

CHEGG, INC  
Form 10-Q  
August 06, 2015  
Table of Contents

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

FORM 10-Q

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

For the quarterly period ended June 30, 2015

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  
(State or other jurisdiction of  
incorporation or organization)

3990 Freedom Circle  
Santa Clara, CA, 95054

(Address of principal executive offices)

(408) 855-5700

(Registrant's telephone number, including area code)

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

Title of each class

Common Stock, \$0.001 par value per share

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

None

(Title of class)

20-3237489  
(I.R.S. employer  
identification no.)

Name of each exchange on which registered  
The New York Stock Exchange

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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting

Edgar Filing: CHEGG, INC - Form 10-Q

company” in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(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 July 31, 2015, the Registrant had 87,655,772 outstanding shares of Common Stock.

---

Table of Contents

## TABLE OF CONTENTS

	Page
	<u>PART I - FINANCIAL INFORMATION</u>
<u>Item 1.</u>	<u>Financial Statements (unaudited):</u> 4
	<u>Condensed Consolidated Balance Sheets - June 30, 2015 and December 31, 2014</u> 4
	<u>Condensed Consolidated Statements of Operations - for the Three and Six Months Ended June 30, 2015 and 2014</u> 5
	<u>Condensed Consolidated Statements of Comprehensive Loss - for the Three and Six Months Ended June 30, 2015 and 2014</u> 6
	<u>Condensed Consolidated Statements of Cash Flows - for the Six Months Ended June 30, 2015 and 2014</u> 7
	<u>Notes to Condensed Consolidated Financial Statements</u> 8
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Result of Operations</u> 20
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 31
<u>Item 4.</u>	<u>Controls and Procedures</u> 31
	<u>PART II - OTHER INFORMATION</u>
<u>Item 1.</u>	<u>Legal Proceedings</u> 32
<u>Item 1A.</u>	<u>Risk Factors</u> 32
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities, Use of Proceeds, and Repurchase of Common Stock</u> 56
<u>Item 6.</u>	<u>Exhibits</u> 56
<u>Signatures</u>	57
<u>Index to Exhibits</u>	58

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 for Good,” “CourseRank,” “Cramster,” “InstaEDU,” “internships.com” “Zinch” 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.

Table of Contents

**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,” “expect,” “plans to,” “if,” “future,” and similar expressions are intended 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.

Table of Contents

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## CHEGG, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

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

	June 30, 2015	December 31, 2014
	(unaudited)	*
Assets		
Current assets		
Cash and cash equivalents	\$35,087	\$56,117
Short-term investments	27,409	33,346
Accounts receivable, net of allowance for doubtful accounts of \$261 and \$559 at June 30, 2015 and December 31, 2014, respectively	12,131	14,396
Prepaid expenses	7,657	3,091
Other current assets	16,872	3,864
Total current assets	99,156	110,814
Long-term investments	4,727	1,451
Textbook library, net	61,260	80,762
Property and equipment, net	18,569	18,369
Goodwill	91,301	91,301
Intangible assets, net	10,629	13,626
Other assets	1,922	1,804
Total assets	\$287,564	\$318,127
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$3,832	\$10,945
Deferred revenue	19,752	24,591
Accrued liabilities	23,903	31,183
Total current liabilities	47,487	66,719
Long-term liabilities		
Total other long-term liabilities	4,732	4,365
Total liabilities	52,219	71,084
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value – 10,000,000 shares authorized, no shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively	—	—
Common stock, \$0.001 par value 400,000,000 shares authorized at June 30, 2015 and December 31, 2014, respectively; 87,560,103 and 84,008,043 shares issued and outstanding at June 30, 2015 and December 31, 2014, respectively	88	84
Additional paid-in capital	543,789	516,845
Accumulated other comprehensive gain (loss)	14	(13 )
Accumulated deficit	(308,546 )	(269,873 )
Total stockholders' equity	235,345	247,043
Total liabilities and stockholders' equity	\$287,564	\$318,127

\* Derived from audited consolidated financial statements as of and for the year ended December 31, 2014.

See Notes to Condensed Consolidated Financial Statements



Table of Contents

CHEGG, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net revenues:				
Rental	\$32,782	\$42,257	\$70,496	\$89,113
Services	29,276	18,599	60,643	35,845
Sales	5,003	3,636	20,794	13,927
Total net revenues	67,061	64,492	151,933	138,885
Cost of revenues:				
Rental	21,238	29,889	59,793	77,586
Services	9,975	4,912	21,812	12,568
Sales	5,043	3,795	20,144	13,927
Total cost of revenues	36,256	38,596	101,749	104,081
Gross profit	30,805	25,896	50,184	34,804
Operating expenses:				
Technology and development	13,268	12,189	29,412	23,509
Sales and marketing	12,382	14,817	33,774	29,844
General and administrative	11,943	10,654	23,720	20,494
Restructuring charges	464	—	2,978	—
Loss (gain) on liquidation of textbooks	2,445	(2,122)	(1,740)	(3,800)
Total operating expenses	40,502	35,538	88,144	70,047
Loss from operations	(9,697)	(9,642)	(37,960)	(35,243)
Interest expense and other income, net:				
Interest expense, net	(60)	(127)	(121)	(188)
Other income, net	56	156	132	276
Total interest expense and other income, net	(4)	29	11	88
Loss before provision for (benefit from) income taxes	(9,701)	(9,613)	(37,949)	(35,155)
Provision for (benefit from) income taxes	430	(1,367)	724	(1,150)
Net loss	\$(10,131)	\$(8,246)	\$(38,673)	\$(34,005)
Net loss per share, basic and diluted	\$(0.12)	\$(0.10)	\$(0.45)	\$(0.41)
Weighted average shares used to compute net loss per share, basic and diluted	86,741	83,209	85,771	82,686
See Notes to Condensed Consolidated Financial Statements				

Table of Contents

CHEGG, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net loss	\$(10,131	) \$(8,246	) \$(38,673	) \$(34,005
Other comprehensive (loss) income:				
Net change in unrealized loss (gain) on available for sale investments	(17	) 54	5	38
Change in foreign currency translation adjustments	—	(27	) 22	(4
Other comprehensive (loss) income:	(17	) 27	27	34
Total comprehensive loss	\$(10,148	) \$(8,219	) \$(38,646	) \$(33,971

See Notes to Condensed Consolidated Financial Statements.



Table of Contents

CHEGG, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended	
	June 30,	
	2015	2014
Cash flows from operating activities		
Net loss	\$(38,673	) \$(34,005
Adjustments to reconcile net loss to net cash provided by operating activities:		
Textbook library depreciation expense	27,476	38,130
Amortization of warrants and deferred loan costs	70	117
Other depreciation and amortization expense	6,413	4,544
Share-based compensation expense	22,851	15,411
Provision for bad debts	(269	) 197
Gain on liquidation of textbooks	(1,740	) (3,800
Loss from write-offs of textbooks	3,611	6,805
Deferred income taxes	—	(1,626
Realized gain on sale of securities	—	(18
Loss from disposal of property and equipment	918	—
Change in assets and liabilities net of effect of acquisition of businesses:		
Accounts receivable	116	(2,211
Prepaid expenses and other current assets	(17,405	) (1,774
Other assets	(253	) (470
Accounts payable	(6,150	) 2,988
Deferred revenue	(4,839	) 1,241
Accrued liabilities	(5,574	) (2,803
Other liabilities	389	(128
Net cash (used in) provided by operating activities	(13,059	) 22,598
Cash flows from investing activities		
Purchases of textbooks	(31,275	) (52,781
Proceeds from liquidations of textbooks	22,693	18,737
Purchases of marketable securities	(17,127	) (54,882
Proceeds from sale of marketable securities	—	38,860
Maturities of marketable securities	19,690	29,600
Purchases of property and equipment	(4,146	) (2,496
Acquisition of businesses, net of cash acquired	—	(43,872
Net cash used in investing activities	(10,165	) (66,834
Cash flows from financing activities		
Proceeds from issuance of common stock under employee stock plans	1,399	1,743
Proceeds from exercise of common stock under employee stock plans	10,530	—
Payment of taxes related to the net share settlement of RSUs	(7,472	) (3,588
Repurchase of common stock	(2,263	) —
Net cash provided by (used in) financing activities	2,194	(1,845
Net decrease in cash and cash equivalents	(21,030	) (46,081
Cash and cash equivalents, beginning of period	56,117	76,864
Cash and cash equivalents, end of period	\$35,087	\$30,783
Cash paid during the period for:		
Interest	\$50	\$31

Edgar Filing: CHEGG, INC - Form 10-Q

Income taxes	\$571	\$445
Non-cash investing and financing activities:		
Accrued purchases of long-lived assets	\$3,805	\$5,528
Issuance of common stock related to prior acquisition	\$825	\$1,585
See Notes to Condensed Consolidated Financial Statements.		

7

---

Table of Contents

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 are driven by our passion to help students become active consumers in the educational process. Our integrated platform offers products and services that students need throughout the college lifecycle, from choosing a college through graduation and beyond. By helping students learn more in less time and at a lower cost, we help them improve the overall return on investment in education. In 2014, nearly 7.5 million students used our platform.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of June 30, 2015, the condensed consolidated statements of operations and the condensed consolidated statements of comprehensive loss for the three and six months ended June 30, 2015 and 2014, the condensed consolidated statements of cash flows for the six months ended June 30, 2015 and 2014, 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 June 30, 2015, our results of operations for the three and six months ended June 30, 2015 and 2014, and cash flows for the six months ended June 30, 2015 and 2014. The results of operations for the three and six months ended June 30, 2015 and cash flows for the six months ended June 30, 2015 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, 2014 as 2014.

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, 2014 (the Annual Report on Form 10-K) filed with the U.S. Securities and Exchange Commission (SEC).

Except for restructuring charges, which are discussed below, 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.

We have presented revenue and cost of revenues separately for rental, service and sale beginning with our Annual Report on Form 10-K. Rental revenue includes the rental of print textbooks for which we take title and bear the risk of loss; service revenue includes Chegg Study, brand advertising, eTextbooks, tutoring, enrollment marketing, and commissions we earn from Ingram and other e-commerce partners; sale revenue includes just-in-time sale of print textbooks and the sale of other required materials. We have reclassified amounts in the prior periods to conform to the current period presentation. None of the changes impact previously reported condensed consolidated revenue, cost of revenue, operating income, or earnings per share.



Table of Contents

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 revenue 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 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.

Restructuring Charges

Restructuring charges are primarily comprised of severance costs, contract and program termination costs, asset impairments and costs of facility consolidation and closure. Restructuring charges are recorded upon approval of a formal management plan and are included in the operating results of the period in which such plan is approved and the expense becomes estimable. To estimate restructuring charges, management utilizes assumptions of the number of employees that would be involuntarily terminated and of future costs to operate and eventually vacate duplicate facilities. Severance and other employee separation costs are accrued when it is probable that benefits will be paid and the amount is reasonably estimable. The rates used in determining severance accruals are based on our policies and practices and negotiated settlements. Restructuring charges for employee workforce reductions are recorded upon employee notification for employees whose required continuing service period is 60 days or less and ratably over the employee's continuing service period for employees whose required continuing service period is greater than 60 days.

Recent Accounting Pronouncements

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.

Table of Contents

## Note 2. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by weighted-average number of shares of common stock outstanding during the period, less 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 June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Numerator:				
Net loss	\$(10,131 )	\$(8,246 )	\$(38,673 )	\$(34,005 )
Denominator:				
Weighted-average common shares outstanding	86,741	83,255	85,771	82,760
Less: Weighted-average unvested common shares subject to repurchase or forfeiture	—	(46 )	—	(74 )
Weighted-average common shares used in computing basic and diluted net loss per share	86,741	83,209	85,771	82,686
Net loss per share, basic and diluted.	\$(0.12 )	\$(0.10 )	\$(0.45 )	\$(0.41 )

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Options to purchase common stock	8,849	15,579	12,011	14,925
RSUs and PSUs	107	714	98	260
Employee stock purchase plan	8	—	8	—
Common stock subject to repurchase or forfeiture	—	40	—	40
Warrants to purchase common stock	324	996	399	996
Total common stock equivalents	9,288	17,329	12,516	16,221

Table of Contents

## 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 (in thousands) as of June 30, 2015 and December 31, 2014:

	June 30, 2015			December 31, 2014		
	Cost	Net Unrealized Gain/(Loss)	Fair Value	Cost	Net Unrealized Gain/(Loss)	Fair Value
Cash and cash equivalents:						
Cash	\$26,093	\$—	\$26,093	\$49,836	\$—	\$49,836
Money market funds	5,995	—	5,995	5,828	—	5,828
Commercial paper	2,999	—	2,999	453	—	453
Total cash and cash equivalents	\$35,087	\$—	\$35,087	\$56,117	\$—	\$56,117
Short-term investments:						
Commercial paper	\$11,044	\$—	\$11,044	\$13,435	\$—	\$13,435
Corporate securities	16,366	(1 )	16,365	18,426	(15 )	18,411
Certificate of deposit	—	—	—	1,499	1	1,500
Total short-term investments	\$27,410	\$(1 )	\$27,409	\$33,360	\$(14 )	\$33,346
Long-term investments:						
Corporate securities	\$3,736	\$(10 )	\$3,726	\$1,453	\$(2 )	\$1,451
Agency bond	1,001	—	1,001	—	—	—
Long-term corporate securities	\$4,737	\$(10 )	\$4,727	\$1,453	\$(2 )	\$1,451
Short-term restricted cash						
Short-term restricted cash	\$300	\$—	\$300	\$300	\$—	\$300
Long-term restricted cash						
Long-term restricted cash	1,480	—	1,480	1,480	—	1,480
Total restricted cash	\$1,780	\$—	\$1,780	\$1,780	\$—	\$1,780

The amortized cost and fair value of available-for-sale investments as of June 30, 2015 by contractual maturity were as follows (in thousands):

	Cost	Fair Value
Due in 1 year or less	\$30,410	\$30,409
Due in 1-2 years	4,736	4,726
Investments not due at a single maturity date	5,995	5,995
Total	\$41,141	\$41,130

Investments not due at a single maturity date in the preceding table consist of money market fund deposits and commercial paper.

As of June 30, 2015, we considered the declines in market value of our investment portfolio to be temporary in nature and did not consider any of our investments to be other-than-temporarily impaired. We typically invest in highly-rated securities with a minimum credit rating of A- and a weighted average maturity of four months, and 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, the investment before recovery of the

investment's cost basis. During the six months ended June 30, 2015, we did not recognize any impairment charges.



Table of Contents

## 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 June 30, 2015 and December 31, 2014 are classified based on the valuation technique level in the tables below (in thousands):

	June 30, 2015		
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets:			
Cash equivalents:			
Money market funds	\$5,995	\$5,995	\$—
Commercial paper	2,999	—	2,999
Short-term investments:			
Commercial paper	11,044	—	11,044
Corporate securities	16,365	—	16,365
Long-term investments:			
Corporate securities	3,726	—	3,726
Agency bond	1,001	—	1,001
Total assets measured and recorded at fair value	\$41,130	\$5,995	\$35,135

Table of Contents

	December 31, 2014				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Other Inputs (Level 3)	Significant Unobservable Inputs (Level 3)
Assets:					
Cash equivalents:					
Money market funds	\$5,828	\$5,828	\$ —		\$—
Commercial paper	453	—	453		—
Short-term investments:					
Commercial paper	13,435	—	13,435		—
Corporate securities	18,411	—	18,411		—
Certificate of deposit	1,500	—	1,500		—
Long-term investments, corporate securities	1,451	—	1,451		—
Total assets measured and recorded at fair value	\$41,078	\$5,828	\$ 35,250		\$—
Liabilities:					
Put option liability	\$1,079	\$—	\$ —		\$1,079

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.

As of June 30, 2015, the put option liability (Level 3) related to a previous acquisition that provided certain employees of the acquired company with the right to require us to acquire vested common shares at a stated contractual price had been fully exercised and the shares were repurchased from employees in the first quarter of 2015. We no longer hold any Level 3 assets or liabilities as of June 30, 2015.

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. Intangible Assets

Intangible assets as of June 30, 2015 and December 31, 2014 consist of the following (in thousands, except weighted-average amortization period):

	June 30, 2015 Weighted-Average Amortization Period (in months)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technologies	52	\$9,417	\$(5,918)	\$3,499
Customer lists	20	2,820	(2,051)	769
Trade names	48	2,343	(627)	1,716

Edgar Filing: CHEGG, INC - Form 10-Q

Non-compete agreements	28	1,220	(557	) 663
Master service agreements	21	1,030	(648	) 382
Indefinite-lived trade name	—	3,600	—	3,600
Total intangible assets		\$20,430	\$(9,801	) \$10,629

13

---

Table of Contents

	December 31, 2014 Weighted-Average Amortization Period (in months)	Gross Carrying Amount	Accumulated Amortization	Impairment	Net Carrying Amount
Developed technologies	50	\$9,792	\$(5,000 )	\$(194 )	\$4,598
Customer lists	15	4,363	(1,816 )	(829 )	1,718
Trade names	44	3,132	(1,085 )	(39 )	2,008
Non-compete agreements	21	1,637	(421 )	(278 )	938
Master service agreements	21	1,030	(266 )	—	764
Corporate partnerships	0	243	(31 )	(212 )	—
Indefinite-lived trade name	—	3,600	—	—	3,600
Total intangible assets		\$23,797	\$(8,619 )	\$(1,552 )	\$13,626

During the three and six months ended June 30, 2015, amortization expense related to our acquired intangible assets totaled approximately \$1.4 million and \$3.0 million, respectively. During the three and six months ended June 30, 2014, amortization expense related to our acquired intangible assets totaled approximately \$1.0 million and \$1.6 million, respectively.

As of June 30, 2015, the estimated future amortization expense related to our finite-lived intangible assets is as follows (in thousands):

Remaining six months of 2015	\$1,765
2016	2,238
2017	1,701
2018	1,018
2019	307
Total	\$7,029

## Note 6. Debt Obligations

In August 2013, we entered into a revolving credit facility with an aggregate principal amount of \$50.0 million (the Revolving Credit Facility). In June 2014 we amended the Revolving Credit Facility to reduce the aggregate principal amount to \$40.0 million with an accordion feature subject to certain financial criteria that would allow us to borrow up to \$75.0 million in total. In August 2015, we amended the Revolving Credit Facility to reduce the financial covenant consolidated EBITDA requirements beginning the quarter ended June 30, 2015 and to reduce the aggregate principal amount to \$30.0 million beginning the quarter ended December 31, 2015. The Revolving Credit Facility carries, at our election, a base 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 will expire in August 2016. The Revolving Credit Facility requires us to repay the outstanding balance at expiration, or to prepay the outstanding balance, if certain reporting and financial covenants are not maintained. These financial covenants are as follows: (1) maintain specified quarterly levels of consolidated EBITDA, which is defined as net income (loss) before tax plus interest expense, provision for (benefit from) income taxes, depreciation and amortization expense, non-cash share-based compensation expense and costs and expenses not to exceed \$2.0 million in closing fees related to the revolving credit facility; and (2) maintain a leverage ratio greater than 1.5 to 1.0 as of the end of each quarter, based on the ratio of the consolidated outstanding debt balance to consolidated EBITDA for the period of the four fiscal quarters most recently ended. As of June 30, 2015, we were in compliance with these financial covenants.

Note 7. 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 June 30, 2015, related to our headquarters in Santa Clara, California, our office in San Francisco, California, and our warehouse 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. On April

14

---

Table of Contents

10, 2015, we signed an agreement to sublease effectively one half of our warehouse in Kentucky. We expect this sublease agreement to generate \$0.1 million of sublease income per month through the end of November 2016. Rental expense, net of sublease income, was approximately \$0.5 million and \$1.4 million in the three and six months ended June 30, 2015, respectively, and \$0.8 million and \$1.6 million in the three and six months ended June 30, 2014, 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, from time to time, we may 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, from time to time, also 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. Due to the preliminary status of the appeal by the Kentucky Department of Revenue and the uncertainties related to the appeal, we are unable to evaluate the likelihood of either a favorable or unfavorable outcome. We believe that it is reasonably possible that we will incur a loss; however, we cannot currently estimate a range of any possible losses we may experience in connection with this case. Accordingly, we are unable at this time to estimate the effects of this matter on our financial condition, results of operations, or cash flows.

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.

Note 8. 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 June 30, 2015.

Table of Contents

## Note 9. Stockholders' Equity

## Share-Based Compensation

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Cost of revenues	\$81	\$134	\$215	\$312
Technology and development	1,273	2,635	5,980	5,017
Sales and marketing	1,034	2,263	6,088	3,595
General and administrative	5,443	3,449	10,568	6,487
Total share-based compensation expense	\$7,831	\$8,481	\$22,851	\$15,411

## Fair Value of Stock Options

We estimate the fair value of each stock option award using the Black-Scholes-Merton option-pricing model, which utilizes the estimated fair value of our common stock and requires input on the following subjective assumptions:

**Expected Term** — The expected term for options granted to employees, officers, and directors is calculated as the midpoint between the vesting date and the end of the contractual term of the options. The expected term for options granted to consultants is determined using the remaining contractual life.

**Expected Volatility** — The expected volatility is based on the average volatility of public companies within our peer group as our common stock has not been publicly trading for a long enough period to rely on our own expected volatility.

**Expected Dividends** — The dividend assumption is based on our historical experience. To date we have not paid any dividends on our common stock.

**Risk-Free Interest Rate** — The risk-free interest rate used in the valuation method is the implied yield currently available on the United States treasury zero-coupon issues, with a remaining term equal to the expected life term of our options.

The following table summarizes the key assumptions used to determine the fair value of our stock options granted to employees, officers and directors:

	Three Months Ended June 30,		Six Months Ended June 30,			
	2015	2014	2015	2014		
Expected term (years)	5.50	6.07	5.50	6.07		
Expected volatility	50.68	% 55.91	% 50.68	% 56.15	%	%
Dividend yield	—	% —	% —	% —	%	%
Risk-free interest rate	1.75	% 1.88	% 1.75	% 1.91	%	%
Weighted-average grant-date fair value per share	\$3.63	\$3.66	\$3.63	\$3.82		



Table of Contents

## 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 and also 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 Employee Stock Purchase Plan

Under the 2013 Employee Stock Purchase Plan (the 2013 ESPP), rights to purchase shares are generally granted during the second and fourth quarter of each year. The fair value of rights granted under the 2013 ESPP was estimated at the date of grant using the Black-Scholes-Merton option-pricing model.

## Stock Option Activity

Option activity under our equity incentive plans was as follows:

	Options Outstanding		Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
	Number of Options Outstanding	Weighted-Average Exercise Price per Share		
Balance at December 31, 2014	14,962,099	\$8.53	7.11	\$6,646,629
Granted	165,456	7.65		
Exercised	(1,646,852 )	6.41		
Canceled	(661,730 )	9.67		
Balance at June 30, 2015	12,818,973	\$8.74	6.88	\$8,122,971

As of June 30, 2015, our total unrecognized compensation expense for stock options granted to employees, officers, directors, and consultants was approximately \$16.6 million, which will be recognized over a weighted-average vesting period of approximately 1.5 years.

We recognize only the portion of the option award granted to employees that is ultimately expected to vest as compensation expense. Estimated forfeitures are determined based on historical data and management's expectation of exercise behaviors. Forfeiture rates and the resulting compensation expense are revised in subsequent periods if actual forfeitures differ from the estimate.

No option awards were granted to consultants during the three and six months ended June 30, 2015 and 2014. Total share-based compensation expense for consultants was not significant for the three and six months ended June 30, 2015 and 2014.

There was no capitalized share-based compensation expense as of June 30, 2015 or 2014.



Table of Contents

## RSU and PSU Activity

	RSUs and PSUs Outstanding	
	Number of RSUs and PSUs Outstanding	Weighted Average Grant Date Fair Value
Balance at December 31, 2014	9,125,190	\$ 6.25
Granted	7,085,445	6.79
Released	(2,320,865	) 7.78
Canceled	(596,939	) 6.48
Balance at June 30, 2015	13,292,831	\$ 6.26

During the three and six months ended June 30, 2014, 29,502 and 1,285,261 RSUs granted prior to our initial public offering (IPO) vested and were settled for shares of our common stock, respectively. Of those shares, we withheld 10,859 and 527,778 shares valued at approximately \$0.1 million and \$3.6 million, respectively, in satisfaction of tax withholding obligations for employees who elected to net settle, i.e., surrender shares of common stock to satisfy their tax obligations. Payment of taxes related to this net share settlement of RSUs is reflected as a financing activity in our condensed consolidated statements of cash flows. The shares withheld by us as a result of the net settlement are no longer considered issued and outstanding, thereby reducing our shares outstanding used to calculate earnings per share. These shares are returned to the reserves and are available for future issuance under the 2013 Equity Incentive Plan (the 2013 Plan).

In February 2015, we granted PSUs under the 2013 Plan to certain of our key employees. 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 Performance Period). Based on the achievement of the performance conditions during the Performance Period for the February grants, the final settlement will range between zero and 100% of the target shares underlying the PSU awards based on a specified objective formula approved by the Compensation Committee. If earned, these PSUs will vest annually over a two or three year period depending on the employee, with the initial vesting in February 2016.

The target number of shares underlying the PSUs that were granted to certain key employees during the six months ended June 30, 2015 totaled 2,300,824 shares and had a weighted average grant date fair value of \$6.59 per share. No PSUs were granted in the three months ended June 30, 2015. As of June 30, 2015, 100% of the PSUs are expected to vest.

As of June 30, 2015, we had a total of approximately \$53.9 million of unrecognized compensation costs related to RSUs and PSUs that is expected to be recognized over the remaining weighted average period of 1.8 years.

## Note 10. Income Taxes

We recorded an income tax provision of approximately \$0.4 million and \$0.7 million for the three and six months ended June 30, 2015, respectively, and an income tax benefit of approximately \$1.4 million and \$1.2 million for the three and six months ended June 30, 2014, respectively. The income tax provision for the three and six months ended June 30, 2015 was primarily due to state and foreign income tax expense and federal tax expense related to the tax amortization of acquired goodwill. The income tax benefit for the three and six months ended June 30, 2014 was the result of the release of valuation allowance resulting from our acquisition of InstaEDU, offset by foreign and state income tax expense.

## Note 11. Restructuring Charges

## 2015 Restructuring Plan

For the three and six months ended June 30, 2015, we recorded restructuring charges of \$0.5 million and \$3.0 million, respectively, related to the closure of our print coupon business and our Kentucky warehouse. The charges include one-time employee termination benefits for approximately 71 employees of \$0.3 million and \$1.1 million during the three and six months ended June 30, 2015, respectively, and lease termination and other costs of \$0.2 million and \$1.8 million for the three and six months ended June 30, 2015, respectively. As a result of the expanded partnership with Ingram, we expect to exit our warehouse facilities by the end of 2015. We expect to incur additional charges in 2015 under the restructuring plan related to these exit activities and related severance costs of approximately \$5.3 million. Costs incurred to date related to employee

Table of Contents

termination benefits are expected to be paid within the next six months. Costs incurred to date related to the lease termination and other costs are expected to be fully paid by 2021.

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

	Workforce Reduction Costs	Lease Termination and Other Costs	Total
Balances at January 1, 2015	\$—	\$—	\$—
Restructuring charges	1,135	1,843	2,978
Cash payments	(612)	(367)	(979)
Write-offs	—	(338)	(338)
Balances at June 30, 2015	\$523	\$ 1,138	\$1,661

As of June 30, 2015, the \$1.7 million liability was comprised of a short-term accrual of \$1.0 million included within accrued liabilities and a long-term accrual of \$0.7 million included within other liabilities on the condensed consolidated balance sheet.

#### Note 12. Related-Party Transactions

Our Chief Executive Officer is a member of the Board of Directors of Adobe Systems (Adobe). During the three and six months ended June 30, 2015, we had purchases of \$0.8 million and \$0.9 million, respectively, and during the three and six months ended June 30, 2014, we had purchases of \$0.3 million and \$0.7 million, respectively, of products from Adobe. We had \$0.1 million in revenues in the three and six months ended June 30, 2015 and \$0.2 million and \$1.0 million in revenues in the three and six months ended June 30, 2014, respectively, from Adobe. We had \$0.1 million in payables as of December 31, 2014 to Adobe. We had \$0.1 million in outstanding accounts receivables to Adobe as of June 30, 2015.

One of our board members is also a member of the Board of Directors of Cengage Learning (Cengage). During the three and six months ended June 30, 2015, we had purchases of \$1.9 million and \$6.2 million, respectively, and during the three and six months ended June 30, 2014 we had purchases of \$0.5 million and \$6.4 million, respectively, of products from Cengage. We had \$0.1 million in payables as of December 31, 2014 to Cengage. We had \$0.1 million in outstanding accounts receivables to Cengage as of December 31, 2014.

One of our board members is the Chief Executive Officer of Shutterfly Inc. (Shutterfly). During the six months ended June 30, 2015, we had purchases of \$1.1 million of products from Shutterfly. We had \$0.1 million and an immaterial amount in revenues in the three and six months ended June 30, 2015, respectively, and \$0.1 million in revenues in the three and six months ended June 30, 2014 from Shutterfly. We had an immaterial amount in outstanding accounts receivables to Shutterfly as of June 30, 2015.

The terms of our contracts with the above related parties are consistent with our contracts with other independent parties.

Table of Contents

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 Information" of this Quarterly Report on Form 10-Q and our audited consolidated financial statements included in our Annual Report on Form 10-K. In addition to historical condensed 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 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. By helping students learn more in less time and at a lower cost, we are improving 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 rent and sell eTextbooks. Students can subscribe to our digital services, such as Chegg Study, which provides Textbook Solutions and Q&A, helping students with their course work. When students are really stuck, they can reach a live tutor online, anytime, anywhere through our Chegg Tutors service. Finally, we provide access to internships to help students gain skills which are critical to securing their first job.

To deliver services to students, we partner with a variety of third parties. We work with colleges who rely on us 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 and growing 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. In addition, because we have a large and growing student user base, local and national brands partner with us to reach the college and high school demographic.

During the three and six months ended June 30, 2015, we generated net revenues of \$67.1 million and \$151.9 million, respectively, and in the same periods had net losses of \$10.1 million and \$38.7 million, respectively. During the three and six months ended June 30, 2014, we generated net revenues of \$64.5 million and \$138.9 million, respectively, and in the same periods had net losses of \$8.2 million and \$34.0 million, respectively. We plan to continue to invest in our long-term growth, particularly further investment in the technology that powers our 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 use our digital offerings to increase student engagement with our connected learning platform. We plan to continue to invest in the expansion of our digital offerings to provide a more compelling and personalized solution and deepen engagement with students. 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 the 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 higher margin digital offerings, 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 our digital offerings and other factors described in greater detail in “Risk Factors.”

## Table of Contents

### Strategic Partnership with Ingram

We expect our partnership with Ingram to accelerate the growth of our higher margin digital offerings while allowing us to maintain our leadership and brand recognition in print textbook rental. We entered into a definitive inventory purchase and consignment agreement with Ingram in April 2015 that we expect will allow us to exit the capital intensive aspects of our print textbook rental business and to focus exclusively on our digital offerings by 2017. Under the agreement, since May 1, 2015, Ingram has been responsible for all new investments in the textbook library, fulfillment logistics, and has title and risk of loss related to textbook rentals. As a result of our partnership with Ingram, our revenue includes a commission on the total revenue that we earn from Ingram upon their fulfillment of a rental transaction using books for which Ingram has title and risk of loss. Additionally, we have ceased making additional investments in our textbook library during 2015 and expect to rent and liquidate our existing inventory of books during the remainder of 2015 and 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 pure digital offerings model, 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 provide Ingram with extended payment terms in 2015 and 2016 as we procure textbooks on behalf of Ingram, before moving to normal payment terms in 2017.

### Our Print Textbook Business

Our print textbook rental business has been highly capital intensive. As a result of our expanded partnership with Ingram, we expect to exit our warehouse facilities in Kentucky by the end of 2015 and transition our textbook library to Ingram's facilities which will help to free up resources historically required by this business. We will continue to liquidate our textbook library through the normal course of our rental operations and expect to be fully liquidated at the end of 2016. Until that point, we will continue to rent textbooks and to recognize revenue on the textbooks that we own as print revenue through the liquidation period. Once our entire textbook library has been liquidated all revenue from textbook rentals will be commission-based and we will no longer report on revenue from our print offerings as all of the revenue will be classified as services revenue.

We capitalize the investment in our textbook library and record depreciation expense in cost of revenues over its useful life using an estimated liquidation value. During the six months ended June 30, 2015 and June 30, 2014, our investment in print textbooks, net of proceeds from textbook liquidation, was \$8.6 million and \$34.0 million, respectively. Investment in our print textbooks, net of proceeds from textbook liquidations, in the six months ended June 30, 2015 decreased and is expected to continue to decrease through 2016 as a result of our partnership with Ingram.

We use our website to liquidate textbooks from our textbook library, which allows us to generate greater recovery on our 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 textbooks allows us to reduce the investments necessary to maintain the rental catalog while at the same time attracting students to our website by offering them more for their textbooks than they could generally get by selling them back to their campus bookstore.

### Our Digital Offerings Business

Our digital learning and advertising offerings, which we refer to as "digital offerings" are experiencing rapid growth and we expect our partnership with Ingram to accelerate the growth of these offerings while allowing us to maintain our leadership and brand recognition in print textbook rental. Our digital offerings for students include our connected learning platform, or the Student Hub, our web-based, multiplatform eTextbook Reader, eTextbooks and supplemental



materials 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, online tutoring, our Chegg Study service, College Admissions, Scholarship Services and Internship Services. Commissions earned through our Ingram partnership are also included within the digital offerings business. 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 Adobe, Dell, Microsoft, PayPal, Proctor & Gamble, Red Bull and Shutterfly, 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 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.

Table of Contents

Students typically pay to access eTextbooks for the academic term or subscribe for other 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 digital offerings were 45% and 42% of net revenues during the three and six months ended June 30, 2015, respectively, and 29% and 26% of net revenues during the three and six months ended June 30, 2014.

Seasonality of Our Business

A substantial majority of our revenue is recognized ratably over the term the student rents our textbooks or has access to our digital offerings. This generally results in our highest revenue in the fourth quarter as it reflects more days of the academic year and our lowest revenue in the second quarter as colleges conclude their academic year for summer and there are fewer days of rentals. 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 through the remainder of 2015 and 2016 as we transition shipping and fulfillment activities related to textbooks to Ingram. As a result of these factors, the most concentrated periods for our revenue 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 expanded strategic partnership with Ingram to shift peak revenue in the periods that a student rents a textbook as a result of our revenue sharing agreement such that our revenue will more closely track the academic calendar as our expenses associated with the textbook rental business decrease.

Table of Contents

## Results of Operations

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

	Three Months Ended June 30,			Six Months Ended June 30,								
	2015		2014		2015		2014					
Net revenues:												
Rental	\$32,782	49	%	\$42,257	66	%	\$70,496	46	%	\$89,113	64	%
Services	29,276	44	%	18,599	29	%	60,643	40	%	35,845	26	%
Sales	5,003	7	%	3,636	6	%	20,794	14	%	13,927	10	%
Total net revenues	67,061	100	%	64,492	100	%	151,933	100	%	138,885	100	%
Cost of revenues <sup>(1)</sup> :												
Rental	21,238	32	%	29,889	46	%	59,793	39	%	77,586	56	%
Services	9,975	15	%	4,912	8	%	21,812	14	%	12,568	9	%
Sales	5,043	8	%	3,795	6	%	20,144	13	%	13,927	10	%
Total cost of revenues	36,256	54	%	38,596	60	%	101,749	67	%	104,081	75	%
Gross profit	30,805	46	%	25,896	40	%	50,184	33	%	34,804	25	%
Operating expenses <sup>(1)</sup> :												
Technology and development	13,268	20	%	12,189	19	%	29,412	19	%	23,509	17	%
Sales and marketing	12,382	18	%	14,817	23	%	33,774	22	%	29,844	21	%
General and administrative	11,943	18	%	10,654	17	%	23,720	16	%	20,494	15	%
Restructuring charges	464	1	%	—	—	%	2,978	2	%	—	—	%
Loss (gain) on liquidation of textbooks	2,445	4	%	(2,122)	(3)	%	(1,740)	(1)	%	(3,800)	(3)	%
Total operating expenses	40,502	60	%	35,538	55	%	88,144	58	%	70,047	50	%
Loss from operations	(9,697)	(14)	%	(9,642)	(15)	%	(37,960)	(25)	%	(35,243)	(25)	%
Total interest expense and other income, net	(4)	—	%	29	—	%	11	—	%	88	—	%
Loss before provision for (benefit from) income taxes	(9,701)	(14)	%	(9,613)	(15)	%	(37,949)	(25)	%	(35,155)	(25)	%
Provision for (benefit from) income taxes	430	(1)	%	(1,367)	2	%	724	—	%	(1,150)	1	%
Net loss	\$(10,131)	(15)	%	\$(8,246)	(13)	%	\$(38,673)	(25)	%	\$(34,005)	(24)	%

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

Cost of revenues	\$81	\$134	\$215	\$312
Technology and development	1,273	2,635	5,980	5,017
Sales and marketing	1,034	2,263	6,088	3,595
General and administrative	5,443	3,449	10,568	6,487
Total share-based compensation expense	\$7,831	\$8,481	\$22,851	\$15,411



Table of Contents

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

## Net Revenues

Net revenues in the three months ended June 30, 2015 increased \$2.6 million, or 4%, compared to the same period in 2014. Rental revenue decreased \$9.5 million or 22%, while service revenue increased \$10.7 million, or 57%, and sale revenue increased \$1.4 million, or 38%.

Net revenues in the six months ended June 30, 2015 increased \$13.0 million, or 9%, compared to the same period in 2014. Rental revenue decreased \$18.6 million or 21%, while service revenue increased \$24.8 million, or 69%, and sale revenue increased \$6.9 million, or 49%.

The decrease in rental revenue in the three and six months ended June 30, 2015 as compared to the same period in 2014 was due to our partnership with Ingram, which commenced in July 2014. As a result of the Ingram partnership, our service revenue and digital offerings revenue is comprised of a commission on the total revenue that we earn from Ingram upon their fulfillment of a rental transaction using books for which Ingram has title and risk of loss. The increase in services and sales revenue in the three and six months ended June 30, 2015 as compared to the same period in 2014 was driven primarily from growth across our digital offerings for students which included increased revenue from Chegg Study, commissions earned from Ingram, and our various acquisitions in 2014.

The following table sets forth our net revenues for the periods shown, in addition to revenue details for our print textbook business and digital offerings business (dollars in thousands):

	Three Months Ended		Change		
	June 30,		\$	%	
	2015	2014			
Print textbooks	\$36,849	\$45,796	(8,947	) (20	)%
Digital offerings	30,212	18,696	11,516	62	
Net revenues	\$67,061	\$64,492	\$2,569	4	%
	Six Months Ended		Change		
	June 30,		\$	%	
	2015	2014			
Print textbooks	\$88,198	\$102,421	(14,223	) (14	)%
Digital offerings	63,735	36,464	27,271	75	
Net revenues	\$151,933	\$138,885	\$13,048	9	%

The increase in net revenues in the three and six months ended June 30, 2015 compared to the same periods in 2014 was the result of a 62% and 75% increase, respectively, in digital offerings due to growth in new memberships for our Chegg Study service, revenue from acquisitions that we completed toward the end of the first half of 2014, an increase in eTextbook volumes as well as our commission earned from Ingram related to textbook rentals. Digital offerings represented 45% and 42% of net revenues during the three and six months ended June 30, 2015, respectively and 29% and 26% of net revenues during the three and six months ended June 30, 2014, respectively. This increase was partially offset by a decrease during the three and six months ended June 30, 2015 compared to the same period in 2014 in print textbook revenue of 20% and 14%, respectively, primarily due to our partnership with Ingram. Because we record the commission we earn from Ingram as digital offerings revenue and service revenue, we expect our print textbook revenue and rental revenue to continue to decrease throughout 2015 as we transition investments in the textbook library and logistics and fulfillment for print textbook rental orders to Ingram. We expect by the end of 2016 we will have substantially liquidated our textbook library through the normal course of our rental operations.



Table of Contents

## Cost of Revenues

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

	Three Months Ended		Change		
	June 30,			%	
	2015	2014	\$		%
Cost of revenues <sup>(1)</sup>	\$36,256	\$38,596	\$(2,340)	)	(6)%

<sup>(1)</sup> Includes share-based compensation expense of: \$81      \$134      \$(53)      ) (40)      )%

	Six Months Ended		Change		
	June 30,			%	
	2015	2014	\$		%
Cost of revenues <sup>(1)</sup>	\$101,749	\$104,081	\$(2,332)	)	(2)%

<sup>(1)</sup> Includes share-based compensation expense of: \$215      \$312      \$(97)      ) (31)      )%

Cost of revenues in each of the three and six months ended June 30, 2015 decreased by \$2.3 million compared to the same periods in 2014. As a result, gross margins increased to 46% and 33% in the three and six months ended June 30, 2015, respectively from 40% and 25% in the three and six months ended June 30, 2014, respectively, as digital offerings continue to become a larger percentage of our business. Further, as we move towards Ingram taking title and risk of loss for the textbook inventory needed to fulfill all print textbooks rentals and sales, we anticipate our print related cost of revenues will continue to decrease and our total gross margins will continually increase to be more in-line with gross margins we experience for digital offerings today.

## Operating Expenses

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

	Three Months Ended		Change		
	June 30,			%	
	2015	2014	\$		%
Technology and development <sup>(1)</sup>	\$13,268	\$12,189	\$1,079		9%
Sales and marketing <sup>(1)</sup>	12,382	14,817	(2,435)	)	(16)%
General and administrative <sup>(1)</sup>	11,943	10,654	1,289		12%
Restructuring charges	464	—	464		n/m
Loss (gain) on liquidation of textbooks	2,445	(2,122)	) 4,567		(215)%
	\$40,502	\$35,538	\$4,964		14%

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

Technology and development	\$1,273	\$2,635	\$(1,362)	)	(52)%
Sales and marketing	1,034	2,263	(1,229)	)	(54)%
General and administrative	5,443	3,449	1,994		58%
Share-based compensation expense	\$7,750	\$8,347	\$(597)	)	(7)%

Table of Contents

	Six Months Ended		Change		
	2015	2014	\$	%	
Technology and development <sup>(1)</sup>	\$29,412	\$23,509	\$5,903	25	%
Sales and marketing <sup>(1)</sup>	33,774	29,844	3,930	13	
General and administrative <sup>(1)</sup>	23,720	20,494	3,226	16	
Restructuring charges	2,978	—	2,978	n/m	
Gain on liquidation of textbooks	(1,740	) (3,800	) 2,060	(54	)
	\$88,144	\$70,047	\$18,097	26	%

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

Technology and development	\$5,980	\$5,017	\$963	19	%
Sales and marketing	6,088	3,595	2,493	69	
General and administrative	10,568	6,487	4,081	63	
Share-based compensation expense	\$22,636	\$15,099	\$7,537	50	%

---

n/m - not meaningful

### Technology and Development

Technology and development expenses during the three months ended June 30, 2015 increased \$1.1 million, or 9%, compared to the same period in 2014. During the three months ended June 30, 2015 our employee-related expenses and expenses for outside services increased \$1.4 million and \$0.4 million, respectively, compared to the same period in 2014 which was partially offset by a decrease in share-based compensation expense of \$1.4 million. Technology and development as a percentage of net revenues was 20% during the three months ended June 30, 2015 compared to 19% during the three months ended June 30, 2014.

Technology and development expenses during the six months ended June 30, 2015 increased \$5.9 million, or 25%, compared to the same period in 2014. During the six months ended June 30, 2015 our employee-related expenses and share-based compensation expenses increased \$3.0 million and \$1.0 million, respectively, compared to the same period in 2014. In addition, expenses for outside services increased \$1.1 million and web hosting and software licensing fees increased \$0.4 million compared to the six months ended June 30, 2014. Technology and development as a percentage of net revenues was 19% during the six months ended June 30, 2015 compared to 17% during the six months ended June 30, 2014.

### Sales and Marketing

Sales and marketing expenses during the three months ended June 30, 2015 decreased by \$2.4 million, or 16%, compared to the same period in 2014. The decrease is primarily attributable to a decrease in our employee-related expenses, share-based compensation, and office expenses of \$1.1 million, \$1.2 million, and \$0.5 million, respectively, compared to the three months ended June 30, 2014. The decrease was partially offset by the amortization of our intangibles which increased \$0.4 million related to acquisitions completed in 2014. Sales and marketing expenses as a percentage of net revenues decreased to 18% during the three months ended June 30, 2015 compared to 23% during the three months ended June 30, 2014.

Sales and marketing expenses during the six months ended June 30, 2015 increased by \$3.9 million, or 13%, compared to the same period in 2014. The increase is primarily attributable to an increase in share-based compensation which increased \$2.5 million compared to the six months ended June 30, 2014. In addition, amortization of our intangibles increased \$1.4 million related to acquisitions completed in 2014. Sales and marketing expenses as a percentage of net revenues increased to 22% during the six months ended June 30, 2015 compared to



21% during the six months ended June 30, 2014.

26

---

Table of Contents

## General and Administrative

General and administrative expenses in the three months ended June 30, 2015 increased \$1.3 million, or 12%, compared to the same period in 2014. The increase was due to higher employee-related expenses and share-based compensation expenses which increased \$0.3 million and \$2.0 million, respectively, compared to the three months ended June 30, 2014, which was partially offset by a decrease in professional fees, office expenses, and insurance of \$0.3 million, \$0.3 million, and \$0.1 million, respectively. General and administrative expenses as a percentage of net revenues increased to 18% during the three months ended June 30, 2015 compared to 17% during the three months ended June 30, 2014.

General and administrative expenses in the six months ended June 30, 2015 increased \$3.2 million, or 16%, compared to the same period in 2014. The increase was due to higher employee-related expenses and share-based compensation expenses which increased \$0.9 million and \$4.1 million, respectively, compared to the six months ended June 30, 2014, which was partially offset by a decrease in professional fees, office expenses, and insurance of \$0.9 million, \$0.2 million, and \$0.3 million, respectively. General and administrative expenses as a percentage of net revenues increased to 16% during the six months ended June 30, 2015 compared to 15% during the six months ended June 30, 2014.

## Restructuring Charges

During the three and six months ended June 30, 2015, we incurred restructuring charges of \$0.5 million and \$3.0 million, respectively, resulting from the closure of our print coupon business and the expected closure of our warehouse in Kentucky. The restructuring charges were comprised of employee severance of \$0.3 million and \$1.1 million for the three and six months ended June 30, 2015, respectively, and lease termination and other contractual termination charges of \$0.2 million and \$1.8 million for the three and six months ended June 30, 2015, respectively. As a result of the expanded partnership with Ingram, we expect to exit our warehouse facilities by the end of 2015. We expect to incur additional charges in 2015 under the restructuring plan related to these exit activities and related severance costs of approximately \$5.3 million. We expect costs savings from the expected closure of our warehouse in Kentucky to be realized beginning in the first quarter of 2016. Costs incurred to date related to employee termination benefits are expected to be paid within the next six months. 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 June 30, 2015 we had a net loss on liquidations of \$2.4 million and during the three months ended June 30, 2014 we had a net gain on liquidations of \$2.1 million resulting from proceeds received from liquidation of previously rented print textbooks on our website and through various other liquidation channels. The loss during the three months ended June 30, 2015 is the result of liquidating more books that had a higher net book value at a lower average liquidation amount per book.

In the six months ended June 30, 2015 and 2014, we had a net gain on liquidations of \$1.7 million and \$3.8 million, respectively, resulting from proceeds received from liquidation of previously rented print textbooks on our website and through various other liquidation channels.

## Interest Expense and Other Income, Net

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

Three Months Ended June 30,	Change
--------------------------------	--------

Edgar Filing: CHEGG, INC - Form 10-Q

	2015	2014	\$	%	
Interest expense, net	\$(60 )	\$(127 )	\$67	(53 )	%
Other income, net	56	156	(100 )	(64 )	)
Total interest expense and other income, net	\$(4 )	\$29	\$(33 )	(114 )	%

27

---

Table of Contents

	Six Months Ended		Change	
	June 30,			
	2015	2014	\$	%
Interest expense, net	\$(121 )	\$(188 )	\$67	(36 )%
Other income, net	132	276	(144 )	(52 )
Total interest expense and other income, net	\$11	\$88	\$(77 )	(88 )%

Interest expense, net decreased during the three and six months ended June 30, 2015 compared to the same period in 2014. In the six months ended June 30, 2014, we reduced our line of credit to \$40.0 million which resulted in a write-off of loan costs in that period.

Other income, net during the three and six months ended June 30, 2015 and June 30, 2014 was primarily due to the interest earned on our investments.

## Provision for (benefit from) Income Taxes

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

	Three Months Ended		Change	
	June 30,			
	2015	2014	\$	%
Provision for (benefit from) income taxes	\$430	\$(1,367 )	\$1,797	(131 )%
	Six Months Ended		Change	
	June 30,			
	2015	2014	\$	%
Provision for (benefit from) income taxes	\$724	\$(1,150 )	\$1,874	(163 )%

We recorded an income tax provision of approximately \$0.4 million and \$0.7 million for the three and six months ended June 30, 2015, respectively, and an income tax benefit of approximately \$1.4 million and \$1.2 million for the three and six months ended June 30, 2014, respectively. The income tax provision for the three and six months ended June 30, 2015, was primarily due to state and foreign income tax expense and federal tax expense related to the tax amortization of acquired goodwill. The income tax benefit for the three and six months ended June 30, 2014 was the result of the release of valuation allowance resulting from our acquisition of InstaEDU, offset by foreign and state income tax expense.

Table of Contents

## Liquidity and Capital Resources

As of June 30, 2015 our principal sources of liquidity were cash, cash equivalents and investments totaling \$67.2 million, which were held for working capital purposes. Our cash equivalents and investments are composed primarily of commercial paper, corporate securities, U.S. government treasuries and money market funds. We also have \$40.0 million available under our Revolving Credit Facility with an accordion feature subject to certain financial criteria that would allow us to increase the amount available to \$75.0 million in total. The Revolving Credit Facility expires in August 2016. As of June 30, 2015, we had no amounts outstanding under the Revolving Credit Facility.

As a result of our expanded strategic partnership with Ingram, 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 provide Ingram with extended payment terms in 2015 and 2016 for the purchase of 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 \$14.8 million as of June 30, 2015. As a result of our partnership with Ingram, we anticipate to have significantly more working capital.

During the six months ended June 30, 2015 and 2014, our investment in print textbooks, net of proceeds from textbook liquidations, was \$8.6 million and \$34.0 million, respectively.

As of June 30, 2015, we have incurred cumulative losses of \$308.5 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 IPO.

We believe that our existing sources of liquidity will be sufficient to fund our operations, debt service and repayment obligations 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 and cash equivalents, investments 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.

As of June 30, 2015 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.

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

	Six Months Ended	
	June 30,	
	2015	2014
Condensed Consolidated Statements of Cash Flows Data:		
Net cash (used in) provided by operating activities	\$(13,059 )	\$22,598
Net cash used in investing activities	(10,165 )	(66,834 )
Net cash provided by (used in) financing activities	2,194	(1,845 )

## Cash Flows from Operating Activities

We incurred net losses and negative cash flows from operating activities during the six months ended June 30, 2015 and net losses and positive cash flows from operating activities during the six months ended June 30, 2014, which was primarily the result of our expanded partnership with Ingram, where we continue to buy books on Ingram's behalf,

while providing them with extended payment terms over the next two years. Cash flows from operating activities are also influenced by the increase in expenses we incur to support the growth in our business. The substantial majority of our net revenue is 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. As a result, changes in our operating accounts are generally a source of cash overall, although they can be a use of cash in the second and fourth quarters of each year as payables become due and new bookings are generally at their low point. In addition, we have significant non-cash operating expenses such as textbook library depreciation expense, other depreciation and amortization expense and share-based compensation expense.

## Table of Contents

Net cash used by operating activities during the six months ended June 30, 2015 was \$13.1 million. Our net loss of \$38.7 million was partially offset by significant non-cash operating expenses, including textbook library depreciation expense of \$27.5 million, other depreciation and amortization expense of \$6.5 million, share-based compensation expense of \$22.9 million and loss from write-offs of textbooks of \$3.6 million.

Net cash provided by operating activities during the six months ended June 30, 2014 was \$22.6 million. Although we incurred a net loss of \$34.0 million, our net loss was more than offset by significant non-cash operating expenses, including textbook library depreciation expense of \$38.1 million, other depreciation and amortization expense of \$4.7 million, share-based compensation expense of \$15.4 million and loss from write-offs of textbooks of \$6.8 million.

### Cash Flows from Investing Activities

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

Net cash used in investing activities during the six months ended June 30, 2015 was \$10.2 million and was primarily used for the purchases of textbooks of \$31.3 million, purchases of investments of \$17.1 million and purchases of property and equipment of \$4.1 million, partially offset by proceeds from the sale or maturity of investments of \$19.7 million and proceeds from the liquidation of textbooks of \$22.7 million.

Net cash used in investing activities during the six months ended June 30, 2014 was \$66.8 million and was primarily used for the acquisition of businesses of \$43.9 million, purchase of textbooks of \$52.8 million, purchase of investments of \$54.9 million and purchase of property and equipment of \$2.5 million, partially offset by proceeds from the sale or maturity of investments of \$68.5 million and proceeds from liquidation of textbooks of \$18.7 million.

### Cash Flows from Financing Activities

Net cash provided by financing activities during the six months ended June 30, 2015 was \$2.2 million and was primarily related to the proceeds from the exercise of stock options totaling \$10.5 million partially offset by the payment of \$7.5 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.

Net cash used in financing activities during the six months ended June 30, 2014 was \$1.8 million and was primarily related to the payment of \$3.6 million in taxes related to the net share settlement of RSUs which became fully vested during the period partially offset by the issuance of common stock from our 2013 ESPP totaling \$1.7 million.

### Contractual Obligations and Other Commitments

As a result of our expanded partnership with Ingram and plan to exit the Kentucky warehouse by the end of 2015, we signed an agreement on April 10, 2015 to sublease effectively one half of our warehouse in Kentucky. We expect this sublease agreement to generate \$0.1 million of sublease income per month through the end of November 2016.

### Off-Balance Sheet Arrangements

Through June 30, 2015, 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.

#### Critical Accounting Policies, Significant Judgments and Estimates

Our condensed consolidated financial statements are prepared in accordance with 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, revenue, 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.



Table of Contents

There have been no material changes in our critical accounting policies and estimates during the six months ended June 30, 2015 as compared to the critical accounting policies and estimates disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in our Annual Report on Form 10-K.

Recent Accounting Pronouncements

There have been no material changes to the recent accounting pronouncements as compared to recent accounting pronouncements described in Note 2 – Significant Accounting Policies in the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our market risk during the six months ended June 30, 2015, compared to the disclosures in “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

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.

Table of Contents

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, from time to time, we may 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, from time to time, also 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. Due to the preliminary status of the appeal by the Kentucky Department of Revenue and the uncertainties related to the appeal, we are unable to evaluate the likelihood of either a favorable or unfavorable outcome. We believe that it is reasonably possible that we will incur a loss; however, we cannot currently estimate a range of any possible losses we may experience in connection with this case. Accordingly, we are unable at this time to estimate the effects of this matter on our financial condition, results of operations, or cash flows.

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 condensed 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.

#### Risks Related to Our Business and Industry

Our limited operating history makes 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 revenue at scale from print textbook rentals until 2010. We began transitioning to a new model for our print textbook business in August 2014 through our strategic partnership with Ingram and recently entered into a new inventory purchase and consignment agreement with Ingram in April 2015 to accelerate our transition away from the more capital intensive aspects of the print textbook rental business. We expect to cease maintaining a textbook library and to be a fully

Table of Contents

digital business by 2017. We continue to market, use our branding and maintain the customer experience around print textbook rentals, while Ingram is responsible for funding all new textbook inventory, fulfillment, logistics, and have title and risk of loss related to textbook rentals with respect to 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 our print textbook rental business to Ingram.

Since July 2010, we also have been focused on expanding our digital 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, 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 digital 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;
- compete with companies that offer similar services or products;
- expand into adjacent markets;
- develop a profitable business model and pricing strategy;
- navigate the ongoing evolution and uncertain application of regulatory requirements, such as privacy laws, to our innovative business;
- maintain relationships with strategic partners, including Ingram and other distributors, publishers, wholesalers, colleges and brands;
- 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.

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 June 30, 2015 and 2014 were \$10.1 million and \$8.2 million, respectively, and for the six months ended June 30, 2015 and 2014 were \$38.7 million and \$34.0 million, respectively. As of June 30, 2015, we had an accumulated deficit of \$308.5 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 revenue sufficiently to offset these higher expenses, and our efforts to grow the business may prove more

Table of Contents

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, slowing demand for 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, difficulties, complications and delays and other unknown factors as we pursue our business plan and our business model continues to evolve. While our revenue has 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 print textbook and digital offerings models to improve the predictability of our revenue. For example, we expect the expansion of our partnership with Ingram to allow us to transition substantially all of our revenue to revenue from digital offerings 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 our business model is evolving. 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 revenue from our print textbook business. During the three months ended June 30, 2015 and 2014, this business accounted for 55% and 71% of our revenue, respectively, and 58% and 74% for the six months ended June 30, 2015 and 2014, respectively. The print textbook rental business is highly capital intensive and presents both business planning and logistical challenges that are complex. To reduce our investment in the highly capital intensive print textbook rental business, we have entered into a partnership with Ingram wherein Ingram makes all new investments in the textbook library, taking title and risk of loss for the books, and provides logistical and fulfillment services for the books 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 and fulfillment and logistics operations. As a result of this change to our model, we stopped making additional investments in our textbook library beginning in May 2015 and we expect to rent and liquidate our existing inventory of books during 2015 and 2016. We expect the transition of these aspects of our print textbook business to Ingram to be complete by 2017. Our partnership with Ingram is non-exclusive and subject to significant risks, including our ability to transition logistical and fulfillment activities to Ingram and liquidate our inventory of textbooks in a cost-effective manner, Ingram's ability to acquire textbooks and manage logistical and fulfillment activities for us, our ability to create a successful and profitable partnership, and that we and/or Ingram may elect to terminate the partnership sooner than anticipated.

The growth of our print textbook rental business is also subject to risks as a result of the changes taking place more generally in the publishing industry and the increasing shift towards digital content. To the extent eTextbooks increase in popularity and demand for print textbooks declines, we anticipate that more and more eTextbooks will be published and distributed in the retail market, which could reduce the demand for print textbooks and materially and adversely affect our operating results. For example, publishers have significant flexibility in pricing eTextbooks due to their low production costs and may change their pricing strategies in the future, especially in light of increasing competition in the print textbook market and the rising costs of education. If the retail price of eTextbooks were to be significantly lower than print textbooks, consumers may purchase eTextbooks directly from the publisher or other retailers rather than use our print textbook or eTextbook services. In the short term, this would have a negative effect on our ability to generate revenue from our print textbook business and could result in our inability to achieve financial return targets set forth in the agreement with Ingram, which could result in additional payments to Ingram and adversely affect our results of operations. In addition, the transition to eTextbooks will greatly reduce the capital requirements that currently serve as a barrier to entry in the textbook distribution market, may result in increased competition and may require us to make significant changes to our business model.

We have added and plan to continue to add new digital offerings to our platform to diversify our sources of revenue, which will require us to make substantial investments in the products and services we develop or acquire. New digital offerings may not achieve market success at levels that recover our investment or contribute to profitability. Because digital 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 digital 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 revenue, margins and profitability. For all of these reasons, the evolution of our business model is ongoing and the future revenue and income potential of our business is uncertain.

## Table of Contents

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 majority 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 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, or Ingram, have to process during these limited periods of time means that any shortfalls or disruptions in our business 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 revenue fluctuates significantly quarter to quarter depending upon the timing of where we are in our “rush” cycle and sequential quarter-over-quarter comparisons of our revenue 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 digital offerings, which includes the commissions we earn from our partnership with Ingram, are relatively new and, as a result, we have limited experience with forecasting revenues from them.

The fourth quarter is typically our highest performing quarter as we are recognizing a full quarter of revenue from peak volumes in August and September and partial revenue from peak volumes in December, while the second quarter typically is our lowest performing quarter as students start their summer vacations and the volume of textbook rentals and sales and purchases of supplemental materials and Chegg Study decreases. Because of our reliance on the academic calendar, we expect this seasonal fluctuation of sequential revenue decline from the fourth to the first then second quarters, followed by sequential increases in the third and fourth quarters, to continue in future periods.

We base our operating expense budgets on expected net revenue trends. Operating expenses, similar to revenue 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 textbook acquisition, shipping, other fulfillment and marketing expense in connection with our peak periods at the beginning of each academic term. We expect these expenses to decrease as we transition textbook acquisition, shipping and fulfillment activities to Ingram. Because our revenue is 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 comparison of our financial results may not be meaningful. In addition, 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 is expected to result in our operating expenses related to textbook acquisition, shipping and fulfillment and warehouse facility lease obligations to decrease and for 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 revenue shortfall. Accordingly, any shortfall in net revenues may cause significant variation in operating results in any quarter.

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

We currently rely on Ingram to make new investments in the textbook library and fulfill a portion of our print textbook rentals and sales orders and we expect to fully rely on Ingram for such activities by 2017. As we continue to



focus on reducing the expense and investment necessary to support our print textbook business, we have become increasingly committed to our strategic partnership. If our continuing relationship with Ingram is interrupted or if Ingram experiences disruptions in its business or is not able perform as anticipated, or we experience problems with the transition of inventory and logistics and fulfillment activities to Ingram, we may experience operational difficulties, an inability to fulfill print textbook orders, increased costs and a loss of business, as well a greater than expected deployment of capital for textbook acquisition, that may have a material adverse effect on our business and results of operations and financial condition.

## Table of Contents

If our efforts to attract new students and increase student engagement with our 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 revenue 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 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 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 digital offerings compared to those of our competitors;
- our ability to engage high school students with our College Admissions and Scholarship Services;
- changes in student spending levels;
- the effectiveness of our sales and marketing efforts;
- our ability to introduce new products and services that are favorably received by students; and
- the rate of adoption of eTextbooks and our ability to capture a significant share of that market.

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 revenue 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 revenues will be adversely affected.

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 revenue 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 revenue, 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, personal computer and mobile 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 other publicity companies that utilize online platforms for advertising and marketing purposes;
- 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.

## Table of Contents

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

Our ability to attract and retain students and increase their engagement with our 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, we acquired our tutoring service in the acquisition of InstaEDU in June 2014 and our internships service in the acquisition of Internships.com in October 2014. 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 or operating experience or may significantly change our existing products and services. If our new or enhanced products and services fail to engage our 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 revenue, operating margin or other value to justify our investments, and our business may be adversely affected. In the future, we may invest in new products and services and other initiatives to generate revenue, but there is no guarantee these approaches will be successful.

Acquisitions of new companies and products create integration risk, while development of new products and services and enhancements to existing products and services involves significant time, labor and expense and is 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 revenue as anticipated or recover any associated development costs, and our financial results could be adversely affected. For example, in 2014 we acquired, but later determined that we would not continue to support or look to expand our print coupon business 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.

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 platform. A strong brand also helps to counteract the significant student turnover we experience from year to year as students graduate.

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

- maintain our reputation as a trusted source of content and services for students;
- maintain the quality of and improve our existing products and services;
- continue to 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 InstaEDU brand and the students who use InstaEDU.com, and the Internships.com brand and the students who use Internships.com into the Chegg brand and Chegg.com.

Our ability to successfully achieve these goals is not entirely within our control and 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 products and services;
- concern from colleges about the ways students use our content offerings, such as our Q&A 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;
- 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; and

Table of Contents

• 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 with our print textbook business.

Our future revenue depends 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. 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 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 revenue 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 platform.

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 students 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 business 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 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 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, operations and personnel of any company that we acquire, particularly if key personnel of the acquired company decide not to work for us;

## Table of Contents

- an acquisition may disrupt our ongoing business, divert resources, increase our expenses and distract our management;
- an acquisition may result in a delay in adoption rates or reduction in 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;
- 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, business and assets can be complex and time consuming to integrate. For example, we recently expanded into online tutoring with the acquisition of InstaEDU in June 2014 and internships with the acquisition of Internships.com in October 2014. We are currently in the process of transitioning the InstaEDU and Internships.com users to the Chegg platform and integrating these brands into Chegg. We may not successfully transition these users to the Chegg platform.

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, but later determined that we would not continue to support or look to expand our print coupon business 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 and require substantial restrictions on the conduct of our business. If we fail to successfully complete any acquisitions, integrate the services, products or technologies associated with such acquisitions into our company, or identify and address liabilities associated with the acquired business or assets, our business, revenue and operating results could be adversely affected. Any future acquisitions we complete may not achieve our goals.

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 students and increase their engagement with our platform, particularly at the beginning of each academic term;
- the rate of adoption of our digital offerings;
- changes in demand for print textbook rentals;
- 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 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 our 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 our shipping center and those of our partners, 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 and technology resulting from acquisitions;
- governmental regulation and taxation policies; and
- general economic conditions and economic conditions specific to higher education.

## Table of Contents

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 textbook library based on our expectations regarding numerous factors, including ongoing demand for these titles in print form. To realize a return on these 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 the 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 our textbook library. These factors are highly unpredictable and can fluctuate substantially, especially if pricing competition 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 us or our fulfillment partner 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 returns damaged books, or if we for any other reason anticipate inaccurately and cause our fulfillment partner to acquire insufficient copies of specific textbooks, we may be unable to satisfy student demand or we may have to incur significantly increased cost 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 our fulfillment partner 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 or damaged prematurely Ingram may not be able to recover its costs or generate revenue 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.

Prior to the Ingram partnership, our print textbook business was highly capital intensive, and our use of cash to invest in our textbook library has historically 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 the new expanded partnership with Ingram, we may require additional financing, particularly if the investment required to fund our print textbook business is greater than we anticipated 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 terms when required, or at all especially considering that we will no longer possess a 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.

## Table of Contents

If our relationships, or 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.

We and Ingram predominantly rely on United Parcel Service (UPS) to deliver textbooks from our textbook warehouse and to return textbooks to us from our students. To a lesser extent we and Ingram rely on FedEx for delivery of print textbook rentals and on publishers, distributors and wholesalers to fulfill textbook sales orders and liquidations. As a result, our print textbook business is 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. In addition, if our shipping vendors increased shipping costs for our textbooks, our gross profit could be affected adversely if we elect not to raise our rental rates to offset the increase. If UPS were to limit its services or delivery areas, such as by the discontinuation of Saturday delivery service, our ability and Ingram's ability to timely deliver textbooks could diminish, and our student satisfaction could be adversely affected. If our or Ingram's relationships with our shipping vendors are terminated or impaired or if our or Ingram's shipping vendors are unable to deliver merchandise for us, we or Ingram would be required to rely on alternative carriers for delivery and return shipments of textbooks to and from students. We or Ingram may be unable to sufficiently engage alternative carriers on a timely basis or on terms favorable to us, 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, online marketplaces such as Amazon.com, eBay.com and Half.com and providers of eTextbooks such as Apple iTunes, Blackboard and Google, 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 print textbook business competes primarily on price. Our eTextbook business 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 digital offerings, our competitors include companies that offer students study materials and educational content such as publishers, Web Assign and other tutorial services, 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 and Internet 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.

**Brand Advertising.** With respect to brands, we compete with online and offline outlets that generate revenue 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 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 eliminate our ability to compete favorably with our print textbook rental business because of the added convenience they offer to students, which may result in reduced textbook rentals, loss of market share and reduced revenue. In addition, our competitors also may form or extend strategic alliances with publishers that could adversely affect our fulfillment partner'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

Table of Contents

our digital 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 our 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 business.

We use complex proprietary software to process deliveries and returns of our 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 of textbooks from and returns of textbooks to our warehouse 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 and a decrease in revenue.

We rely on computer systems housed in two facilities, one located on the East Coast and one 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 could 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 and result in a loss of revenue.

We rely on third-party software and service providers, including AWS, to provide systems, storage and services 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 revenue or incur substantial recovery costs and distract management from operating our business. AWS may terminate its agreement with us upon 30 day 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.

Table of Contents

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 our operating results and financial condition.

We expect 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 or prevent us or 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 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 independent contractors and temporary personnel to supplement our workforce primarily in our warehouse and student advocacy organizations. Competition for qualified personnel has historically been intense, and we may be unable to adequately staff our warehouse and student advocacy organizations 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 a book, which could lead to customer dissatisfaction, and the amount of time required to process a rental return, which could result in us purchasing more inventory than necessary. Moreover, UPS and FedEx, the third-party carriers that we rely 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 revenue.

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 system. 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 beginnings 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 platform is accessible and delivers a satisfactory user experience to students.

It is important to our success that students be able to access our 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, human or software errors and capacity constraints due to an overwhelming number of students accessing our platform simultaneously. If our 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 revenue, 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, 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.

Table of Contents

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 revenue any of which could adversely affect our business and financial results.

Growing our student user base and their engagement with our 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 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 application 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 revenue could 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 may 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. We do not have long-term contracts or arrangements with most publishers that guarantee the availability of eTextbooks. If we are unable to secure and maintain rights to distribute eTextbooks to students upon terms that are acceptable to us, or if publishers terminate their agreements with us, we would not be able to acquire eTextbooks 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 eTextbooks 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

Table of Contents

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 consumers 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 providers of mobile application "store fronts" 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' 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 without advertising 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 the student 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;

the 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

Table of Contents

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 United States 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 revenue. 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. 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. This act does not apply to general audience Internet websites but it is not

Table of Contents

clear how this Act 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 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 digital 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. In the future, 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 to be 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, state and other laws 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. 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 Federal Trade Commission and the 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,

Table of Contents

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 on-line, 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 directed to children under 13, 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 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. Similarly, if a well-publicized breach of the consumer data security of any other major consumer website were to occur, there could be a general public loss of confidence in the use of the Internet for commerce transactions which could adversely affect our business. 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 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.

Table of Contents

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 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 this Act. 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 laws pertaining to this Act change, we may be subject to potential liability for caching or hosting, or for listing or linking to, 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, monitor potentially infringing content of which we become aware. 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. For example, in September 2011, a copyright infringement claim was brought against us in connection with our acquisition of Student of Fortune, which we settled in October 2011. A subsequent copyright infringement claim also related to the Student of Fortune business was brought against us in February 2013, which we settled in June 2013. Separately, we decided to discontinue the Student of Fortune business and shut down the website in August 2013. 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 results.

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 June 30, 2015, we had nine patents and 31 patent applications pending, primarily in the United States and ten patents pending internationally. We own six 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 the registered U.S. trademarks “Chegg,” “Chegg.com,” “Chegg for Good,” “CourseRank,” “Cramster,” “InstaEDU,” “Internships.com”, “Zinch” and “#1 In Textbook Rentals,” among others, as well as a variety of service marks. We own over 550 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;
- 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.

Table of Contents

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 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.

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.

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.

Table of Contents

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

We currently own over 550 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 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 business and operating results.

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 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 customer categories 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 Israel, India and the People's Republic of China (China), we indirectly contract with individuals in the Ukraine and we expect to continue to expand our international operations in the future. 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;

Table of Contents

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 could slow, student engagement could decrease and we could lose revenue. 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.

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. Our textbook warehouse is located in Shepherdsville, Kentucky, which is adjacent to a flood zone. We store our textbook library in a single location in Kentucky and 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 our warehouse and our textbook library, our 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.

Table of Contents

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.

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. The Kentucky Department of Revenue filed an appeal to the Circuit Court ruling in December 2014 (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 are currently under tax audit in India for the 2011-12 fiscal year. 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, 2014, we had federal and state net operating loss carryforwards due to prior period losses of approximately \$96.9 million and \$56.5 million, respectively, which if not utilized will begin to expire in 2028 and 2015 for federal and state purposes, respectively. At December 31, 2014, we also had federal tax credit carryforwards of approximately \$2.5 million, which if not utilized will begin to expire in 2030, and state tax credit carryforwards of approximately \$2.7 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 credit facility could have a material adverse effect on us.

We have an outstanding \$40.0 million revolving credit facility with an accordion feature subject to certain financial criteria that would allow us to borrow up to \$75.0 million in total, with Bank of America as lender and letter of credit issuer that

## Table of Contents

expires in August 2016. We currently have no amount drawn down under our credit facility. If we default on our credit obligations, our lenders may, among other things, require immediate repayment of amounts drawn on our credit facilities, terminate our credit facilities or require us to pay significant fees, penalties or damages.

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;
- 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;
- enter into secured financing arrangements;
- enter into sale and leaseback transactions; and
- enter into unrelated businesses.

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 \$4.82 to \$11.25 through June 30, 2015. 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 revenue 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 revenue generated by our digital 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;
- 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; 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, the 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.

Table of Contents

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 this offering, (b) in which we have total annual gross revenue 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;

Table of Contents

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

Use of Proceeds from Registered Securities

On November 12, 2013, our registration statement on Form S-1 (File No. 333-190616) was declared effective by the SEC for our IPO pursuant to which we sold an aggregate of 15,000,000 shares of our common stock at a price to the public of \$12.50 per share. During the three months ended June 30, 2015, there were no material changes to our use of proceeds from our IPO as described in our final prospectus filed with the SEC on November 13, 2013 pursuant to Rule 424(b) and we used the remaining proceeds for general corporate purposes, including working capital and capital expenditures and to acquire or invest in complementary businesses, products, services, technologies or assets.

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.

Table of Contents

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.

August 6, 2015

CHEGG, INC.

By: /S/ ANDREW BROWN

Andrew Brown

Vice President, Chief Financial Officer

(Duly Authorized Officer and Principal Financial Officer)

Table of Contents

## Index to Exhibits

Exhibit No.	Exhibit	Incorporated by Reference			Exhibit No.	Filed Herewith
		Form	File No	Filing Date		
10.01†	2015 Inventory Purchase and Consignment Agreement dated April 3, 2015, by and among Ingram Hosting Holdings Inc., the Company and Ingram Book Group Inc.					X
10.02	Third Amendment to Credit Agreement, dated August 3, 2015, by and among Bank of America, N.A. and the domestic subsidiaries of Chegg, Inc.					X
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 (Securities Act) or the Exchange Act.					
†	Confidential treatment has been requested for portions of this exhibit pursuant to Rule 24b-2 promulgated under the Exchange Act. These portions have been omitted and submitted separately to the Securities and Exchange Commission.					