the predictability of our revenues. For example, we expect the expansion of our partnership with Ingram to allow us to transition substantially all of our print textbook rental revenues to commissions-based revenues by 2017. If we fail to implement these changes on a timely basis or are unable to implement them due to factors beyond our control, our business may suffer. If we do achieve profitability, we may not be able to sustain or increase such profitability.

We operate in a rapidly changing market and we are transitioning our business model to a fully digital business. If we do not successfully adapt to known or unforeseen market developments, our business and financial condition could be materially and adversely affected.

The market for our connected learning platform is still unproven and rapidly changing. Historically, we generated the majority of our revenues from print textbooks. Print textbook rental is highly capital intensive and presents both business planning and logistical challenges that are complex. To reduce our investment in the highly capital intensive nature of print textbook rentals, we entered into a partnership with Ingram wherein Ingram makes all new investments in the rental library of print textbooks, taking title and risk of loss for the books, and provides logistical and fulfillment services for the print textbooks that we rent and sell. The partnership allows us to market, use our branding and maintain the customer experience around print textbook rentals, while reducing our investments in textbook inventory, fulfillment and logistics operations. As a result of this change, we stopped making additional investments in our textbook library beginning in May 2015 and we expect to rent and liquidate our remaining inventory of print textbooks during 2016. We expect the transition of these aspects of our print textbook offerings to Ingram to be complete by 2017. Our partnership with Ingram is non-exclusive and subject to significant risks, including our ability to cost-effectively liquidate our remaining inventory of textbooks, Ingram's ability to acquire textbooks and manage logistical and fulfillment activities for us, our ability to create a successful and profitable partnership, the provision of extended payment terms to Ingram for the facilitation of textbook purchases beyond Ingram's capital commitment, and that we and/or Ingram may elect to terminate the partnership sooner than anticipated.

We have added and plan to continue to add new offerings to our connected learning platform, including for example writing tools, to diversify our sources of revenues, which will require us to make substantial investments in the products and services we develop or acquire. New offerings may not achieve market success at levels that recover our investment or contribute to profitability. Because these offerings are not as capital intensive as our print textbook rental service, the barriers to entry for existing and future competitors may be lower and allow for even more rapid changes to the market. Furthermore, the market for these other products and services is relatively new and may not

develop as we expect. If the market for our offerings does not develop as we expect, or if we fail to address the needs of this market, our business will be harmed. We may not be successful in executing on our evolving business model, and if we cannot provide an increasing number of products and services that students, colleges and brands find compelling, we will not be able to continue our recent growth and increase our revenues, margins and profitability. For all of these reasons, the evolution of our business model is ongoing and the future revenues and income potential of our business is uncertain.

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Our business is highly seasonal and our reliance on a concentration of activity at the beginning of each academic term exposes our business to increased risk from disruption during peak periods and makes our operating results difficult to predict.

We derive a significant portion of our net revenues from print textbook rental and, to a lesser extent, sale transactions, which occur in large part during short periods of time around the commencement of the fall, winter and spring academic terms. In particular, we and Ingram experience the largest increase in rental and sales volumes during the last two weeks of August and first two weeks of September and to a lesser degree in December and in January. The increased volume of orders that we and Ingram have to process during these limited periods of time means that any shortfalls or disruptions in our operations during these peak periods will have a disproportionately large impact on our annual operating results and the potential future growth of our business.

As a result of this seasonality, which corresponds to the academic calendar, our revenues fluctuate significantly quarter to quarter depending upon the timing of where we are in our “rush” cycle and sequential quarter-over-quarter comparisons of our revenues and operating results are not likely to be meaningful. In addition, our operating results for any given quarter cannot be used as an accurate indicator of our results for the year. In particular, we anticipate that our ability to accurately forecast financial results for future periods will be most limited at the time we present our second quarter financial results, which will generally occur midsummer and precede the “fall rush.” In addition, our other offerings are relatively new and, as a result, we have limited experience with forecasting revenues from them.

The fourth quarter has typically been our highest performing quarter as we were recognizing a full quarter of revenues on print textbooks that we owned from peak volumes in August and September and partial revenues from peak volumes in December, while the second quarter has typically been our lowest performing quarter as students start their summer vacations and the volume of our textbook rentals and sales and purchases of supplemental materials and Chegg Study decreases. With Ingram fulfilling more of the print textbook rental orders through our strategic partnership, we now expect our first and third quarters to be higher as we now recognize a commission immediately on the transaction of an Ingram-owned print textbook rather than recognizing the revenues ratably over the term the student rents one of our print textbooks. This will continue to the point where all print textbook rental transactions are fulfilled by Ingram and our revenues are comprised entirely of a commission earned on the transaction.

We base our operating expense budgets on expected net revenue trends. Operating expenses, similar to revenues and cost of revenues, fluctuate significantly quarter to quarter due to the seasonality of our business and are generally higher during the first and third quarters as we incur marketing expense in connection with our peak periods at the beginning of each academic term. Because our revenues were historically concentrated in the fourth quarter and expenses are concentrated in the first and third quarters, we have experienced operating losses in the first and third quarters and operating income in the fourth quarter. As a result, sequential quarterly comparison of our financial results has not been meaningful. We expect our seasonality to shift as a result of our strategic partnership with Ingram and our highest quarters for revenues and operating expense to coincide. Further, a portion of our expenses, such as office space and warehouse facility lease obligations and personnel costs, are largely fixed and are based on our expectations of our peak levels of operations. The Ingram partnership has resulted in our operating expenses related to textbook acquisition, shipping and fulfillment and warehouse facility lease obligations to decrease and we expect that our overall operating expenses to be more evenly distributed throughout the year. Nonetheless, we expect to continue to incur significant marketing expenses during peak periods and to have fixed expenses for office space and personnel and as such, we may be unable to adjust spending quickly enough to offset any unexpected revenues shortfall. Accordingly, any shortfall in net revenues may cause significant variation in operating results in any quarter.

Our operating results are expected to be difficult to predict based on a number of factors.

We expect our operating results to fluctuate in the future based on a variety of factors, many of which are outside our control and are difficult to predict. As a result, period-to-period comparisons of our operating results may not be a good indicator of our future or long-term performance. The following factors may affect us from period-to-period and may affect our long-term performance:

- our ability to attract and retain students and increase their engagement with our connected learning platform and mobile applications, particularly at the beginning of each academic term;
- the rate of adoption of our offerings;
- changes in demand for print textbook rentals, including as a result of pricing changes for alternatives or by us;
- changes in demand for eTextbooks, including as a result of pricing changes by publishers;

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our ability and Ingram's ability to manage fulfillment processes to handle significant volume increases in the number of students and student selections, during peak periods and as a result of the potential growth in volume of transactions over time;

- our ability to successfully utilize the information gathered from our connected learning platform to target sales of complementary products and services to our users;
- changes by our competitors to their product and service offerings;
- price competition and our ability to react appropriately to such competition;
- our ability and Ingram's ability to manage the textbook library;
- our ability to execute on the expanded partnership with Ingram to facilitate our transition to digital content;
- disruptions to our internal computer systems and our fulfillment information technology infrastructure, particularly during peak periods;
- the effectiveness of Ingram's shipping center, particularly in peak periods;
- the amount and timing of operating costs and capital expenditures relating to expansion of our business, operations and infrastructure;
- our ability to successfully manage the integration of operations, technology and personnel resulting from acquisitions;
- governmental regulation in particular regarding privacy and advertising and taxation policies; and
- general macroeconomic conditions and economic conditions specific to higher education.

Difficulties that could arise from our partnership with Ingram may have an adverse effect on our business and results of operations.

We rely on Ingram to make new investments in the textbook library and fulfill our print textbook rentals and sales orders. We purchase used books on Ingram's behalf, including books through our buyback program, and invoice Ingram at cost. As we continue to focus on reducing the expense and investment necessary to support the rental of Chegg owned textbooks, we have become increasingly committed to this strategic partnership. If our continuing partnership with Ingram is interrupted or if Ingram experiences disruptions in its business or is not able to perform as anticipated, or we experience problems with the transition of inventory and logistics and fulfillment activities to Ingram, Ingram may not be able to reimburse us for the books we have procured on their behalf, especially before we move to normal payment terms in 2017, or we may experience operational difficulties, an inability to fulfill print textbook orders, increased costs and a loss of business, as well as a greater than expected deployment of capital for textbook acquisition, that may have a material adverse effect on our business, results of operations and financial condition. Furthermore, if we are unable to achieve the financial return targets set forth in our agreement with Ingram, we could be required to make additional payments to Ingram which could adversely affect our results of operations.

If our efforts to attract new students to use our products and services and increase student engagement with our connected learning platform are not successful, our business will be adversely affected.

The growth of our business depends on our ability to attract new students to use our products and services and to increase the level of engagement by existing students with our connected learning platform. The substantial majority of our revenues depends on small transactions made by a widely dispersed student population with an inherently high rate of turnover primarily as a result of graduation. Many of the students we desire to attract are accustomed to obtaining textbooks through bookstores or used booksellers. The rate at which we expand our student user base and increase student engagement with our connected learning platform may decline or fluctuate because of several factors, including:

- our ability and Ingram's ability to consistently provide students with a convenient, high quality experience for selecting, receiving and returning print textbooks;
- our ability and Ingram's ability to accurately forecast and respond to student demand for print textbooks;
- .

- the pricing of our textbooks for rental or sale in relation to other alternatives, including the textbook prices offered by publishers or by other competing textbook rental providers;
- the quality and prices of our offerings compared to those of our competitors;
- the rate of adoption of eTextbooks and our ability to capture a significant share of that market;
- our ability to engage high school students with our College Admissions and Scholarship Services, Chegg Tutors, Chegg Test Prep and Chegg Writing Tools;
- changes in student spending levels;
- changes in the number of students attending college;
- the effectiveness of our sales and marketing efforts; and
- our ability to introduce new products and services that are favorably received by students.



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If we do not attract more students to our connected learning platform and the products and services that we offer or if students do not increase their level of engagement with our platform, our revenues may grow more slowly than expected or decline. Many students use our print textbook service as a result of word-of-mouth advertising and referrals from students who have used this service in the past. If our efforts to satisfy our existing student user base are not successful, we may not be able to attract new students and, as a result, our business will be adversely affected.

If our efforts to build a strong brand are not successful, we may not be able to grow our student user base, which could adversely affect our operating results.

We believe our brand is a key asset of our business. Developing, protecting and enhancing the “Chegg” brand is critical to our ability to expand our student user base and increase student engagement with our connected learning platform. A strong brand also helps to counteract the significant student turnover we experience from year to year as students graduate and differentiates us from our competitors.

To succeed in our efforts to strengthen our brand identity, we must, among other activities:

- maintain our reputation as a trusted source of textbooks, content and services for students;
- maintain the quality of and improve our existing products and services;
- maintain and control the quality of our brand as we transition to Ingram for our textbook fulfillment logistics;
- introduce products and services that are favorably received;
- adapt to changing technologies;
- adapt to students’ rapidly changing tastes, preferences, behavior and brand loyalties;
- protect our students’ data, such as passwords and personally identifiable information;
- protect our trademark and other intellectual property rights;
- continue to expand our reach to students in high school, graduate school and internationally;
  - ensure that the content posted to our website by students is reliable and does not infringe on third-party copyrights or violate other applicable laws, our terms of use or the ethical codes of those students’ colleges;
- adequately address students’ concerns with our products and services; and
- convert and fully integrate the brands and students that we acquire, including the brands acquired with the acquisition of Imagine Easy Solutions and the students who use the products acquired from Imagine Easy Solutions and the Internships.com brand and the students who use Internships.com, each into the Chegg brand and Chegg.com.

Our ability to successfully achieve these goals is not entirely within our control and we may not be able to maintain the strength of our brand or do so in a cost effective manner. Factors that could negatively affect our brand include:

- changes in student sentiment about the quality or usefulness of our connected learning platform and our products and services;
- technical or other problems that prevent us, or Ingram, from delivering our products and services in a rapid and reliable manner or that otherwise affect the student experience on our website or our mobile application;
- concern from colleges about the ways students use our content offerings, such as our Expert Answers service;
- brand conflict between acquired brands and the Chegg brand;
- student concerns related to privacy and the way in which we use student data as part of our products and services;
  - the reputation or products and services of competitive companies;
  - and
- students’ misuse of our products and services in ways that violate our terms of services, applicable laws or the code of conduct at their colleges.

We intend to offer new products and services to students to grow our business. If our efforts are not successful, our business and financial results would be adversely affected.

Our ability to attract and retain students and increase their engagement with our connected learning platform depends on our ability to connect them with the product, person or service they need to save time, save money, and get smarter. Part of our strategy is to offer students new products and services in an increasingly relevant and personalized way. We may develop such products and services independently, by acquisition or in conjunction with developers and other third parties. For example, in 2014, we acquired our tutoring and internships services in the acquisitions of InstaEDU and Internships.com, respectively, in 2016, we acquired our Chegg Writing Tools in the acquisition of Imagine Easy Solutions and we developed Chegg Test Prep internally, the paid version of which we launched in July 2016. The markets for these new products and services may be unproven, and these products may include technologies and business models with which we have little or no prior development

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or operating experience or may significantly change our existing products and services. In addition, we may be unable to obtain long-term licenses from third-party content providers of content necessary to allow a product or service, including a new or planned product or service, to function. If our new or enhanced products and services fail to engage our students or attract new students, or if we are unable to obtain content from third parties that students want, we may fail to grow our student base or generate sufficient revenues, operating margin or other value to justify our investments, and our business would be adversely affected.

In the future, we may invest in new products and services and other initiatives to generate revenues, but there is no guarantee these approaches will be successful. Acquisitions of new companies, products and services create integration risk, while development of new products and services and enhancements to existing products and services involve significant time, labor and expense and are subject to risks and challenges including managing the length of the development cycle, entry into new markets, integration into our existing business, regulatory compliance, evolution in sales and marketing methods and maintenance and protection of intellectual property and proprietary rights. If we are not successful with our new products and services, we may not be able to maintain or increase our revenues as anticipated or recover any associated development costs, and our financial results could be adversely affected. For example, in 2014 we acquired a print coupon business, which we later determined to no longer support or expand, and as a result, in 2014 recorded an impairment charge of \$1.6 million related to the write-off of intangible assets from that acquisition.

Our future revenues depend on our ability to continue to attract new students from a high school and college student population that has an inherently high rate of turnover primarily due to graduation, requiring us to invest continuously in marketing to the student population to build brand awareness and loyalty, which we may not be able to accomplish on a cost-effective basis or at all.

We are dependent on the acquisition of new students from a high school and college student population that has an inherently high rate of turnover primarily due to graduation. Most incoming college students will not have previously used products and services like the ones we provide that are geared towards the college market. We rely heavily on word-of-mouth and other marketing channels, including online advertising, search engine marketing and social media. The student demographic is characterized by rapidly changing tastes, preferences, behavior, and brand loyalty. Developing an enduring business model to serve this population is particularly challenging. Our ability to attract new students depends not only on investment in our brand and our marketing efforts, but also on the perceived value of our products and services versus competing alternatives among our extremely price conscious student user base. If our marketing initiatives are not successful or become less effective, or if the cost of such initiatives were to significantly increase, we may not be able to attract new students as successfully or efficiently and, as a result, our revenues and results of operations would be adversely affected. Even if our marketing initiatives succeed in establishing brand awareness and loyalty, we may be unable to maintain and grow our student user base if our competitors, some of whom are substantially larger and have greater financial resources, adopt aggressive pricing strategies to compete against us. If we are unable to offer competitive prices for our products and services fewer students may use our connected learning platform, products or services.

If we fail to convince colleges and brands of the benefits of advertising on our platform or to use our marketing services, our business could be harmed.

Our business strategy includes increasing our revenues from enrollment marketing services and brand advertising. Colleges and brands may view our connected learning platform as experimental and unproven. They may not do business with us, or may reduce the amounts they are willing to spend to advertise with us, if we do not deliver ads, sponsorships and other commercial content and marketing programs in an effective manner, or if they do not believe that their investment in advertising with us will generate a competitive return relative to other alternatives. Our ability to grow the number of colleges that use our enrollment marketing services and brands that use our brand advertising,

and ultimately to generate advertising and marketing services revenues, depends on a number of factors, including our ability to successfully:

- compete for advertising and marketing dollars from colleges, brands, online marketing and media companies and advertisers;
- penetrate the market for student-focused advertising;
- develop a platform that can deliver advertising and marketing services across multiple channels, including print, email, Internet, mobile applications and other connected devices;
- improve our analytics and measurement solutions to demonstrate the value of our advertising and marketing services;
- maintain the retention, growth and engagement of our student user base;
- strengthen our brand and increase our presence in media reports and with publicity companies that utilize online platforms for advertising and marketing purposes;

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- create new products that sustain or increase the value of our advertising and marketing services and other commercial content;
- manage changes in the way online advertising and marketing services are priced;
- weather the impact of macroeconomic conditions and conditions in the advertising industry and higher education in general; and
- manage legal developments relating to data privacy, advertising or marketing services, legislation and regulation and litigation.

If we are not able to manage the growth of our business both in terms of scale and complexity, our operating results and financial condition could be adversely affected.

We have expanded rapidly since we launched our online print textbook rental service in 2007. We anticipate further expanding our operations to offer additional products, services and content to help grow our student user base and to take advantage of favorable market opportunities. As we grow, our operations and the technology infrastructure we use to manage and account for our operations will become more complex, and managing these aspects of our business will become more challenging. Any future expansion will likely place significant demands on our resources, capabilities and systems, and we may need to develop new processes and procedures and expand the size of our infrastructure to respond to these demands. If we are not able to respond effectively to new and increasingly complex demands that arise because of the growth of our business, or, if in responding to such demands, our management is materially distracted from our current operations, our operating results and financial condition may be adversely affected.

We may not realize the anticipated benefits of acquisitions, which could disrupt our business and harm our financial condition and results of operations.

As part of our business strategy, we have made and intend to make acquisitions to add specialized employees, complementary businesses, products, services, operations or technologies. Realizing the benefits of acquisitions depends, in part, on our successful integration of acquired companies including their technologies, products, services, operations and personnel in a timely and efficient manner. We may incur significant costs integrating acquired companies and if our integration efforts are not successful we may not be able to offset our acquisition costs. Acquisitions involve many risks that may negatively impact our financial condition and results of operations, including the risks that the acquisitions may:

- require us to incur charges and substantial debt or liabilities;
- cause adverse tax consequences, substantial depreciation or deferred compensation charges;
- result in acquired in-process research and development expenses or in the future may require the amortization, write-down or impairment of amounts related to deferred compensation, goodwill and other intangible assets; and
- give rise to various litigation risks, including the increased likelihood of litigation.

In addition:

- we may not generate sufficient financial return to offset acquisition costs;
- we may encounter difficulties or unforeseen expenditures in integrating the business, technologies, products, services, operations and personnel of any company that we acquire, particularly if key personnel of the acquired company decide not to work for us;
- an acquisition may disrupt our ongoing business, divert resources, increase our expenses and distract our management;
- an acquisition may delay adoption rates or reduce engagement rates for our products and services and those of the company acquired by us due to student uncertainty about continuity and effectiveness of service from either company;
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we may encounter difficulties in, or may be unable to, successfully sell or otherwise monetize any acquired products and services; and

an acquisition may involve the entry into geographic or business markets in which we have little or no prior experience.

Acquired companies, businesses and assets can be complex and time consuming to integrate. For example, we recently expanded into internships with the acquisition of Internships.com in October 2014 and into writing tools with the acquisition of Imagine Easy Solutions in 2016. We are currently in the process of transitioning these users to the Chegg platform and integrating these brands into the Chegg platform. We may not successfully transition these users to the Chegg platform.

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In addition, we have made, and may make in the future, acquisitions that we later determine are not complementary with our evolving business model. For example, in 2014 we acquired a print coupon business, which we later determined to no longer support or expand and as a result, in 2014 recorded an impairment charge of \$1.6 million related to the write-off of acquired intangible assets.

We may pursue additional acquisitions in the future to add specialized employees, complementary companies, products, services or technologies. Our ability to acquire and integrate larger or more complex companies, products, or technologies in a successful manner is unproven. We may not be able to find suitable acquisition candidates, and we may not be able to complete acquisitions on favorable terms, if at all. To finance any future acquisitions we may issue equity, which could be dilutive, or debt, which could be costly, potentially dilutive, and require substantial restrictions on the conduct of our business. If we fail to successfully complete any acquisitions, integrate the services, products, personnel, operations or technologies associated with such acquisitions into our company, or identify and address liabilities associated with the acquired business or assets, our business, revenues and operating results could be adversely affected. Any future acquisitions we complete may not achieve our goals.

Ingram purchases, and we price, textbooks based on anticipated levels of demand and other factors that we estimate based on historical experience and various other assumptions. If actual results differ materially from our estimates, our gross margins may decline.

The print textbook rental distribution model requires our fulfillment partner, Ingram, to make substantial investments in their print textbook library based on our expectations regarding numerous factors, including ongoing demand for these titles in print form. To realize a return on their investments, we must rent each purchased textbook multiple times, and as such, we are exposed to the risk of not achieving financial return targets set forth in our agreement with Ingram, which could result in additional payments to Ingram and adversely affect our results of operations. We typically plan the textbook purchases based on factors such as pricing, our demand forecast for the most popular titles, estimated timing of edition changes, estimated utilization levels and planned liquidations of stale, old or excess titles in the print textbook library. These factors are highly unpredictable and can fluctuate substantially, especially if pricing pressure becomes more intense, as we have seen in recent rush cycles, or demand is reduced due to seasonality or other factors, including increased use of eTextbooks. We rely on a proprietary model to analyze and optimize the purchasing decisions and rely on inputs from third parties including publishers, distributors, wholesalers and colleges to make our decisions. We also rely on students to return print textbooks to Ingram in a timely manner and in good condition so that we can re-rent or sell those textbooks. If the information we receive from third parties is not accurate or reliable, if students fail to return books or return damaged books, or if we for any other reason forecast demand inaccurately and cause Ingram to acquire insufficient copies of specific textbooks, we may be unable to satisfy student demand or we may have to incur significantly increased costs in order to do so, in which event our student satisfaction and results of operations could be affected adversely. Conversely, if we attempt to mitigate this risk and cause Ingram to acquire more copies than needed to satisfy student demand, then our textbook utilization rates would decline and we may be required to make additional payments to Ingram and our gross margins would be affected adversely.

When deciding whether to offer a textbook for rent and the price we charge for that rental, we also must weigh a variety of factors and assumptions and if our judgments or assumptions are incorrect, our gross margins may be adversely affected. Certain textbooks cost more to acquire depending on the source from which they are acquired and the terms on which they are acquired. We must factor in some projection of the number of rentals we will be able to achieve with such textbooks and at what rental price, among other factors, to determine whether we believe it will be profitable to cause Ingram to acquire such textbooks and for us to offer them for rent. If the textbooks Ingram acquires are lost, determined to be unauthorized copies, or damaged prematurely, Ingram may not be able to recover its costs or generate revenues on those textbooks. If we are unable to effectively make decisions about whether to cause Ingram to acquire textbooks and the price we charge to rent those textbooks, including if the assumptions upon which our decisions are made prove to be inaccurate, our gross margins may decline significantly.

We may need additional capital, and we cannot be sure that additional financing will be available or on favorable terms.

Historically, investments in our business have substantially exceeded the cash we have generated from our operations. We have funded our operating losses and capital expenditures through proceeds from equity and debt financings, equipment leases and cash flow from operations. Although we currently anticipate that our available funds and cash flow from operations will be sufficient to meet our cash needs for the foreseeable future, especially considering our expanded partnership with Ingram, we may require additional financing, particularly if the investment required to fund our operations is greater than we anticipate or we choose to invest in new technologies or complementary businesses or change our business model. Our ability to obtain financing will depend, among other things, on our development efforts, business plans, operating performance and condition of the capital markets at the time we seek financing. Additional financing may not be available to us on favorable



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terms when required, or at all especially considering that we will no longer own a print textbook library, which we previously used as collateral for our debt financings, following the full transition resulting from the expanded Ingram partnership. If we raise additional funds through the issuance of equity, equity-linked or debt securities, those securities may have rights, preferences or privileges senior to the rights of our common stock, and our stockholders may experience substantial dilution.

If Ingram's relationships with the shipping providers that deliver textbooks directly to our students are terminated or impaired, if shipping costs increase or if these vendors are unable to timely deliver textbooks to our students, our business and results of operations could be substantially harmed.

Ingram predominantly relies on United Parcel Service (UPS) to deliver textbooks from its textbook warehouse and to return textbooks to Ingram from our students. To a lesser extent Ingram relies on FedEx for delivery of print textbook rentals and on publishers, distributors and wholesalers to fulfill a certain portion of textbook sales orders and liquidations. As a result, our business could be subject to carrier disruptions and increased costs due to factors that are beyond our control, including labor difficulties, inclement weather, increased fuel costs and other rising costs of transportation and terrorist activity. If the delivery failures or delays or damage rates for our textbooks increase as a result of any such factors, this would increase our cost to deliver textbooks. If UPS were to limit its services or delivery areas, such as by the discontinuation of Saturday delivery service, Ingram's ability to timely deliver textbooks could diminish, and our student satisfaction could be adversely affected. If Ingram's relationships with its shipping vendors are terminated or impaired or if Ingram's shipping vendors are unable to deliver merchandise for us, Ingram would be required to rely on alternative carriers for delivery and return shipments of textbooks to and from students. Ingram may be unable to sufficiently engage alternative carriers on a timely basis or on terms favorable to them, if at all. If textbooks are not delivered on time to students, they could become dissatisfied and discontinue their use of our service, which could adversely affect our operating results.

We face significant competition in each aspect of our business, and we expect such competition to increase, particularly in the market for textbooks.

Our products and services compete for students, colleges and advertisers and we expect such competition to increase, as described below.

**Products and Services for Students.** The market for textbooks and supplemental materials is intensely competitive and subject to rapid change. We face competition from college bookstores, some of which are operated by Follett and Barnes & Noble Education, online marketplaces such as Amazon.com, eBay.com and Half.com and providers of eTextbooks such as Apple iTunes, and Blackboard, as well as various private textbook rental websites. Many students purchase from multiple textbook providers, are highly price sensitive and can easily shift spending from one provider or format to another. As a consequence, our Required Materials product line competes primarily on price. Our eTextbook product competes on price, selection and the functionality and compatibility of our eTextbook Reader across a wide variety of desktop and mobile devices. With respect to our other offerings, our competitors include companies that offer students study materials and educational content such as publishers, Web Assign and other tutorial services, test preparation services, writing tools, job boards, and other online career guidance services.

**Enrollment Marketing Services.** With respect to our enrollment marketing services, we compete against traditional methods of student recruitment, including student data providers such as standardized test providers, radio, television, Internet and email advertising and print mail marketing programs. In this area, we compete primarily on the basis of the number of high quality connections between prospective students and institutions of higher learning we are able to provide as well as on price.

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Brand Advertising. With respect to brands, we compete with online and offline outlets that generate revenues from advertisers and marketers, especially those that target high school and college students.

Our industry is evolving rapidly and is becoming increasingly competitive. Many of our competitors have longer operating histories, larger customer bases, greater brand recognition and significantly greater financial, marketing and other resources than we do. Some of our competitors have adopted, and may continue to adopt, aggressive pricing policies and devote substantially more resources to marketing, website and systems development than we do. In addition, a variety of business models are being pursued for the provision of print textbooks, some of which may be more profitable or successful than our business model. For example, a recent U.S. Supreme Court decision may make it easier for third parties to import low-cost “gray market” textbooks for resale in the United States, and these textbooks may compete with our offerings. In addition, Follett has partnered with some colleges through its includedED program, which allows schools to deliver required course materials directly to students by including them in the cost of college as part of tuition and fees. Such strategic alliances may

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eliminate our ability to compete favorably with our Required Materials product line because of the added convenience they offer to students, which may result in reduced textbook rentals, loss of market share and reduced revenues. In addition, our competitors also may form or extend strategic alliances with publishers that could adversely affect Ingram's ability to obtain textbooks on favorable terms. We face similar risks from strategic alliances by other participants in the education ecosystem with respect to our newer offerings. We may, in the future, establish alliances or relationships with other competitors or potential competitors. To the extent such alliances are terminated or new alliances and relationships are established, our business could be harmed.

We rely heavily on our proprietary technology to process deliveries and returns of the textbooks and to manage other aspects of our operations. The failure of this technology to operate effectively, particularly during peak periods, could adversely affect our ability to retain and attract student users.

We use complex proprietary software to process deliveries and returns of the textbooks and to manage other aspects of our operations, including systems to consider the market price for textbooks, general availability of textbook titles and other factors to determine how to buy textbooks and set prices for textbooks and other content in real time. We rely on the expertise of our engineering and software development teams to maintain and enhance the software used for our distribution operations. We cannot be sure that the maintenance and enhancements we make to our distribution operations will achieve the intended results or otherwise be of value to students. If we are unable to maintain and enhance our technology to manage the shipping and return of textbooks in a timely and efficient manner, particularly during peak periods, our ability to retain existing students and to add new students may be impaired.

Any significant disruption to our computer systems, especially during peak periods, could result in a loss of students, colleges and/or brands which could harm our business, results of operations and financial condition.

We rely on computer systems housed in six facilities, three located on the East Coast and three located on the West Coast, to manage our operations. We have experienced and expect to continue to experience periodic service interruptions and delays involving our systems. While we maintain a live fail-over capability that would allow us to switch our operations from one facility to another in the event of a service outage, that process would still result in service interruptions. These service interruptions could have a disproportionate effect on our operations if they were to occur during one of our peak periods. Our facilities are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. For example, our operations in Visakhapatnam, India were disrupted for several days following the landfall of cyclone Hudhud in October 2014. Our facilities also are subject to break-ins, sabotage, intentional acts of vandalism, the failure of physical, administrative and technical security measures, terrorist acts, natural disasters, human error, the financial insolvency of our third-party vendors, and other unanticipated problems or events. The occurrence of any of these events could result in interruptions in our service and unauthorized access to, theft or alteration of, the content and data contained on our systems. We also rely on systems and infrastructure of the Internet to operate our business and provide our services. Interruptions in our own systems or in the infrastructure of the Internet could hinder our ability to operate our business, damage our reputation or brand and result in a loss of students, colleges or brands which could harm our business, results of operations and financial condition.

We rely on third-party software and service providers, including Amazon Web Services (AWS), to provide systems, storage and services for our website. Any failure or interruption experienced by such third parties could result in the inability of students to use our products and services, result in a loss of revenues and harm our reputation.

We rely on third-party software and service providers, including AWS, to provide systems, storage and services, including user log in authentication, for our website. Any technical problem with, cyber-attack on, or loss of access to such third parties' systems, servers or technologies could result in the inability of our students to rent or purchase print textbooks, interfere with access to our digital content and other online products and services or result in the theft of

end-user personal information. For example, AWS experienced a service disruption during the second quarter of 2012, which affected some aspects of the delivery of our products and services for approximately one day. While this particular event did not adversely impact our business, a similar outage of a longer duration or during peak periods could.

Our reliance on AWS makes us vulnerable to any errors, interruptions, or delays in their operations. Any disruption in the services provided by AWS could harm our reputation or brand or cause us to lose students or revenues or incur substantial recovery costs and distract management from operating our business. AWS may terminate its agreement with us upon 30 days' notice. Upon expiration or termination of our agreement with AWS, we may not be able to replace the services provided to us in a timely manner or on terms and conditions, including service levels and cost, that are favorable to us, and a transition from one vendor to another vendor could subject us to operational delays and inefficiencies until the transition is complete.

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Increased activity during peak periods places substantially increased strain on our operations and any failure to deliver our products and services during these periods will have an adverse effect on student satisfaction and our revenues.

We historically experience a disproportionate amount of activity to occur on our website at the beginning of each academic term as students search our textbook catalog and place orders for course materials. If too many students access our website within a short period of time due to increased demand, we may experience system interruptions that make our website unavailable, slowed or prevent Ingram from efficiently fulfilling rental orders, which may reduce the volume of textbooks we are able to rent or sell and may also impact our ability to sell marketing services to colleges and brands. If our connected learning platform is unavailable when students attempt to access it or it does not load as quickly as they expect, we may rent or sell fewer textbooks and services. In addition, during peak periods, we utilize, and Ingram utilizes, independent contractors and temporary personnel to supplement the workforce primarily in our student advocacy organizations and in Ingram's warehouses. Competition for qualified personnel has historically been intense, and we or Ingram may be unable to adequately staff our student advocacy organizations or Ingram's warehouses during these peak periods. For example, during the 2014 fall rush period, our staffing agencies were not able to provide as many temporary personnel as we expected. Any understaffing could lead to an increase in both the amount of time required to ship textbooks, which could lead to student dissatisfaction, and increase the amount of time required to process a rental return, which could result in Ingram purchasing more inventory than necessary. Moreover, UPS and FedEx, the third-party carriers that Ingram primarily relies on to deliver textbooks to students, and publishers, wholesalers and distributors that ship directly to our students may be unable to meet our shipping and delivery requirements during peak periods. Any such disruptions to our business could cause our customers to be dissatisfied with our products and services and have an adverse effect on our revenues.

Computer malware, viruses, hacking, phishing attacks and spamming could harm our business and results of operations.

Computer malware, viruses, physical or electronic break-ins and similar disruptions could lead to interruptions and delays in our services and operations and loss, misuse or theft of data. Computer malware, viruses, computer hacking and phishing attacks against online networking platforms have become more prevalent and may occur on our systems in the future. We believe that we could be a target for such attacks because of the incidence of hacking among students.

Any attempts by hackers to disrupt our website service or our internal systems, if successful, could harm our business, be expensive to remedy and damage our reputation or brand. Our network security business disruption insurance may not be sufficient to cover significant expenses and losses related to direct attacks on our website or internal systems. Efforts to prevent hackers from entering our computer systems are expensive to implement and may limit the functionality of our services. Though it is difficult to determine what, if any, harm may directly result from any specific interruption or attack, any failure to maintain performance, reliability, security and availability of our products and services and technical infrastructure may harm our reputation, brand and our ability to attract students to our website. Any significant disruption to our website or internal computer systems could result in a loss of students, colleges or brands and, particularly if disruptions occur during the peak periods at the beginning of each academic term, could adversely affect our business and results of operations.

We may not timely and effectively scale and adapt our existing technology and network infrastructure to ensure that our connected learning platform is accessible and delivers a satisfactory user experience to students.

It is important to our success that students be able to access our connected learning platform at all times. We have previously experienced, and may in the future experience, service disruptions, outages and other performance problems due to a variety of factors, including infrastructure changes, third-party service providers, human or software errors and capacity constraints due to an overwhelming number of students accessing our platform simultaneously. If

our connected learning platform is unavailable when students attempt to access it or it does not load as quickly as they expect, students may seek other services to obtain the information for which they are looking and may not return to our platform as often in the future, or at all. This would negatively impact our ability to attract students and brands and the frequency with which they use our website and mobile applications.

Our platform functions on software that is highly technical and complex and may now or in the future contain undetected errors, bugs, or vulnerabilities. Some errors in our software code may only be discovered after the code has been deployed. Any errors, bugs, or vulnerabilities discovered in our code after deployment, inability to identify the cause or causes of performance problems within an acceptable period of time or difficulty maintaining and improving the performance of our platform, particularly during peak usage times, could result in damage to our reputation or brand, loss of students, colleges and brands, loss of revenues, or liability for damages, any of which could adversely affect our business and financial results.

We expect to continue to make significant investments to maintain and improve the availability of our platform and to enable rapid releases of new features and products. To the extent that we do not effectively address capacity constraints,

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upgrade our systems as needed and continually develop our technology and network architecture to accommodate actual and anticipated changes in technology, our business and operating results may be harmed.

We have a disaster recovery program to transition our operating platform and data to a failover location in the event of a catastrophe and have tested this capability under controlled circumstances, however, there are several factors ranging from human error to data corruption that could materially lengthen the time our platform is partially or fully unavailable to our student user base as a result of the transition. If our platform is unavailable for a significant period of time as a result of such a transition, especially during peak periods, we could suffer damage to our reputation or brand, loss of students, colleges and brands or loss of revenues any of which could adversely affect our business and financial results.

Growing our student user base and their engagement with our connected learning platform through mobile devices depends upon the effective operation of our mobile applications with mobile operating systems, networks and standards that we do not control.

There is no guarantee that students will use our mobile applications, such as the mobile version of our website, m.chegg.com, Chegg Flashcards and Chegg Textbook Solutions, rather than competing products. We are dependent on the interoperability of our mobile applications with popular mobile operating systems that we do not control, such as Google's Android and iOS, and any changes in such systems that degrade our products' functionality or give preferential treatment to competitive products could adversely affect the usage of our applications on mobile devices. Additionally, in order to deliver high quality mobile products, it is important that our products work well with a range of mobile technologies, systems, networks and standards that we do not control. We may not be successful in developing relationships with key participants in the mobile industry or in developing products that operate effectively with these technologies, systems, networks or standards. In the event that it is more difficult for students to access and use our applications on their mobile devices, or if students choose not to access or use our applications on their mobile devices or use mobile products that do not offer access to our applications, our student growth and student engagement levels could be harmed.

If we are not able to maintain the compatibility of our eTextbook Reader with third-party operating systems, demand for our eTextbooks may decline and have an adverse effect on our operating results.

Our eTextbook Reader is designed to provide students with access to eTextbooks from any device with an Internet connection and an Internet browser, including PCs, iPads, Android tablets, Kindles, Nooks and mobile phones. Our eTextbook Reader can be used across a variety of third-party operating systems. If we are not able to maintain the compatibility of our eTextbook Reader with third-party operating systems, demand for our eTextbooks could decline and revenues would be adversely affected. We may desire in the future to make our eTextbook Reader compatible with new or existing third-party operating systems that achieve popularity within the education marketplace, and these third-party operating systems may not be compatible with our designs. Any failure on our part to modify our applications to ensure compatibility with such third-party operating systems could reduce demand for our products and services.

If the transition from print to digital distribution does not proceed as we expect, our business and financial condition will be adversely affected.

The textbook distribution market has begun shifting toward digital distribution. If demand for eTextbooks accelerates more rapidly than we expect, we could be required to write-off excess print textbooks for which the rental demand has eroded or make additional payments to Ingram under our inventory purchase and consignment agreement. Further, our sale of used print textbooks represents a substantial source of cash from investing activities, and a substantial diminution on the value of these assets due to a shift in demand toward digital, or any other reason, could materially

and adversely affect our financial condition. Conversely, if the transition to digital distribution of textbooks does not gain market acceptance as we expect, capital requirements over the long term may be greater than we expect and our opportunities for growth may be diminished. In that case, we may need to raise additional capital, which may not be available on reasonable terms, or at all, and we may not realize the potential long-term benefits of a shift to digital distribution, including greater pricing flexibility, the ability to distribute a larger library of eTextbooks compared to print textbooks and lower cost of revenues.

If publishers refuse to grant us distribution rights to digital content on acceptable terms or terminate their agreements with us, or if we are unable to adequately protect their digital content rights, our business could be adversely affected.

We rely on licenses from publishers to distribute eTextbooks to our customers and to provide some of our other products and services. We do not have long-term contracts or arrangements with most publishers that guarantee the availability of such digital content. If we are unable to secure and maintain rights to distribute, or otherwise use, the digital content upon terms that are acceptable to us, or if publishers terminate their agreements with us, we would not be able to acquire such digital



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content from other sources and our ability to attract new students and retain existing students could be adversely impacted. Some of our licenses give the publisher the right to withdraw our rights to distribute or use the digital content without cause and/or give the publisher the right to terminate the entire license agreement without cause. If a publisher exercises such a right, this could adversely affect our business and financial results. Moreover, to the extent we are able to secure and maintain rights to distribute eTextbooks, our competitors may be able to obtain the same rights on more favorable terms.

In addition, our ability to distribute eTextbooks depends on publishers' belief that we include effective digital rights management technology to control access to digital content. If the digital rights management technology that we use is compromised or otherwise malfunctions, we could be subject to claims, and publishers may be unwilling to include their content in our service. If users are able to circumvent the digital rights management technology that we use, they may acquire unauthorized copies of the textbooks that they would otherwise rent from us, which could decrease our textbook rental volume and adversely affect our results of operations.

If Internet search engines' methodologies are modified or our search result page rankings decline for other reasons, student engagement with our website could decline.

We depend in part on various Internet search engines, such as Google, Bing and Yahoo!, to direct a significant amount of traffic to our website. Similarly, we depend on mobile app stores such as iTunes and Google Play to allow students to locate and download Chegg mobile applications that enable our service. Our ability to maintain the number of students directed to our website is not entirely within our control. Our competitors' search engine optimization (SEO) efforts may result in their websites receiving a higher search result page ranking than ours, or Internet search engines could revise their methodologies in an attempt to improve their search results, which could adversely affect the placement of our search result page ranking. If search engine companies modify their search algorithms in ways that are detrimental to our search result page ranking or in ways that make it harder for students to find our website, or if our competitors' SEO efforts are more successful than ours, overall growth could slow, student engagement could decrease, and fewer students may use our platform. These modifications may be prompted by search engine companies entering the online networking market or aligning with competitors. Our website has experienced fluctuations in search result rankings in the past, and we anticipate similar fluctuations in the future. Any reduction in the number of students directed to our website could harm our business and operating results.

Our core value of putting students first may conflict with the short-term interests of our business.

We believe that adhering to our core value of putting students first is essential to our success and in the best interests of our company and the long-term interests of our stockholders. In the past, we have forgone, and in the future we may forgo, short-term revenue opportunities that we do not believe are in the best interests of students, even if our decision negatively impacts our operating results in the short term. For example, we offer free services to students that require investment by us, such as our Internships service, in order to promote a more comprehensive solution. As part of our College Admissions and Scholarship Services marketing efforts, we identify select partner organizations who offer complementary content and services that support students in exploring colleges. We enable these partner organizations to use our college match service through their websites to enable students to request information about colleges of interest. We also developed the Chegg for Good program to connect students and employees with partners to engage them in causes related to education and the environment. We work with the nonprofit conservation organization American Forest to plant trees around the world and our funding has enabled the planting of more than six million trees to date. We formed the Chegg Foundation, a California nonprofit public benefit corporation, to engage in charitable and education-related activities, which we funded with one percent of the net proceeds from our IPO in November 2013. Our philosophy of putting students first may cause us to make decisions that could negatively impact our relationships with publishers, colleges and brands, whose interests may not always be aligned with ours or those of our students. Our decisions may not result in the long-term benefits that we expect, in which case our level of

student satisfaction and engagement, business and operating results could be harmed.

If we are required to discontinue certain of our current marketing activities, our ability to attract new students may be adversely affected.

Laws or regulations may be enacted which restrict or prohibit use of emails or similar marketing activities that we currently rely on. For example:

the CAN-SPAM Act of 2003 and similar laws adopted by a number of states regulate unsolicited commercial emails, create criminal penalties for emails containing fraudulent headers and control other abusive online marketing practices;

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the U.S. Federal Trade Commission (FTC) has guidelines that impose responsibilities on companies with respect to communications with consumers and impose fines and liability for failure to comply with rules with respect to advertising or marketing practices they may deem misleading or deceptive; and the TCPA restricts telemarketing and the use of automated telephone equipment. The TCPA limits the use of automatic dialing systems, artificial or prerecorded voice messages and SMS text messages. It also applies to unsolicited text messages advertising the commercial availability of goods or services. Additionally, a number of states have enacted statutes that address telemarketing. For example, some states, such as California, Illinois and New York, have created do-not-call lists. Other states, such as Oregon and Washington, have enacted “no rebuttal statutes” that require the telemarketer to end the call when the consumer indicates that he or she is not interested in the product being sold. Restrictions on telephone marketing, including calls and text messages, are enforced by the FTC, the Federal Communications Commission, states and through the availability of statutory damages and class action lawsuits for violations of the TCPA.

Even if no relevant law or regulation is enacted, we may discontinue use or support of these activities if we become concerned that students or potential students deem them intrusive or they otherwise adversely affect our goodwill and brand. If our marketing activities are curtailed, our ability to attract new students may be adversely affected.

Our business and growth may suffer if we are unable to hire and retain key personnel.

We depend on the continued contributions of our senior management and other key personnel. In particular, we rely on the contributions of our Chief Executive Officer, Dan Rosensweig. All of our executive officers and key employees are at-will employees, meaning they may terminate their employment relationship at any time. We compensate our employees through a combination of salary, benefits and equity compensation. Volatility or a decline in our stock price may affect our ability to retain and motivate key employees, each of whom has been granted stock options, RSUs or both. Competition for qualified personnel can be intense, and we may not be successful in retaining and motivating such personnel, particularly to the extent our stock price remains volatile or at a depressed level, as equity compensation plays an important role in how we compensate our employees. Such individuals may elect to seek employment with other companies that they believe have better long-term prospects. If we lose the services of one or more members of our senior management team or other key personnel, or if one or more of them decides to join a competitor or otherwise compete directly or indirectly with us, we may not be able to successfully manage our business or achieve our business objectives. Our future success also depends on our ability to identify, attract and retain highly skilled technical, managerial, finance and media procurement personnel. Qualified individuals are in high demand, particularly in the San Francisco Bay Area where our executive offices are located, and we may incur significant costs to attract them. If we are unable to attract or retain the personnel we need to succeed, our business may suffer.

Government regulation of education and student information is evolving, and unfavorable developments could have an adverse effect on our operating results.

We are subject to regulations and laws specific to the education sector because we offer our products and services to students and collect data from students. Data privacy and security with respect to the collection of personally identifiable information from students continues to be a focus of worldwide legislation and regulation. This includes significant regulation in the European Union and legislation and compliance requirements in various jurisdictions around the world. Within the United States, several states have enacted legislation that goes beyond any federal requirements relating to the collection and use of personally identifiable information and other data from students. Examples include statutes adopted by the State of California and most other States that require online services to report certain breaches of the security of personal data and a California statute that requires companies to provide choice to California customers about whether their personal data is disclosed to direct marketers or to report to California customers when their personal data has been disclosed to direct marketers. In this regard, there are a large

number of legislative proposals before the U.S. Congress and various state legislative bodies regarding privacy issues related to our business. It is not possible to predict whether or when such legislation may be adopted, and certain proposals, if adopted, could harm our business through a decrease in student registrations and revenues. These decreases could be caused by, among other possible provisions, the required use of disclaimers or other requirements before students can utilize our services. We post our privacy policies and practices concerning the use and disclosure of student data on our website. However, any failure by us to comply with our posted privacy policies, FTC requirements or other privacy-related laws and regulations could result in proceedings by governmental or regulatory bodies or by private litigants that could potentially harm our business, results of operations and financial condition.

Our business may also be subject to laws specific to students, such as the Family Educational Rights and Privacy Act, the Delaware Higher Education Privacy Act and a California statute which restricts the access by postsecondary educational institutions of prospective students' social media account information. Compliance levels include disclosures, consents, transfer restrictions, notice and access provisions for which we may in the future need to build further infrastructure to further support.

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We cannot guarantee that we have been or will be fully compliant in every jurisdiction, as it is not entirely clear how existing laws and regulations governing educational institutions affect our business. Moreover, as the education industry continues to evolve, increasing regulation by federal, state and foreign agencies becomes more likely. Recently, California adopted the Student Online Personal Information Protection Act which prohibits operators of online services used for K-12 school purposes from using or sharing student personal information and Colorado adopted House Bill 16-1423 designed to protect the use of student personal data in elementary and secondary school. These acts do not apply to general audience Internet websites but it is not clear how these acts will be interpreted and the breadth of services that will be restricted by it. Other states may adopt similar statutes. The adoption of any laws or regulations that adversely affect the popularity or growth in the use of the Internet particularly for educational services, including laws limiting the content that we can offer, and the audiences that we can offer that content to, may decrease demand for our service offerings and increase our cost of doing business. Future regulations, or changes in laws and regulations or their existing interpretations or applications, could also hinder our operational flexibility, raise compliance costs and result in additional historical or future liabilities for us, resulting in adverse impacts on our business and our operating results.

While we expect and plan for new laws, regulations and standards to be adopted over time that will be directly applicable to the Internet and to our student-focused activities, any existing or new legislation applicable to our business could expose us to substantial liability, including significant expenses necessary to comply with such laws and regulations and potential penalties or fees for non-compliance, and could negatively impact the growth in the use of the Internet for educational purposes and for our services in particular. We may also run the risk of retroactive application of new laws to our business practices that could result in liability or losses. Due to the global nature of the Internet, it is possible that the governments of other states and foreign countries might attempt to change previous regulatory schemes or choose to regulate transmissions or prosecute us for violations of their laws. We might unintentionally violate such laws, such laws may be modified and new laws may be enacted in the future. Any such developments could harm our business, operating results and financial condition. We may be subject to legal liability for our offerings.

We collect, process, store and use personal information and data, which subjects us to governmental regulation and other legal obligations related to privacy and our actual or perceived failure to comply with such obligations could harm our business.

In the ordinary course of business, and in particular in connection with merchandising our service to students, we collect, process, store and use personal information and data supplied by students. We may enable students to share their personal information with each other and with third parties and to communicate and share information into and across our platform. Other businesses have been criticized by privacy groups and governmental bodies for attempts to link personal identities and other information to data collected on the Internet regarding users' browsing and other habits. There are numerous federal, state and local laws regarding privacy and the collection, storing, sharing, using, processing, disclosing and protecting of personal information and other user data, the scope of which are changing, subject to differing interpretations, and which may be costly to comply with and may be inconsistent between countries and jurisdictions or conflict with other rules.

We currently face certain legal obligations regarding the manner in which we treat such information. Increased regulation of data utilization practices, including self-regulation or findings under existing laws, or new regulations restricting the collection, use and sharing of information from minors under the age of 18, that limit our ability to use collected data could have an adverse effect on our business. In addition, if unauthorized access to our students' data were to occur or if we were to disclose data about our student users in a manner that was objectionable to them, our business reputation and brand could be adversely affected, and we could face legal claims that could impact our operating results. Our reputation and brand and relationships with students would be harmed if our billing data were accessed by unauthorized persons.

We strive to comply with all applicable laws, policies, legal obligations and industry codes of conduct relating to privacy and data protection. However, U.S. federal, U.S. state and international laws and regulations regarding privacy and data protection are rapidly evolving and may be inconsistent and we could be deemed out of compliance as such laws and their interpretation change. In addition, foreign privacy, data protection, and other laws and regulations, particularly in Europe, are often more restrictive than those in the United States. The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to our business operations may limit the use and adoption of our services and reduce overall demand for them. Furthermore, foreign court judgments or regulatory actions could impact our ability to transfer, process and/or receive transnational data, including data relating to students or partners outside the United States. Such judgments or actions could affect the manner in which we provide our services or adversely affect our financial results if foreign students and partners are not able to lawfully transfer data to us. For example, the European Court of Justice recently invalidated the U.S.-EU Safe Harbor framework that had been in place since 2000, which allowed companies to meet certain European legal requirements for the transfer of personal data from the European Economic Area to the United States. While other adequate legal mechanisms to lawfully transfer such data remain, the invalidation of the U.S.-EU Safe Harbor framework may result in

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different European data protection regulators applying differing standards for the transfer of personal data, which could result in increased regulation, cost of compliance and limitations on data transfer for us and our customers. In addition, some countries are considering or have passed legislation implementing data protection requirements or requiring local storage and processing of data or similar requirements that could increase the cost and complexity of delivering our services.

Any failure or perceived failure by us to comply with our privacy policies, our privacy or data-protection obligations to students or other third parties, our privacy or data-protection legal obligations or any compromise of security that results in the unauthorized release or transfer of sensitive information, which may include personally identifiable information or other data, may result in governmental enforcement actions, litigation or public statements against us by consumer advocacy groups or others and could cause students to lose trust in us, which could have an adverse effect on our business. Additionally, if third parties we work with, such as colleges and brands, violate applicable laws or our policies, such violations may also put our student users' information at risk and could in turn have an adverse effect on our business.

Public scrutiny of Internet privacy issues may result in increased regulation and different industry standards, which could deter or prevent us from providing our current products and services to students, thereby harming our business.

The regulatory framework for privacy issues worldwide is currently in flux and is likely to remain so for the foreseeable future. Practices regarding the collection, use, storage, display, processing, transmission and security of personal information by companies offering online services have recently come under increased public scrutiny. The U.S. government, including the White House, the FTC and the U.S. Department of Commerce, are reviewing the need for greater regulation of the collection and use of information concerning consumer behavior with respect to online services, including regulation aimed at restricting certain targeted advertising practices. The FTC in particular has approved consent decrees resolving complaints and their resulting investigations into the privacy and security practices of a number of online, social media companies. Similar actions may also impact us directly, particularly because high school students who use our College Admissions, College Counseling and Scholarship Services are typically under the age of 18, which subjects our business to laws covering the protection of minors. For example, various U.S. and international laws restrict the distribution of materials considered harmful to children and impose additional restrictions on the ability of online services to collect information from minors. The FTC has also revised the rules under the Children's Online Privacy Protection Act effective July 1, 2013. Although our services are not primarily directed to children under 13, our Chegg Writing Tools, in particular, could be used by students as early as in middle school, and the FTC could decide that our site now or in the future has taken inadequate precautions to prevent children under 13 from accessing our site and providing us information.

The White House published a report calling for a consumer privacy Bill of Rights that could impact the collection of data, and the Department of Commerce seeks to establish a consensus-driven Do-Not-Track standard that could impact on-line and mobile advertising. The State of California and several other states have adopted privacy guidelines with respect to mobile applications. Our business, including our ability to operate internationally, could be adversely affected if legislation or regulations are adopted, interpreted or implemented in a manner that is inconsistent with our current business practices and that require changes to these practices, the design of our websites, mobile applications, products, features or our privacy policy. In particular, the success of our business has been, and we expect will continue to be, driven by our ability to responsibly use the data that students share with us. Therefore, our business could be harmed by any significant change to applicable laws, regulations or industry standards or practices regarding the use or disclosure of data that students choose to share with us or regarding the manner in which the express or implied consent of consumers for such use and disclosure is obtained. Such changes may require us to modify our products and services, possibly in a material manner, and may limit our ability to develop new products and services that make use of the data that we collect about our student users.

Our reputation and relationships with students would be harmed if our student users' data, particularly billing data, were to be accessed by unauthorized persons.

We maintain personal data regarding students who use our platform, including names and, in many cases, mailing addresses. We take measures to protect against unauthorized intrusion into our student users' data. If, despite these measures, we or our payment processing services experience any unauthorized intrusion into our student users' data, current and potential student users may become unwilling to provide the information to us necessary for them to engage with our platform, we could face legal claims and our business and reputation could be adversely affected. The breach of a third-party's website, resulting in theft of user names and passwords, could result in the fraudulent use of that user login information on our platform. In addition, we do not obtain signatures from students in connection with the use of credit cards by them. Under current credit card practices, to the extent we do not obtain cardholders' signatures, we are liable for fraudulent credit card transactions, even when the associated financial institution approves payment of the orders. From time to time, fraudulent credit cards may be used. We may experience some loss from these fraudulent transactions. As an example, we discovered in 2014 that certain individuals fraudulently obtained several thousand textbooks from us. While we do have safeguards in place, we cannot be certain that



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other fraudulent schemes will not be successful. A failure to adequately control fraudulent transactions would harm our business and results of operations.

If we become subject to liability for the Internet content that we publish or that is uploaded to our websites by students, our results of operations could be adversely affected.

As a publisher and distributor of online content, we face potential liability for negligence, copyright or trademark infringement or other claims based on the nature and content of materials that we publish or distribute. We also may face potential liability for content uploaded by students in connection with our community-related content. If we become liable, then our business may suffer. Third parties may initiate litigation against us without warning. Others may send us letters or other communications that make allegations without initiating litigation. We have in the past and may in the future receive such communications, which we assess on a case-by-case basis. We may elect not to respond to the communication if we believe it is without merit or we may attempt to resolve disputes out-of-court by removing content or services we offer or paying licensing or other fees. If we are unable to resolve such disputes, litigation may result. Litigation to defend these claims could be costly and harm our results of operations. We may not be adequately insured to cover claims of these types or indemnified for all liability that may be imposed on us. Any adverse publicity resulting from actual or potential litigation may also materially and adversely affect our reputation, which in turn could adversely affect our results of operations.

In addition, the Digital Millennium Copyright Act (DMCA) has provisions that limit, but do not necessarily eliminate, our liability for caching or hosting or for listing or linking to, content or third-party websites that include materials or other content that infringe copyrights or other intellectual property or proprietary rights, provided we comply with the strict statutory requirements of the DMCA. The interpretations of the statutory requirements of the DMCA are constantly being modified by court rulings and industry practice. Accordingly, if we fail to comply with such statutory requirements or if the interpretations of the DMCA change, we may be subject to potential liability for caching or hosting, or for listing or linking to, content or third-party websites that include materials or other content that infringe copyrights or other intellectual property or proprietary rights.

We maintain content usage review systems that, through a combination of manual and automated blocks, monitors for and makes us aware of potentially infringing content on our platform. Nevertheless, claims may continue to be brought and threatened against us for negligence, intellectual property infringement, or other theories based on the nature and content of information, its origin and its distribution and there is no guarantee that we will be able to resolve any such claims quickly and without damage to us, our business model, our reputation or our operations. From time to time, we have been subject to copyright infringement claims, some of which we have settled. While these settlements have not had a material impact on our financial condition, we may be subject to similar lawsuits in the future, including in connection with our other services. The outcome of any such lawsuits may not be favorable to us and could have a material adverse effect on our financial condition.

Failure to protect or enforce our intellectual property and other proprietary rights could adversely affect our business and financial condition and results of operations.

We rely and expect to continue to rely on a combination of trademark, copyright, patent and trade secret protection laws, as well as confidentiality and license agreements with our employees, consultants and third parties with whom we have relationships to protect our intellectual property and proprietary rights. As of September 30, 2016, we had 11 patents and 30 patent applications pending in the United States. We own three U.S. registered copyrights and have unregistered copyrights in our eTextbook Reader software, software documentation, marketing materials and website content that we develop. We own U.S. trademark registrations for the marks “Chegg,” “Chegg.com,” “Chegg Study,” “Chegg for Good,” “Student Hub,” “internships.com,” “ResearchReady,” “InstaEDU,” “EasyBib” and “#1 In Textbook Rentals,” among others, as well twenty foreign registrations. As of September 30, 2016, we own over 600 registered domain names.

We also have a number of pending trademark applications in the United States and foreign jurisdictions and unregistered marks that we use to promote our brand. From time to time we expect to file additional patent, copyright and trademark applications in the United States and abroad. Nevertheless, these applications may not be approved or otherwise provide the full protection we seek. Third parties may challenge any patents, copyrights, trademarks and other intellectual property and proprietary rights owned or held by us. Third parties may knowingly or unknowingly infringe, misappropriate or otherwise violate our patents, copyrights, trademarks and other proprietary rights and we may not be able to prevent infringement, misappropriation or other violation without substantial expense to us.

Furthermore, we cannot guarantee that:

- our intellectual property and proprietary rights will provide competitive advantages to us;
- our competitors or others will not design around our intellectual property or proprietary rights;

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our ability to assert our intellectual property or proprietary rights against potential competitors or to settle current or future disputes will not be limited by our agreements with third parties;

our intellectual property and proprietary rights will be enforced in jurisdictions where competition may be intense or where legal protection may be weak;

any of the patents, trademarks, copyrights, trade secrets or other intellectual property or proprietary rights that we presently employ in our business will not lapse or be invalidated, circumvented, challenged or abandoned; or

we will not lose the ability to assert our intellectual property or proprietary rights against or to license our intellectual property or proprietary rights to others and collect royalties or other payments.

If we pursue litigation to assert our intellectual property or proprietary rights, an adverse decision in any of these legal actions could limit our ability to assert our intellectual property or proprietary rights, limit the value of our intellectual property or proprietary rights or otherwise negatively impact our business, financial condition and results of operations. If the protection of our intellectual property and proprietary rights is inadequate to prevent use or misappropriation by third parties, the value of our brand and other intangible assets may be diminished, competitors may be able to more effectively mimic our service and methods of operations, the perception of our business and service to customers and potential customers may become confused in the marketplace and our ability to attract customers may be adversely affected.

We are a party to a number of third-party intellectual property license agreements. For example, in 2012, we entered into an agreement with a textbook publisher that provides access to textbook solutions content for our Chegg Study service over a five-year term, for which we paid an upfront license fee. In addition, we have agreements with certain eTextbook publishers under which we incur non-refundable fees at the time we provide students access to an eTextbook. We cannot guarantee that the third-party intellectual property we license will not be licensed to our competitors or others in our industry. In the future, we may need to obtain additional licenses or renew existing license agreements. We are unable to predict whether these license agreements can be obtained or renewed on acceptable terms, or at all. Any failure to obtain or renew such third-party intellectual property license agreements on commercially competitive terms could adversely affect our business and financial results.

We are, and may in the future be, subject to intellectual property claims, which are costly to defend and could harm our business, financial condition and operating results.

From time to time, third parties have alleged and are likely to allege in the future that we or our business infringes, misappropriates or otherwise violates their intellectual property or proprietary rights. Many companies, including various “non-practicing entities” or “patent trolls,” are devoting significant resources to developing or acquiring patents that could potentially affect many aspects of our business. There are numerous patents that broadly claim means and methods of conducting business on the Internet. We have not exhaustively searched patents related to our technology. In addition, the publishing industry has been, and we expect in the future will continue to be, the target of counterfeiting and piracy. We have in the past and may continue to receive communications alleging that physical textbooks sold or rented by us are counterfeit. For example, we recently cooperated, and continue to cooperate, with a group of publishers in a series of audits which have identified several thousand potentially fraudulent textbooks which we have removed from our inventory. While our fulfillment partner, Ingram, has a system for inspecting the physical textbooks in our catalog of books, many of the books sold or rented to students are shipped directly from our suppliers, and, in any case, unauthorized or counterfeit textbooks may inadvertently be included in the catalog of books we offer and may be subsequently sold or rented by us to students, or purchased by us through our buyback program, including on behalf of other buyers participating in our buyback program, and we may be subject to allegations of civil or criminal liability. We may implement measures in an effort to protect against these potential liabilities that could require us to spend substantial resources. Any costs incurred as a result of liability or asserted liability relating to sales of unauthorized or counterfeit textbooks could harm our business, reputation and financial condition.

Third parties may initiate litigation against us without warning. Others may send us letters or other communications that make allegations without initiating litigation. We have in the past and may in the future receive such communications, which we assess on a case-by-case basis. We may elect not to respond to the communication if we believe it is without merit or we may attempt to resolve disputes out-of-court by electing to pay royalties or other fees for licenses. If we are forced to defend ourselves against intellectual property claims, whether they are with or without merit or are determined in our favor, we may face costly litigation, diversion of technical and management personnel, inability to use our current website or inability to market our service or merchandise our products. As a result of a dispute, we may have to develop non-infringing technology, enter into licensing agreements, adjust our merchandising or marketing activities or take other action to resolve the claims. These actions, if required, may be unavailable on terms acceptable to us or may be costly or unavailable. If we are unable to obtain sufficient rights or develop non-infringing intellectual property or otherwise alter our business practices, as appropriate, on a timely basis, our reputation or brand, our business and our competitive position may be affected adversely and we may be subject to an injunction or be required to pay or incur substantial damages and/or fees.

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In addition, we use open source software in connection with certain of our products and services. Companies that incorporate open source software into their products have, from time to time, faced claims challenging the ownership of open source software and/or compliance with open source license terms. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software or noncompliance with open source licensing terms. Some open source software licenses require users who distribute or use open source software as part of their software to publicly disclose all or part of the source code to such software and/or make available any derivative works of the open source code on unfavorable terms or at no cost. Any requirement to disclose our proprietary source code or pay damages for breach of contract could have a material adverse effect on our business, financial condition and results of operations.

Confidentiality agreements with employees and others may not adequately prevent disclosure of trade secrets and proprietary information.

We have devoted substantial resources to the development of our intellectual property and proprietary rights. In order to protect our intellectual property and proprietary rights, we rely in part on confidentiality agreements with our employees, book vendors, licensees, independent contractors and other advisors. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover trade secrets and proprietary information and in such cases we could not assert any trade secret rights against such parties. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

If we are unable to protect our domain names, our reputation and brand could be adversely affected.

As of September 30, 2016, we own over 600 registered domain names relating to our brand, including Chegg.com. Failure to protect our domain names could affect adversely our reputation and brand and make it more difficult for students to find our website, our content and our services. The acquisition and maintenance of domain names generally are regulated by governmental agencies and their designees. The regulation of domain names in the United States may change in the near future. Governing bodies may establish additional top-level domains, appoint additional domain name registrars or modify the requirements for holding domain names. As a result, we may be unable to acquire or maintain relevant domain names. Furthermore, the relationship between regulations governing domain names and laws protecting trademarks and similar intellectual property and proprietary rights is unclear. We may be unable to prevent third parties from acquiring and using domain names that are similar to, infringe upon or otherwise decrease the value of our brand name, trademarks or other intellectual property or proprietary rights.

Our wide variety of accepted payment methods subjects us to third-party payment processing-related risks.

We accept payments from students using a variety of methods, including credit cards, debit cards and PayPal. As we offer new payment options to students, we may be subject to additional regulations, compliance requirements and incidents of fraud. For certain payment methods, including credit and debit cards, we pay interchange and other fees, which may increase over time and raise our operating costs and lower our profit margins. For example, we have in the past experienced higher transaction fees from our third-party processors as a result of chargebacks on credit card transactions.

We rely on third parties to provide payment processing services, including the processing and information storage of credit cards and debit cards. If these companies become unwilling or unable to provide these services to us, our business could be disrupted. We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it

difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to additional fines and higher transaction fees and lose our ability to accept credit and debit card payments from our students, process electronic funds transfers or facilitate other types of online payments, and our business and operating results could be adversely affected.

Worsening or stagnant economic conditions and their effect on funding levels of colleges, spending behavior by students and advertising budgets, may adversely affect our operating results and financial condition.

Our business is dependent on, among other factors, general economic conditions, which affect college funding, student spending and brand advertising. The economic downturn and slow economic recovery over the last several years has resulted in reductions in both state and federal funding levels at colleges across the United States, which has led to increased tuition and decreased amounts of financial aid offered to students. To the extent that the economy continues to stagnate or worsens, students may reduce the amount they spend on textbooks and other educational content, which could have a serious adverse

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impact on our business. In addition to decreased spending by students, the colleges and brands that use our marketing services have advertising budgets that are often constrained during periods of stagnant or deteriorating economic conditions. In a difficult economic environment, customer spending in each of our products and services is likely to decrease, which could adversely affect our operating results and financial condition. A deterioration of the current economic environment may also have a material adverse effect on our ability to fund our growth and strategic business initiatives.

Our international operations are subject to increased challenges and risks.

We have employees in Germany, Israel, India and the People's Republic of China (China), we indirectly contract with individuals in the Ukraine and we own a minority stake in a learning platform for high school and college students in Brazil. Although today our international operations represent less than 5% of our total consolidated operating expenses and we currently do not expect our international operations to materially increase in the near future, we expect to continue to expand our international operations and such operations may expand more quickly than we currently anticipate. However, we have limited operating history as a company outside the United States and our ability to manage our business and conduct our operations internationally requires considerable management attention and resources and is subject to the particular challenges of supporting a rapidly growing business in an environment of multiple languages, cultures, customs, tax systems, legal systems, alternative dispute systems, regulatory systems and commercial infrastructures. Operating internationally has required and will continue to require us to invest significant funds and other resources, subjects us to new risks and may increase the risks that we currently face, including risks associated with:

- recruiting and retaining talented and capable employees in foreign countries and maintaining our company culture across all of our offices;
- compliance with applicable foreign laws and regulations;
- compliance with anti-bribery laws including, without limitation, compliance with the Foreign Corrupt Practices Act;
- currency exchange rate fluctuations;
- political and economic instability; and
- higher costs of doing business internationally.

As part of our business strategy, we may make our products and services available in more countries outside of the U.S. market, where we are currently focused. The markets in which we may undertake international expansion may have educational systems, technology and online industries that are different or less well developed than those in the United States, and if we are unable to address the challenges of operating in international markets, it could have an adverse effect on our results of operations and financial condition.

Colleges and certain governments may restrict access to the Internet or our website, which could lead to the loss of or slowing of growth in our student user base and their level of engagement with our platform.

The growth of our business and our brand depends on the ability of students to access the Internet and the products and services available on our website. Colleges that provide students with access to the Internet either through physical computer terminals on campus or through wired or wireless access points on campus could block or restrict access to our website, content or services or the Internet generally for a number of reasons including security or confidentiality concerns, regulatory reasons, such as compliance with the Family Educational Rights and Privacy Act, which restricts the disclosure of student information or concerns that certain of our products and services, such as Chegg Study, may contradict or violate their policies.

We depend in part on colleges to provide their students with access to the Internet. If colleges modify their policies in ways that are detrimental to the growth of our student user base or in ways that make it harder for students to use our

website, or if our competitors' are able to reach more students than us, the overall growth in our student user base would slow, student engagement would decrease and we would lose revenues. Any reduction in the number of students directed to our website would harm our business and operating results.

In addition to our U.S. operations, we currently offer our college and university matching service in China. The Chinese government may seek to restrict access to the Internet or to our website specifically and our content and services could be suspended, blocked (in whole or in part) or otherwise adversely impacted in China. Any restrictions on the use of our website by students could lead to the loss or slowing of growth in the number of students who use our platform or the level of student engagement.

Our operations are susceptible to earthquakes, floods, rolling blackouts and other types of power loss. If these or other natural or man-made disasters were to occur, our operations and operating results would be adversely affected.



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Our business and operations could be materially adversely affected in the event of earthquakes, blackouts or other power losses, floods, fires, telecommunications failures, break-ins, acts of terrorism, inclement weather, shelving accidents or similar events. Our executive offices are located in the San Francisco Bay Area, an earthquake-sensitive area. In the recent past, California has experienced deficiencies in its power supply, resulting in occasional rolling blackouts. If floods, fire, inclement weather including extreme rain, wind, heat or cold or accidents due to human error were to occur and cause damage to a warehouse of Ingram or its textbook library, Ingram's ability to fulfill orders for textbook rental and sales transactions would be materially and adversely affected and our results of operations would suffer, especially if such events were to occur during peak periods. We may not be able to effectively shift our operations due to disruptions arising from the occurrence of such events, and our business could be affected adversely as a result. Moreover, damage to or total destruction of our executive offices resulting from earthquakes may not be covered in whole or in part by any insurance we may have.

If we are unable to implement and maintain effective internal control over financial reporting in the future, the accuracy, and timeliness of our financial reporting may be adversely affected.

The Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and the effectiveness of our disclosure controls and procedures quarterly. If we are not able to comply with the requirements of the Sarbanes-Oxley Act in a timely manner, the market price of our stock could decline and we could be subject to sanctions or investigations by the New York Stock Exchange, the SEC or other regulatory authorities, which would require additional financial and management resources.

If we conclude in future periods that our internal control over financial reporting is not effective, we may be required to expend significant time and resources to correct the deficiency and could be subject to one or more investigations or enforcement actions by state or federal regulatory agencies, stockholder lawsuits or other adverse actions requiring us to incur defense costs, pay fines, settlements or judgments and causing investor perceptions to be adversely affected and potentially resulting in a decline in the market price of our stock.

In addition, we are an “emerging growth company” as defined in the Jumpstart Our Business Startups Act of 2012 (JOBS Act), and as such we have elected to avail ourselves of the exemption from the requirement that our independent registered public accounting firm audit our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act until we cease to be an “emerging growth company.” See “—We are an “emerging growth company,” and we cannot be certain if the reduced disclosure requirements applicable to “emerging growth companies” will make our common stock less attractive to investors.” for additional risks relating to our “emerging growth company” status.

If we are unable to maintain effective internal control over financial reporting to meet the demands placed upon us as a public company, including the requirements of the Sarbanes-Oxley Act, we may be unable to accurately report our financial results, or report them within the timeframes required by law or exchange regulations.

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We may be subject to greater than anticipated liabilities for income, property, sales and other taxes, and any successful action by federal, state, foreign or other authorities to collect additional taxes could adversely harm our business.

We are subject to regular review and audit by both U.S. federal and state and foreign tax authorities and such jurisdictions may assess additional taxes against us. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical tax provisions and accruals and could have a negative effect on our financial position and results of operations. For example, we appealed the Kentucky Tax Authority's property tax assessment on our textbook library located in our Kentucky warehouse and the Commonwealth of Kentucky issued a ruling in favor of the Kentucky Department of Revenue in January 2014, which was reversed in our appeal to the Franklin Circuit Court in Kentucky in October 2014 before the Kentucky Court of Appeals ruled unanimously in our favor in March 2016. The Kentucky Department of Revenue petitioned the Kentucky Supreme Court for discretionary review, which was denied in September 2016. The case was determined in our favor with no property tax due related to our textbook library (see discussion above under Part II, Item 1, "Legal Proceedings"). In addition, the taxing authorities of the jurisdictions in which we operate may challenge our methodologies for valuing and allocating income from our intercompany transactions, which could increase our worldwide effective income tax rate. For example, we have been and are currently under tax audit in India for the 2014-15 fiscal years. Further, we file sales tax returns in a number of states within the United States as required by law and collect and remit sales tax for some content owners. We do not collect sales or other similar taxes in some U.S. and foreign jurisdictions, with respect to some of our sale, rental or service transactions because we believe that they do not apply to the relevant transactions. However, these and other tax laws and regulations are ambiguous or their application to our business is uncertain and the interpretation of them may be subject to change. In addition, one or more states could seek to impose new or additional sales, use or similar tax collection and record-keeping obligations on us. Any successful action by federal, state, foreign or other authorities to impose or collect additional income or property taxes, or compel us to collect and remit sales, use or similar taxes, either retroactively, prospectively or both, could harm our business, financial position and results of operations.

We may not be able to utilize a significant portion of our net operating loss or tax credit carryforwards, which could adversely affect our profitability.

At December 31, 2015, we had federal and state net operating loss carryforwards due to prior period losses of approximately \$159.0 million and \$120.0 million, respectively, which if not utilized will begin to expire in 2028 and 2016 for federal and state purposes, respectively. A portion of the state net operating loss carryforwards expired in 2015. At December 31, 2015, we also had federal tax credit carryforwards of approximately \$3.7 million, which if not utilized will begin to expire in 2030, and state tax credit carryforwards of approximately \$4.0 million, which do not expire. These net operating loss and tax credit carryforwards could expire unused and be unavailable to offset future income tax liabilities, which could adversely affect our profitability.

In addition, under Section 382 of the Internal Revenue Code of 1986, as amended (the Code), our ability to utilize net operating loss carryforwards or other tax attributes, such as tax credits, in any taxable year may be limited if we experience an "ownership change." A Section 382 "ownership change" generally occurs if one or more stockholders or groups of stockholders who own at least 5% of our stock increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. Similar rules may apply under state tax laws. As a result of prior equity issuances and other transactions in our stock, we have previously experienced "ownership changes" under Section 382 of the Code and comparable state tax laws. We may experience ownership changes in the future as a result of future issuances and other transactions of our stock. It is possible that any future ownership change could have a material effect on the use of our net operating loss carryforwards or other tax attributes, which could adversely affect our profitability.

Our failure to comply with the terms of our revolving line of credit could have a material adverse effect on us.

We have a revolving line of credit pursuant to a credit facility with Wells Fargo Bank, National Association (Bank) that provides an aggregate principal amount of \$30.0 million with an accordion feature that, subject to the Bank's discretion, allows us to borrow up to a total of \$50.0 million (the Line of Credit). The Line of Credit expires in September 2019. We currently have no amount drawn down under our Line of Credit. Our personal property secures the Line of Credit. If we default on our credit obligations, the Bank may, among other things, require immediate repayment of amounts drawn on the Line of Credit or terminate the Line of Credit or may foreclose on our personal property that secures the Line of Credit.

The agreements governing our indebtedness contain various covenants, including those that restrict our ability to, among other things:

• borrow money and guarantee or provide other support for indebtedness of third-parties;

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- pay dividends on, redeem or repurchase our capital stock;
- make investments in entities that we do not control, including joint ventures;
- consummate a merger, consolidation or sale of all or substantially all of our assets;
  - enter into certain asset sale transactions; and
- enter into secured financing arrangements;

These covenants may limit our ability to effectively operate our businesses. Any failure to comply with the restrictions of any agreement governing our other indebtedness may result in an event of default under those agreements.

## Risks Related to Ownership of Our Common Stock

Our stock price has been and will likely continue to be volatile.

The trading price of our common stock has been, and is likely to continue to be, volatile. Since shares of our common stock were sold in our IPO in November 2013 at a price of \$12.50 per share, our stock price has ranged from \$3.15 to \$11.25 through September 30, 2016. In addition to the factors discussed in this Quarterly Report on Form 10-Q, the trading price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our financial condition and operating results, including as a result of the seasonality in our business that results from the academic calendar;
- our announcement of actual results for a fiscal period that are higher or lower than projected results or our announcement of revenues or earnings guidance that is higher or lower than expected, including as a result of difficulty forecasting seasonal variations in our financial condition and operating results or the revenues generated by our offerings;
- issuance of new or updated research or reports by securities analysts, including the publication of unfavorable reports or change in recommendation or downgrading of our common stock;
- announcements by us or our competitors of significant products or features, technical innovations, acquisitions, strategic relationships and partnerships, joint ventures or capital commitments;
- actual or anticipated changes in our growth rate relative to our competitors;
- changes in the economic performance or market valuations of companies perceived by investors to be comparable to us;
- additional shares of our common stock being sold into the market by us or our existing stockholders or the anticipation of such sales;
- issuances of additional shares of our common stock in connection with acquisitions;
- share price and volume fluctuations attributable to inconsistent trading volume levels of our shares;
- lawsuits threatened or filed against us;
- regulatory developments in our target markets affecting us, students, colleges or brands, publishers or our competitors;
- terrorist attacks or natural disasters or other such events impacting countries where we have operations;
- international stock market conditions; and
- general economic, political and market conditions, such as recessions, unemployment rates, the limited availability of consumer credit, interest rate changes and currency fluctuations.

Furthermore, both domestic and international stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of companies in general and technology companies in particular. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. We believe our stock price may be particularly susceptible to volatility as the stock prices of

technology and Internet companies have often been subject to wide fluctuations. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

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If securities or industry analysts do not publish research reports about our business or publish inaccurate or unfavorable research about our business, our stock price could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us downgrade our common stock or publish inaccurate or unfavorable research about our business, our common stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

We do not intend to pay dividends for the foreseeable future.

We have never declared or paid cash dividends on our capital stock. We currently intend to retain any future earnings to finance the operation and expansion of our business, and we do not expect to declare or pay any dividends in the foreseeable future. As a result, our stockholders may only receive a return on their investment in our common stock if the market price of our common stock increases. In addition, our credit facility contains restrictions on our ability to pay dividends.

We are an “emerging growth company” and we cannot be certain if the reduced disclosure requirements applicable to “emerging growth companies” will make our common stock less attractive to investors.

We are an “emerging growth company,” as defined under the JOBS Act. For so long as we are an “emerging growth company,” we may take advantage of certain exemptions from reporting requirements that are applicable to other public companies that are not “emerging growth companies” including, but not limited to, compliance with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved.

We could be an “emerging growth company” for up to five years, although we may lose such status earlier, depending on the occurrence of certain events. We will remain an “emerging growth company” until the earliest to occur of (i) the last day of the year (a) following the fifth anniversary of our initial public offering, (b) in which we have total annual gross revenues of at least \$1.0 billion or (c) in which we are deemed to be a “large accelerated filer” under the Exchange Act, which means that the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the prior June 30, and (ii) the date on which we have issued more than \$1.0 billion in non-convertible debt securities during the prior three-year period.

We cannot predict if investors will find our common stock less attractive or our company less comparable to certain other public companies because we will rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

Under the JOBS Act, “emerging growth companies” can delay adopting new or revised accounting standards issued subsequent to the enactment of the JOBS Act until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards and will be subject to the same new or revised accounting standards as other public companies that are not “emerging growth companies.”

Delaware law and provisions in our restated certificate of incorporation and restated bylaws that went into effect at the closing of our IPO could make a merger, tender offer or proxy contest difficult, thereby depressing the trading price of

our common stock.

Our status as a Delaware corporation and the anti-takeover provisions of the Delaware General Corporation Law may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. In addition, our restated certificate of incorporation and restated bylaws contain provisions that may make the acquisition of our company more difficult, including the following:

our board of directors is classified into three classes of directors with staggered three-year terms and directors can only be removed from office for cause and by the approval of the holders of at least two-thirds of our outstanding common stock;

subject to certain limitations, our board of directors has the sole right to set the number of directors and to fill a vacancy resulting from any cause or created by the expansion of our board of directors, which prevents stockholders from being able to fill vacancies on our board of directors;

only our board of directors is authorized to call a special meeting of stockholders;

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- certain litigation against us can only be brought in Delaware;
- our restated certificate of incorporation authorizes undesignated preferred stock, the terms of which may be established and shares of which may be issued, without the approval of the holders of common stock;
  - advance notice procedures apply for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders;
- our stockholders cannot act by written consent;
- our restated bylaws can only be amended by our board of directors or by the approval of the holders of at least two-thirds of our outstanding common stock; and
- certain provisions of our restated certificate of incorporation can only be amended by the approval of the holders of at least two-thirds of our outstanding common stock.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 6. EXHIBITS

The exhibits listed in the accompanying “Index to Exhibits” are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.



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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHEGG, INC.

November 7, 2016 By: /S/ ANDREW BROWN

Andrew Brown

Chief Financial Officer

(Duly Authorized Officer and Principal Financial Officer)

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## Index to Exhibits

| Exhibit No. | Exhibit  | Incorporated by Reference |           |             | Exhibit No. | Filed Herewith |
|-------------|--|---------------------------|-----------|-------------|-------------|----------------|
|             |  | Form                      | File No   | Filing Date |             |                |
| 10.01       | Credit Agreement dated September 21, 2016 by and between Chegg, Inc. and Wells Fargo Bank, National Association.   | 8-K                       | 001-36180 | 9/22/16     | 99.1        |                |
| 31.01       | Certification of Dan Rosensweig, Chief Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |                           |           |             |             | X              |
| 31.02       | Certification of Andrew Brown, Chief Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |                           |           |             |             | X              |
| 32.01**     | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002   |                           |           |             |             | X              |
| 101.INS     | XBRL Instance  |                           |           |             |             | X              |
| 101.SCH     | XBRL Taxonomy Extension Schema   |                           |           |             |             | X              |
| 101.CAL     | XBRL Taxonomy Extension Calculation  |                           |           |             |             | X              |
| 101.LAB     | XBRL Taxonomy Extension Labels   |                           |           |             |             | X              |
| 101.PRE     | XBRL Taxonomy Extension Presentation   |                           |           |             |             | X              |
| 101.DEF     | XBRL Taxonomy Extension Definition   |                           |           |             |             | X              |

This certification is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act), or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended or the Exchange Act.