CHEGG, INC
Form 10-Q
November 07, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2014

or

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

Commission file number 001-36180

CHEGG, INC.

(Exact name of registrant as specified in its charter)

Delaware	20-3237489
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification no.)
3990 Freedom Circle	
Santa Clara, CA	95054
(Address of principal executive offices)	(Zip Code)

(408) 855-5700

(Registrant’s telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock, $0.001 par value per share	The New York Stock Exchange

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

None

(Title of class)

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x (Do not check if a smaller reporting company)	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 x

As of October 31, 2014, there were 83,849,487 shares of the registrant’s common stock outstanding.

TABLE OF CONTENTS

		Page
	PART I – FINANCIAL INFORMATION	
Item 1.	Financial Statements (unaudited):	3
	Condensed consolidated balance sheets—September 30, 2014 and December 31, 2013	3
	Condensed consolidated statements of operations—three and nine months ended September 30, 2014 and 2013	4
	Condensed consolidated statements of comprehensive loss—three and nine months ended September 30, 2014 and 2013	5
	Condensed consolidated statements of cash flows—nine months ended September 30, 2014 and 2013	6
	Notes to condensed consolidated financial statements	7
Item 2.	Management's discussion and analysis of financial condition and results of operations	18
Item 3.	Quantitative and qualitative disclosures about market risk	27
Item 4.	Controls and procedures	27
	PART II – OTHER INFORMATION	
Item 1.	Legal proceedings	28
Item 1A.	Risk factors	28
Item 2.	Unregistered sales of equity securities and use of proceeds	51
Item 6.	Exhibits	51
Signature		52
Index to Exhibits		53

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

“Campus Special,” “Chegg,” “Chegg.com,” “Chegg for Good,” “CourseRank,” “Cramster,” “InstaEDU,” “Zinch” and “#1 in T 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.

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,” “plan to,” and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in Part II, Item 1A, “Risk Factors” in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

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

PART i – FINANCIAL INFORMATION

Item 1. Financial Statements

CHEGG, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

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

	September 30, 2014	December 31, 2013 *
Assets	(unaudited)	
Current assets:		
Cash and cash equivalents	$ 53,186	$ 76,864
Short-term investments	30,035	37,071
Accounts receivable, net of allowance for doubtful accounts of $835 and $317 at September 30, 2014 and December 31, 2013, respectively	15,758	7,091
Prepaid expenses	3,391	2,134
Other current assets	8,679	1,149
Total current assets	111,049	124,309
Long-term investments	14,124	24,320
Textbook library, net	105,205	105,108
Property and equipment, net	18,298	18,964
Goodwill	86,685	49,545
Intangible assets, net	10,972	3,311
Other assets	1,800	1,814
Total assets	$ 348,133	$ 327,371
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 6,063	$ 4,078
Deferred revenue	72,462	22,804
Accrued liabilities	29,563	21,270
Total current liabilities	108,088	48,152
Long-term liabilities		
Other liabilities	5,315	4,979
Total long-term liabilities	5,315	4,979
Total liabilities	113,403	53,131
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, $0.001 par value –10,000,000 shares authorized, no shares issued and	—	—

outstanding at September 30, 2014 and December 31, 2013, respectively		
Common stock, $0.001 par value – 400,000,000 shares authorized at September 30, 2014 and December 31, 2013, respectively; 83,738,790 and 81,708,202 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	84	82
Additional paid-in capital	506,208	479,279
Accumulated other comprehensive loss	(1)	(6)
Accumulated deficit	(271,561)	(205,115)
Total stockholders' equity	234,730	274,240
Total liabilities and stockholders' equity	$ 348,133	$ 327,371

*Derived from audited consolidated financial statements as of and for the year ended December 31, 2013
See Notes to Condensed Consolidated Financial Statements.

CHEGG, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net revenues	$81,532	$61,587	$220,417	$178,459
Cost of revenues	68,281	58,425	172,362	137,486
Gross profit	13,251	3,162	48,055	40,973
Operating expenses:				
Technology and development	13,490	9,999	36,999	29,351
Sales and marketing	23,453	14,223	53,297	36,645
General and administrative	10,986	6,247	31,480	20,530
Gain on liquidation of textbooks	(2,044)	(2,403)	(5,844)	(3,012)
Total operating expenses	45,885	28,066	115,932	83,514
Loss from operations	(32,634)	(24,904)	(67,877)	(42,541)
Interest and other income (expense), net:				
Interest expense, net	(67)	(1,306)	(255)	(3,662)
Other income (expense), net	541	(2,840)	817	(3,688)
Total interest and other income (expense), net	474	(4,146)	562	(7,350)
Loss before provision for (benefit from) income taxes	(32,160)	(29,050)	(67,315)	(49,891)
Provision for (benefit from) income taxes	281	205	(869)	542
Net loss	$(32,441)	$(29,255)	$(66,446)	$(50,433)
Net loss per share, basic and diluted	$(0.39)	$(2.27)	$(0.80)	$(4.04)
Weighted average shares used to compute net loss per share, basic and diluted	83,688	12,873	82,963	12,488

See Notes to Condensed Consolidated Financial Statements.

Chegg, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net loss	$(32,441)	$(29,255)	$(66,446)	$(50,433)
Other comprehensive (loss) income:				
Net change in unrealized gain (loss) on available for sale investments	(18)	—	20	—
Change in foreign currency translation adjustments	(11)	12	(15)	(35)
Other comprehensive (loss) income	(29)	12	5	(35)
Total comprehensive loss	$(32,470)	$(29,243)	$(66,441)	$(50,468)

See Notes to Condensed Consolidated Financial Statements.

CHEGG, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2014	2013
Operating activities		
Net loss	$ (66,446)	$ (50,433)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Textbook library depreciation expense	54,220	45,287
Amortization of warrants and deferred loan costs	152	1,516
Other depreciation and amortization expense	7,823	8,080
Stock-based compensation expense	27,205	11,888
Provision for bad debts	516	194
Gain on liquidation of textbooks	(5,844)	(3,012)
Loss from write-offs of textbooks	10,133	3,289
Deferred income taxes	(1,626)	—
Realized gain on sale of securities	(18)	—
Revaluation of preferred stock warrants	—	3,906
Change in assets and liabilities net of effect of acquisition of businesses:		
Accounts receivable	(3,633)	(2,382)
Prepaid expenses and other current assets	(8,356)	(1,156)
Other assets	(147)	(4,087)
Accounts payable	(319)	2,605
Deferred revenue	49,528	52,115
Accrued liabilities	4,826	4,285
Other liabilities	(12)	46
Net cash provided by operating activities	68,002	72,141
Cash flows from investing activities		
Purchases of textbooks	(99,469)	(108,492)
Proceeds from liquidations of textbooks	40,175	32,555
Purchases of marketable securities	(63,872)	—
Proceeds from sale of marketable securities	42,708	—
Maturities of marketable securities	38,230	—
Purchases of property and equipment	(3,807)	(5,204)
Acquisition of businesses, net of cash acquired	(43,872)	—
Net cash used in investing activities	(89,907)	(81,141)
Cash flows from financing activities		
Proceeds from debt obligations	—	21,000
Payments of debt obligations	—	(20,000)
Proceeds from issuance of common stock under employee stock plans	2,001	2,897
Payment of taxes related to the net share settlement of RSUs	(3,774)	—
Net cash (used in) provided by financing activities	(1,773)	3,897

Net decrease in cash and cash equivalents	(23,678)	(5,103)
Cash and cash equivalents, beginning of period	76,864	21,030
Cash and cash equivalents, end of period	$ 53,186	$ 15,927
Cash paid during the period for:		
Interest	$ 88	$ 2,338
Income taxes	$ 518	$ 388
Non-cash investing and financing activities:		
Accrued purchases of long-lived assets	$ 6,736	$ 7,576
Issuance of common stock warrants in connection with consulting services	$ —	$ 130
Issuance of common stock related to acquisition	$ 1,585	$ —

See Notes to Condensed Consolidated Financial Statements.

CHEGG, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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, which we call the Student Hub, offers products and services that students need throughout the college lifecycle, from choosing a college through graduation and beyond. Our Student Graph builds on the information generated through students' and other participants' use of our platform to increasingly enrich the experience for participants as it grows in scale and power the Student Hub. 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 2013, nearly seven million students used our platform.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of September 30, 2014, the condensed consolidated statements of operations and, the condensed consolidated statements of comprehensive loss for the three and nine months ended September 30, 2014 and 2013, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2014 and 2013 and the related footnote disclosures are unaudited. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, including normal recurring adjustments, necessary to present fairly our financial position as of September 30, 2014 and our results of operations for the three and nine months ended September 30, 2014 and 2013 and cash flows for the nine months ended September 30, 2014. The results of operations for the three and nine months ended September 30, 2014 and cash flows for the nine months ended September 30, 2014 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, 2013 as 2013.

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 for 2013, included in our Annual Report on Form 10-K for 2013 filed with the U.S. Securities and Exchange Commission (SEC).

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

Reverse Stock Split

In August 2013, our board of directors and stockholders approved an amendment to our certificate of incorporation to effect a two-for-three reverse split of our common stock. The record date of the reverse stock split was September 3, 2013, the date the amendment to our certificate of incorporation was filed with the Delaware Secretary of State. In accordance with our certificate of incorporation, the conversion ratios of the convertible preferred stock were adjusted to reflect the reverse stock split. The number of outstanding shares of convertible preferred stock was not adjusted. Additionally, the par value and the authorized shares of common stock and convertible preferred stock were not adjusted as a result of the reverse stock split. The reverse stock split has been reflected in the accompanying consolidated financial statements and related notes on a retroactive basis for all periods presented.

Initial Public Offering

In November 2013, we completed our initial public offering (IPO), whereby 14.4 million shares of common stock were sold to the public at a price of $12.50 per share.

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 assets and 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 related to our textbook library, valuation of preferred stock warrants, and stock-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.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (ASU 2014-09). This standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 provides companies with two implementation methods. Companies can choose to apply the standard retrospectively to each prior reporting period presented (full retrospective application) or retrospectively with the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings of the annual reporting period that includes the date of initial application (modified retrospective application). This guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is not permitted. We are currently in the process of evaluating this new guidance.

Note 2. Net Loss per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested common stock subject to repurchase or forfeiture. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including stock options, warrants, RSUs and convertible preferred stock prior to its conversion in our IPO, 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 basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended	Nine Months Ended
	September 30,	September 30,

	2014	2013	2014	2013
Numerator:				
Net loss	$(32,441)	$(29,255)	$(66,446)	$(50,433)
Denominator:				
Weighted-average common shares outstanding	83,704	13,054	83,010	12,745
Less: Weighted-average unvested common shares subject to repurchase or forfeiture	(16)	(181)	(47)	(257)
Weighted-average common shares used in computing basic and diluted net loss per share	83,688	12,873	82,963	12,488
Net loss per share, basic and diluted	$(0.39)	$(2.27)	$(0.80)	$(4.04)

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Options to purchase common stock	13,936	13,054	14,592	13,362
Restricted stock units	334	1,313	355	1,313
Common stock subject to repurchase or forfeiture	9	131	9	131
Warrants to purchase common stock	996	36	996	36
Warrants to purchase convertible preferred stock	—	1,130	—	1,130
Convertible preferred stock	—	42,244	—	42,244
Total common stock equivalents	15,275	57,908	15,952	58,216

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

The following tables show our cash and cash equivalents, restricted cash and investments' adjusted cost, unrealized gain (loss) and fair value (in thousands):

	September 30, 2014			December 31, 2013		
	Cost	Net Unrealized Gain/(Loss)	Fair Value	Cost	Net Unrealized Gain/(Loss)	Fair Value
Cash and cash equivalents:						
Cash	$46,300	$ —	$46,300	$33,322	$ —	$33,322
Money market funds	5,696	—	5,696	42,042	—	42,042
Commercial paper	1,190	—	1,190	1,500	—	1,500
Total cash and cash equivalents	$53,186	$ —	$53,186	$76,864	$ —	$76,864
Short-term investments:						
Commercial paper	$18,859	$ —	$18,859	$35,571	$ —	$35,571
Corporate securities	8,171	4	8,175	—	—	—
Certificate of deposit	3,000	1	3,001	1,500	—	1,500
Total short-term investments	$30,030	$ 5	$30,035	$37,071	$ —	$37,071
Long-term investments:						
Corporate securities	$13,130	$ (6)	$13,124	$24,338	$ (18)	$24,320
Agency bond	999	1	1,000	—	—	—

Total long-term investments	$14,129	$ (5)	$14,124	$24,338	$ (18)	$24,320
Short-term restricted cash	$352	$ —	$352	$352	$ —	$352
Long-term restricted cash	1,350	—	1,350	1,350	—	1,350
Total restricted cash	$1,702	$ —	$1,702	$1,702	$ —	$1,702

The amortized cost and fair value of available-for-sale investments as of September 30, 2014 by contractual maturity were as follows (in thousands):

	Cost	Fair Value
Due in 1 year or less	$31,220	$31,225
Due in 1-2 years	14,129	14,124
Investments not due at a single maturity date	5,696	5,696
Total	$51,045	$51,045

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

As of September 30, 2014, 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 nine 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 nine months ended September 30, 2014, we did not recognize any impairment charges.

Note 4. Fair Value Measurement

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

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

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

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

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

Financial instruments measured and recorded at fair value on a recurring basis as of September 30, 2014 and December 31, 2013 are classified based on the valuation technique level in the tables below (in thousands):

	September 30, 2014			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Money market funds	$5,696	$ 5,696	$ —	$ —

Commercial paper	1,190	—	1,190	—
Short-term investments:				
Commercial paper	18,859	—	18,859	—
Corporate securities	8,175	—	8,175	—
Certificate of deposit	3,001	—	3,001	—
Long-term investments:				
Corporate securities	13,124	—	13,124	—
Agency bond	1,000	—	1,000	—
Total assets measured and recorded at fair value	$51,045	$ 5,696	$ 45,349	$ —
Liabilities:				
Put option liability	$1,588	$ —	$ —	$ 1,588

	December 31, 2013			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Money market funds	$42,042	$ 42,042	$ —	$ —
Commercial paper	1,500	—	1,500	—
Short-term investments:				
Commercial paper	35,571	—	35,571	—
Certificate of deposit	1,500	—	1,500	—
Corporate securities, long-term	24,320	—	24,320	—
Total assets measured and recorded at fair value	$104,933	$ 42,042	$ 62,891	$ —
Liabilities:				
Put option liability	$1,521	$ —	$ —	$ 1,521

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

The following table summarizes the change in the fair value of our Level 3 liabilities (in thousands):

	Level 3 September 30, 2014
Beginning balance	$ 1,521
Vesting of put options	271
Fair value adjustment related to put options	(204)
Total financial liabilities	$ 1,588

As of September 30, 2014, we did not have observable inputs for the valuation of our put option liability, which relates to a previous acquisition, and provides certain employees of the acquired company the right to require us to acquire vested common shares at a stated contractual price. As shares associated with these put options vest, the liability is recognized as stock-based compensation expense in our condensed consolidated statements of operations and results in a change in our Level 3 liabilities.

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. Acquisitions

On June 5, 2014, we acquired 100% of the outstanding shares and voting interest of InstaEDU, Inc. (InstaEDU), headquartered in San Francisco, California. With this acquisition, we aimed to expand our digital offerings to help students excel in school by including real time tutoring services. We see the acquisition of InstaEDU as a method to connect the book offering and service offerings of Chegg together. The total fair value of the purchase consideration was $31.1 million in cash, which included $4.5 million that was placed into escrow, for indemnification against breaches of general representations and warranties, and will be released 18 months from the closing date of the acquisition.

On April 9, 2014, we acquired 100% of the outstanding shares and voting interest of The Campus Special, LLC and The Campus Special Food, LLC (together, the Campus Special), headquartered in Duluth, Georgia for a total fair value purchase consideration of $16.0 million, consisting of $14.0 million in cash and 250,000 shares of our common stock, and all of such shares of our common stock were placed in escrow for indemnification against breaches of general representations and warranties and will be released one year from closing date, and a fair value contingent consideration of additional shares of common stock, which is payable on the attainment of certain performance metrics. With the Campus Special acquisition, we aimed to expand our offerings to students to include coupon specials on consumer goods and services. The probability-weighted fair value contingent consideration was recorded in other accrued liabilities in our condensed consolidated balance sheet as of the date of acquisition, and we will record any future fair value adjustments to other acquisition costs.

On March 7, 2014, we acquired certain assets from Bookstep LLC, (Bookstep) to expand our technical resources and research and development capabilities. The total fair value of the purchase consideration was $0.5 million. The acquisition agreement requires us to pay approximately $2.5 million in cash, payable over two years, contingent upon the continuation of services by a certain number of consultants during the period after acquisition. The fair value of these subsequent payments was $2.5 million, which is being accounted for as post-combination compensation expense.

The acquisition date fair value of the consideration for the above three transactions consisted of the following as of September 30, 2014 (in thousands):

Cash consideration	$45,537
Fair value of stock escrow consideration	1,585
Fair value of stock contingent consideration	193
Fair value of purchase consideration	$47,315

The fair value of the intangible assets acquired was determined under the acquisition method of accounting for business combinations. The excess of purchase consideration paid over the fair value of identifiable intangible assets acquired was recorded as goodwill.

The following table summarizes the fair value of the net identifiable assets acquired in the first nine months of 2014 (in thousands):

	2014
Cash	$1,667
Other acquired assets	415
Acquired intangible assets:	
Developed technology	3,894
Customer list	2,720
Trade name	2,390
Non-compete agreements	1,310
Corporate partnerships	243
Master services agreement	400
Total acquired intangible assets	10,957
Total identifiable assets acquired	13,039

Liabilities assumed	(2,864)
Net identifiable assets acquired	10,175
Goodwill	37,140
Net assets acquired	$47,315

For the nine months ended September 30, 2014, we incurred $0.6 million of acquisition-related expenses associated with the three acquisitions which have been included in general and administrative expenses in the condensed consolidated statements of operations.

The results of operations of the above acquisitions have been included in our condensed consolidated results of operations from the date of acquisition and were not material to our results of operations.

The amounts recorded for goodwill related to the Campus Special and Bookstep transactions are expected to be deductible for tax purposes. The amount recorded for goodwill related to the InstaEDU transaction is not deductible for tax purposes.

Note 6. Goodwill and Intangible Assets

Goodwill consists of the following (in thousands):

	September 30, 2014
Beginning balance	$ 49,545
Additions due to acquisition	37,140
Ending balance	$ 86,685

Intangible assets consist of the following (in thousands):

	September 30, 2014			
	Weighted-Average Amortization Period (in months)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	51	$ 9,512	$ (4,417)	$ 5,095
Customer list	26	3,312	(1,248)	2,064
Trade name	44	3,132	(932)	2,200
Non-compete agreements	24	1,318	(250)	1,068
Master service agreement	36	400	(75)	325
Corporate partnerships	60	243	(23)	220
Total intangible assets		$ 17,917	$ (6,945)	$ 10,972

	December 31, 2013			
	Weighted-Average Amortization Period (in months)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	46	$ 8,008	$ (5,386)	$ 2,622
Customer list	24	5,472	(5,029)	443

Trade name	33	1,182	(942)	240
Non-compete agreements	34	1,068	(1,062)	6
Total intangible assets		$ 15,730	$ (12,419)	$ 3,311

During the three and nine months ended September 30, 2014, amortization expense related to our acquired intangible assets totaled approximately $1.7 million and $3.3 million, respectively. During the three and nine months ended September 30, 2013, amortization expense related to our acquired intangible assets totaled approximately $1.0 million and $3.7 million, respectively.

As of September 30, 2014, the estimated future amortization expense related to our intangible assets, subject to amortization, is as follows (in thousands):

Remaining three months of 2014	$ 1,434
2015	4,297
2016	2,078
2017	1,586
2018	1,204
Thereafter	373
Total	$ 10,972

Note 7. Debt Obligations

In May 2012, we entered into a term loan facility with the aggregate principal of $20.0 million, ("the Term Loan"), with interest payable on a monthly basis at the rate of 11.5%. In connection with the Term Loan, we issued preferred stock warrants to the lender. In August 2013, we repaid the loan in full, including the outstanding principal balance of $20.0 million and an end-of-term fee of $850,000.

In August 2013, we entered into a revolving credit facility with an aggregate principal amount of $50.0 million (the Revolving Credit Facility). On June 30, 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 draw down to $75.0 million in total. 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 on August 12, 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 stock-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 September 30, 2014, we were in compliance with these financial covenants. In August 2013, we drew down $21.0 million in proceeds from the Revolving Credit Facility and with these proceeds we repaid in full our Term Loan outstanding principal balance of $20.0 million. In October 2013, we drew down an additional $10.0 million in proceeds from the Revolving Credit Facility. In November 2013, we repaid in full our $31.0 million outstanding balance of the Revolving Credit Facility.

Note 8. Commitments and Contingencies

We lease our office and warehouse facilities under operating leases, which expire at various dates through 2019. Our primary operating lease commitments at September 30, 2014, related to our headquarters in Santa Clara, California and our warehouse in Shepardsville, 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. Rental expense, net of sublease income, was approximately $0.9 million and $0.7 million in the three months ended September 30, 2014 and 2013, respectively, and $2.5 million and $2.1 million in the nine months ended September 30, 2014 and 2013, 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 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 on July 23, 2013 and the Board issued a ruling in favor of the Department of Revenue on January 13, 2014. On February 7, 2014, we filed an appeal to the Franklin Circuit Court in Kentucky and on June 17, 2014 the court held in abeyance our motion to appeal. On October 29, 2014 the Franklin Circuit Court in Kentucky issued its opinion and order in Chegg's challenge in the Kentucky Board of Tax Appeals decision regarding Chegg's property tax assessment. The Circuit Court ruling reversed the Board of Tax Appeal's decision setting aside the Kentucky Department of Revenue's tax assessments against Chegg and further vacated all penalties and interest. The Kentucky Department of Revenue has 30 days to file an appeal to the Circuit Court ruling. Due to the preliminary status and uncertainties related to this matter, 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.

Note 9. Guarantees and Indemnifications

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

Note 10. Stock-Based Compensation

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Cost of revenues	$160	$126	$472	$422
Technology and development	3,235	1,530	8,252	4,874
Sales and marketing	4,476	564	8,071	2,063
General and administrative	3,923	1,637	10,410	4,529
Total stock-based compensation expense	$11,794	$3,857	$27,205	$11,888

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 the input of subjective assumptions.

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 September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Expected term (years)	5.98	6.07	5.97
Expected volatility	57.37 %	56.15 %	57.29 %
Dividend yield	0.00 %	0.00 %	0.00 %
Risk-free interest rate	1.71 %	1.91 %	1.20 %
Weighted-average grant-date fair value per share	$ 7.31	$ 3.82	$ 5.25

No options awards were granted to employees in the three months ended September 30, 2014.

Fair Value of Restricted Stock Units (RSUs)

Restricted stock units are converted into shares of Chegg common stock upon vesting on a one-for-one basis. Vesting of restricted stock units is subject to the employee's continuing service to the Company. The compensation expense related to these awards 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. Restricted stock units are typically fully vested at the end of four years.

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 option-pricing model.

Stock Option Activity

Option activity under our option plans was as follows:

	Options Outstanding		
	Number of Options Outstanding	Weighted-Average Exercise Price per Share	Aggregate Intrinsic Value
Balance at December 31, 2013	17,971,969	$ 8.35	$22,253,373
Granted	640,138	7.09	
Exercised	(635,745)	1.63	
Cancelled	(2,411,866)	8.51	
Balance at September 30, 2014	15,564,496	$ 7.42	$5,247,243

As of September 30, 2014, our total unrecognized compensation expense for stock options granted to employees, officers, directors, and consultants was approximately $27.2 million, which will be recognized over a weighted-average vesting period of approximately 2.1 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 in the three and nine months ended June 30, 2014 or 2013. Total stock-based compensation expense for consultants was not significant for the three and nine months ended June 30, 2014 or 2013.

There was no capitalized stock-based compensation expense as of September 30, 2014 or 2013.

Restricted Stock Units Activity

	Restricted Stock Units Outstanding Number of RSUs Outstanding		Weighted Average Grant Date Fair Value
Balance at December 31, 2013	1,479,898		$ 10.01
Granted	9,562,990		6.22
Released	(1,402,563	)	9.78
Cancelled	(329,064	)	6.61
Balance at September 30, 2014	9,311,261		$ 6.27

During the nine months ended September 30, 2014, 1,285,619 RSUs granted prior to our IPO vested, respectively, and were settled for shares of our common stock. Of those shares, we withheld 527,805 shares valued at approximately $3.6 million 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. During the three months ended September 30, 2014, an insignificant amount RSUs granted prior to our IPO vested. 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 2014, the Compensation Committee of the Board of Directors (the Compensation Committee) approved a grant of performance-based restricted stock units (PSUs) under the 2013 Plan to certain of our executive officers. The PSUs entitle the executives to receive a certain number of shares of our common stock based on our satisfaction of certain financial and strategic performance goals, including net revenue growth, digital revenue growth and free cash flow during 2014 (the Performance Period). Based on the achievement of the performance conditions during the Performance Period for both the February grants, the final settlement of the PSU awards will range between none and 150% of the target shares underlying the PSU awards based on a specified objective formula approved by the Compensation Committee. If earned, the PSUs will vest annually over a three year period. In June 2014, the Compensation Committee approved a grant of PSUs under the 2013 Plan to the employees of InstaEDU, which are based on achieving certain revenue targets in years 2014 and 2015.

The target number of shares underlying the PSUs that were granted to certain executive officers during the nine months ended September 30, 2014, totaled 1,208,560 shares and had a weighted average grant date fair value of $6.37 per share. The target number of shares underlying the PSUs that were granted to certain employees of our InstaEDU acquisition during the nine months ended September 30, 2014 totaled 2,280,081 and had a weighted average grant date fair value of $6.00 per share. As of September 30, 2014, we expect that 100% of the PSUs will vest.

As of September 30, 2014, we had a total of approximately $35.0 million of unrecognized compensation costs related to RSUs and PSUs that is expected to be recognized over the remaining weighted average period of 2.1 years.

Note 11. Income Taxes

We recorded an income tax provision of approximately $0.3 million and an income tax benefit of $0.9 million for the three and nine months ended September 30, 2014, respectively and an income tax provision of $0.2 million and $0.5 million for the three and nine months ended September 30, 2013, respectively. The income tax provision in the three months ended September 30, 2014 was the result of foreign and state income tax expense. The income tax benefit of $0.9 million in the nine months ended September 30, 2014, was primarily the result of the release of valuation allowance resulting from our acquisition of InstaEDU, offset by foreign and state income taxes. The income tax expense in the three and nine months ended September 30, 2013 was due to state and foreign income tax expense.

Note 12. Related-Party Transactions

During the three and nine months ended September 30, 2014, we had purchases of $0.4 million and $0.8 million, respectively of products from Adobe Systems (Adobe). There were no purchases from Adobe in the three and nine months ended September 30, 2013. Further, we had no revenues in each of the three months ended September 30, 2014 and 2013 and $1.0 million and $0 in the nine months ended September 30, 2014 and 2013, respectively of products from Adobe for which our Chief Executive Officer is a member of the Board of Directors. As of September 30, 2014, we had no outstanding accounts receivable and $0.1 million payables to Adobe. There was no outstanding accounts receivable from and payable to Adobe as of December 31, 2013.

During the nine months ended September 30, 2014, one of our board members was appointed to the Board of Directors of Cengage Learning (Cengage). During the three and nine months ended September 30, 2014, we had purchases of $4.7 million and $10.8 million, respectively, of products from Cengage. As of September 30, 2014, we had accounts payable of $0.8 million and no outstanding accounts receivable from Cengage.

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

Note 13. Subsequent Events

On October 2, 2014, we acquired Internships.com, a division of CareerArc Group LLC. Pursuant to the terms of this purchase agreement, we paid a purchase consideration of approximately $10.0 million in cash and issued approximately 160,000 shares of our common stock, valued at $1.0 million as of the acquisition date, which is being withheld for indemnification against breaches of general representations and warranties and will be released 18 months from closing date. An estimate of the financial effect cannot be made as we are current assessing the impact to the financial statements as a result of this acquisition.

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 financial consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC. 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, 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, which we call the Student Hub, offers products and services that students need throughout the college lifecycle, from choosing a college through graduation and beyond. Our Student Graph builds on the information generated through students’ and other participants’ use of our platform to increasingly enrich the experience for participants as it grows in scale and power the Student Hub. By helping students learn more in less time and at a lower cost, we help them improve the overall return on investment in education.

We have an extensive print textbook and eTextbook library available for rent and sale. Our Chegg Study service helps students solve problems and master challenging concepts on their own. We also offer free services to students, such as helping high school students find colleges, scholarship opportunities and supplemental materials and services. These and other free services we offer are designed to round out the Student Hub as a one-stop destination for critical student needs. We intend to expand our user base to reach students beyond college, including graduate and professional school students and other lifelong learners.

We partner with other key constituents in the education ecosystem, such as publishers, colleges and brands, to provide a comprehensive, student-first connected learning platform. We currently 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 are working to become the digital distribution platform of choice for these publishers. We also partner with approximately 875 colleges in the United States to help them achieve greater efficiency in student recruiting by offering connections to interested students. We offer leading brands compelling marketing solutions for reaching the college demographic. As we continue to grow our platform, we believe it will become increasingly valuable to the education ecosystem and benefit publishers, content providers, colleges, educators and brands as they connect to our student user base.

Our digital learning and advertising offerings, which we refer to as “digital offerings” are experiencing rapid growth. During the three months ended September 30, 2014 and 2013, we generated net revenues of $81.5 million and $61.6 million, respectively, and in the same periods had net losses of $32.4 million and $29.3 million. During the nine months ended September 30, 2014 and 2013, we generated net revenues of $220.4 million and $178.5 million, respectively, and in the same periods had net losses of $66.4 million and $50.4 million. We plan to continue to invest in the long-term growth of the company, particularly further investment in the technology that powers the Student Hub and the Student Graph and in the development of products and services that serve students. On October 2, 2014, we acquired Internships.com, a division of CareerArc Group LLC. On June 5, 2014, we acquired InstaEDU, Inc., (InstaEDU) to expand our digital offerings to help students excel in school and has provided us a method to connect

Chegg's book offering and service offerings. On April 9, 2014, we acquired The Campus Special, LLC and The Campus Special Food, LLC (together, the Campus Special), a company offering local campus deals, serving students at over 500 universities nationwide, which we now call Chegg Deals, and continue to see future growth opportunity by expanding into local and national advertising. On March 7, 2014, we acquired Bookstep LLC, (Bookstep) to expand our technical resources and research and development capabilities. We cannot assure you that our newer products and services, or any other products and services we may introduce or acquire, will be integrated effectively into our business, achieve or sustain profitability or achieve market acceptance at levels sufficient to justify our investment.

Our strategy for achieving and maintaining profitability is centered upon our ability to expand the number of students using our products and services and increase student engagement with our connected learning platform. For the foreseeable future we expect to continue to invest in our print textbook business as a means of expanding student acquisition and generating operating cash flow. To deepen student engagement we will continue to invest in the expansion of our digital offerings to provide a more compelling and personalized solution. We believe this expanded and deeper penetration of the student demographic will allow us to drive 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 from our digital offerings and other factors described in greater detail in "Risk Factors."

Our Print Textbook Business

With our print textbook business, we purchase textbooks, rent them to students for the academic term at a substantial discount from list price to attract volume and realize return on our investment by renting the same book over multiple academic terms.

Our print textbook rental business is highly capital intensive. While we generate positive cash flows from operations on an annual basis, this has been more than offset by the cash we use for our investing activities, primarily due to the purchase of print textbooks. We expect this trend to continue in the foreseeable future. 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 nine months ended September 30, 2014, our investment in print textbooks, net of proceeds from textbook liquidation, was $59.3 million. We recently entered into an agreement whereby, for an initial period of eight months, Ingram Content Group (Ingram) will own and provide the fulfillment services for a portion of the books rented by our student customers. We expect Ingram will purchase approximately $25 million of textbooks during the initial period, some directly from Chegg and some in the open marketplace. As of September 30, 2014 Ingram has purchased approximately $18.0 million of textbooks during the initial period.

We also increasingly 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. As an example, in the second half of 2013, we elected to optimize our textbook library more for rental than liquidation in anticipation of greater rental demand for the winter rush cycle. This decision led to less site liquidations in that quarter of the books that typically have higher source cost recovery but also increased our available inventory of books for rent. We source 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 our textbook library 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. Through these refinements to our model, we have achieved greater overall efficiency, enabling us to lower our per unit rental rates, which has driven revenue growth and, to a greater extent, print textbook unit volumes beginning in 2012.

Our Digital Offerings Business

Our digital offerings for students include the Student Hub, our connected learning platform, 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 for students awaiting the arrival of their print textbook rental, online tutoring, our Chegg Study service, College Admissions, Career Counseling, Scholarship Services, and internship services. Commissions earned through our Ingram partnership are included within the digital offering 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, Microsoft, Red Bull and Serve from American Express, 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.

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. While none of our digital offerings individually has amounted to more than

10% of our net revenues to date, in the aggregate these offerings amounted to 32% and 28% of net revenues during the three and nine months ended September 30, 2014, respectively, up from less than 1% in 2010.

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. 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.

Results of Operations

The following table summarizes our historical consolidated statements of operations (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net revenues	$81,532	$61,587	$220,417	$178,459
Cost of revenues (1)	68,281	58,425	172,362	137,486
Gross profit	13,251	3,162	48,055	40,973
Operating expenses(1):				
Technology and development	13,490	9,999	36,999	29,351
Sales and marketing	23,453	14,223	53,297	36,645
General and administrative	10,986	6,247	31,480	20,530
Gain on liquidation of textbooks	(2,044)	(2,403)	(5,844)	(3,012)
Total operating expenses	45,885	28,066	115,932	83,514
Loss from operations	(32,634)	(24,904)	(67,877)	(42,541)
Interest and other income (expense), net	474	(4,146)	562	(7,350)
Loss before provision for (benefit from) income taxes	(32,160)	(29,050)	(67,315)	(49,891)
Provision for (benefit from) income taxes	281	205	(869)	542
Net loss	$(32,441)	$(29,255)	$(66,446)	$(50,433)
(1) Includes stock-based compensation expense as follows:				
Cost of revenues	$160	$126	$472	$422
Technology and development	3,235	1,530	8,252	4,874
Sales and marketing	4,476	564	8,071	2,063
General and administrative	3,923	1,637	10,410	4,529
Total stock-based compensation expense	$11,794	$3,857	$27,205	$11,888

The following table summarizes our historical condensed consolidated statements of operations data as a percentage of net revenues for the periods shown:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net revenues	100%	100 %	100%	100 %
Cost of revenues	84	95	78	77

Gross profit	16	5	22	23
Operating expenses:				
Technology and development	17	16	17	16
Sales and marketing	29	23	24	21
General and administrative	12	10	14	12
Gain on liquidation of textbooks	(3)	(4)	(3)	(2)
Total operating expenses	55	45	52	47
Loss from operations	(39)	(40)	(30)	(24)
Interest and other income (expense), net	—	(6)	—	(4)
Loss before provision for (benefit from) income taxes	(39)	(47)	(31)	(28)
Provision for (benefit from) income taxes	—	—	—	—
Net loss	(39)%	(47)%	(31)%	(28)%

Three and Nine Months Ended September 30, 2014 and 2013

Net Revenues

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			
	September 30,		Change	
	2014	2013	$	%
Print textbooks	$55,296	$48,568	$6,728	14 %
Digital offerings	26,236	13,019	13,217	102
Net revenues	$81,532	$61,587	$19,945	32 %

	Nine Months Ended			
	September 30,		Change	
	2014	2013	$	%
Print textbooks	$157,717	$142,611	$15,106	11%
Digital offerings	62,700	35,848	26,852	75
Net revenues	$220,417	$178,459	$41,958	24%

Net revenues in the three months ended September 30, 2014 increased $19.9 million, or 32%, compared to the same period during 2013 as a result of an increase in our digital offerings of 102% primarily from growth in new memberships of our Chegg Study service, an increase in eTextbook volumes, growth in our enrollment marketing services, revenues from our new product lines, including Chegg Deals and tutoring, and our partnership with Ingram. Digital offerings represented 32% and 21% of net revenues during the three months ended September 30, 2014 and 2013, respectively. Revenue from print textbooks increased $6.7 million in the three months ended September 30, 2014 as compared to the same period last year as a result of higher rental units and sales of textbooks during our peak rush period.

Net revenue in the nine months ended September 30, 2014 increased $42.0 million, or 24%, compared to the same period during 2013 as a result of an increase in our digital offerings of 75% primarily from growth in new memberships of our Chegg Study service, an increase in eTextbook volumes, growth in our enrollment marketing services, revenues from our new product lines, including Chegg Deals and tutoring, and our partnership with Ingram. Digital offerings represented 28% and 20% of net revenues during the nine months ended September 30, 2014 and 2013, respectively. Revenue from print textbooks increased $15.1 million in the nine months ended September 30, 2014 as compared to the same period last year as a result of higher rental units and sales of textbooks.

We anticipate that our digital offerings will continue to grow at a rate greater than our overall revenue growth in future periods.

Cost of Revenues

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

	Three Months Ended			
	September 30,		Change	
	2014	2013	$	%
Cost of revenues(1)	$68,281	$58,425	$9,856	17%
(1) Includes stock-based compensation expense	$160	$126	$34	27%

	Nine Months Ended			
	September 30,		Change	
	2014	2013	$	%
Cost of revenues(1)	$172,362	$137,486	$34,876	25%
(1) Includes stock-based compensation expense	$472	$422	$50	12%

21

Cost of revenues in the three months ended September 30, 2014 increased $9.9 million, or 17%, compared to the same period during 2013. The increase in absolute dollars and the decrease as a percentage of revenues for the three months ended September 30, 2014 was primarily due to an increase in, textbook depreciation of $1.6 million, write-offs and reserves related to our textbook library of $2.3 million the cost of digital content of $1.0 million, and higher warehouse personnel costs of $0.4 million. The cost of digital content increased during the three months ended September 30, 2014 due to our expansion of digital content solutions made available to students. In addition we experienced an increase in the cost of textbooks purchased of $8.7 million, which was primarily driven by increased unit shipments. These increases were partially offset by lower order fulfillment costs of $4.3 million, which is comprised of shipping and handling expenses, as well as e-textbook fees paid to our publishers. Order fulfillment costs have decreased in the three months ended September 30, 2014 as compared to the same period in the prior year due to lower per unit charges.

Cost of revenues in the nine months ended September 30, 2014 increased $34.9 million, or 25%, compared to the same period during 2013. The increase in absolute dollars and as a percentage of revenues for the nine months ended September 30, 2014 was primarily due to an increase in textbook depreciation of $8.9 million, write-offs and reserves related to our textbook library of $6.8 million the cost of digital content of $2.9 million, and higher warehouse personnel costs of $1.7 million to cover higher volumes during this rush period, offset by full time employees salaries which decreased $0.5 million. The costs of digital content increased during the nine months ended September 30, 2014 due to our expansion of digital content solutions made available to students. In addition we experienced an increase in the cost of textbooks purchased of $15.0 million, which was primarily driven by increased unit shipments.

Operating Expenses

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

	Three Months Ended			
	September 30,		Change	
	2014	2013	$	%
Technology and development[(1)]	$13,490	$9,999	$3,491	35 %
Sales and marketing[(1)]	23,453	14,223	9,230	65
General and administrative[(1)]	10,986	6,247	4,739	76
Gain on liquidation of textbooks	(2,044)	(2,403)	359	(15)
	$45,885	$28,066	$17,819	63 %
(1) Includes stock-based compensation expense of:				
Technology and development	$3,235	$1,530	$1,705	111%
Sales and marketing	4,476	564	3,912	n/m
General and administrative	3,923	1,637	2,286	140
Stock-based compensation expense	$11,634	$3,731	$7,903	212%

	Nine Months Ended			
	September 30,		Change	
	2014	2013	$	%

Technology and development(1)	$36,999	$29,351	$7,648	26 %
Sales and marketing(1)	53,297	36,645	16,652	45
General and administrative(1)	31,480	20,530	10,950	53
Gain on liquidation of textbooks	(5,844)	(3,012)	(2,832)	94
	$115,932	$83,514	$32,418	39 %
(1) Includes stock-based compensation expense of:				
Technology and development	$8,252	$4,874	$3,378	69 %
Sales and marketing	8,071	2,063	6,008	n/m
General and administrative	10,410	4,529	5,881	130
Stock-based compensation expense	$26,733	$11,466	$15,267	133 %

n/m – Not meaningful

Technology and Development

Technology and development expenses during the three months ended September 30, 2014 increased $3.5 million, or 35%, compared to the three months ended September 30, 2013. During the three months ended September 30, 2014 our employee-related expenses and stock-based compensation expenses increased $0.9 million and $1.7 million, respectively, compared to the same period in 2013. Stock-based compensation expense increased primarily due to expense associated with restricted stock units (RSUs) for which there was no expense prior to our IPO. In addition, we experienced an increase in outside services of $1.0 million. Technology and development as a percentage of net revenues was 17% of net revenues in the three months ended September 30, 2014 compared to 16% of net revenues in the three months ended September 30, 2013.

Technology and development expenses during the nine months ended September 30, 2014 increased $7.6 million, or 26%, compared to the nine months ended September 30, 2013. During the nine months ended September 30, 2014 our employee-related expenses and stock-based compensation expenses increased by $2.4 million and $3.4 million, respectively, compared to the same period in the prior year. Stock-based compensation expense increased primarily due to expense associated with RSUs for which there was no expense prior to our IPO. In addition, we experienced an increase in web hosting costs of $1.2 million and outside services of $1.7 million. Technology and development as a percentage of net revenues was 17% and 16% of net revenues in each of the nine month periods ended September 30, 2014 and 2013, respectively.

Sales and Marketing

Sales and marketing expenses during the three months ended September 30, 2014 increased by $9.2 million, or 65%, compared to the three months ended September 30, 2013. The increase in absolute dollars and as a percentage of revenues is primarily attributable to an increase in advertising and marketing expenses of $0.9 million as a result of search engine marketing to increase customer acquisition and online or social media marketing during the period compared to the three months ended September 30, 2013. In addition, during the three months ended September 30, 2014 our employee-related expenses and stock-based compensation increased $2.9 million and $3.9 million, respectively, compared to the same period in the prior year. The increase in employee related expenses increased primarily due to a higher average headcount and acquisition related retention bonuses and stock-based compensation increased primarily due to expense associated with RSUs for which there was no expense prior to our IPO. Amortization of our intangibles increased $0.8 million related to our acquisitions made in the second quarter of 2014. Sales and marketing expenses as a percentage of net revenues increased to 29% during the three months ended September 30, 2014 compared to 23% of net revenues during the three months ended September 30, 2013.

Sales and marketing expenses during the nine months ended September 30, 2014 increased by $16.7 million, or 45%, compared to the nine months ended September 30, 2013. The increase in absolute dollars and as a percentage of revenues is primarily attributable to an increase in advertising and marketing expenses of $2.9 million as a result of search engine marketing to increase customer acquisition and online or social media marketing during the period compared to the nine months ended September 30, 2013. In addition, during the nine months ended September 30, 2014 our employee-related expenses and stock-based compensation increased $6.0 million and $6.0 million, respectively, compared to the same period in the prior year. The increase in employee related expenses increased primarily due to a higher average headcount and stock-based compensation increased primarily due to expense associated with RSUs for which there was no expense prior to our IPO. Sales and marketing expenses as a percentage of net revenues increased 24% during the nine months ended September 30, 2014 compared to 21% of net revenues during the nine months ended September 30, 2013.

General and Administrative

General and administrative expenses in the three months ended September 30, 2014 increased $4.7 million, or 76%, compared to the three months ended September 30, 2013. The increase in absolute dollars and as a percentage of net revenues was due to an increase in stock-based compensation expense of $2.3 million primarily due to expense associated with RSUs which did not incur expense prior to our IPO.   In addition, employee-related and benefit expenses, audit and legal fees, and insurance increased by $2.5 million, as a result of Chegg now being a publicly traded company. General and administrative expenses as a percentage of net revenues increased to 12% during the three months ended September 30, 2014 compared to 10% of net revenues during the three months ended September 30, 2013.

General and administrative expenses in the nine months ended September 30, 2014 increased $11.0 million, or 53%, compared to the nine months ended September 30, 2013. The increase in absolute dollars and as a percentage of net revenues was due to an increase in stock-based compensation expense of $5.9 million primarily due to expense associated with RSUs which did not incur expense prior to our IPO.   Our employee-related and benefit expenses, audit and legal fees, insurance, and professional and other fees increased by $5.2 million, as a result of Chegg now being a publicly traded company. General and administrative expenses as a percentage of net revenues increased to 14% during the nine months ended September 30, 2014 compared to 12% of net revenues during the nine months ended September 30, 2013.

Gain on Liquidation of Textbooks

In the three months ended September 30, 2014 and 2013, we had a net gain on liquidations of $2.0 million and $2.4 million, respectively, resulting from proceeds received from liquidation of previously rented print textbooks on our website and through various other liquidation channels.

In the nine months ended September 30, 2014 and 2013, we had a net gain on liquidations of $5.8 million and $3.0 million, respectively, resulting from proceeds received from liquidation of previously rented print textbooks on our website and through various other liquidation channels.

Interest and Other Income (Expense), Net

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

	Three Months Ended September 30,		Change	
	2014	2013	$	%
Interest expense, net	$(67)	$(1,306)	$1,239	(95)%
Other income (expense), net	541	(2,840)	3,381	(119)
Total interest and other income (expense), net	$474	$(4,146)	$4,620	(111)%

	Nine Months Ended September 30,		Change	
	2014	2013	$	%
Interest expense, net	$(255)	$(3,662)	$3,407	(93)%
Other income (expense), net	817	(3,688)	4,505	(122)
Total interest and other income (expense), net	$562	$(7,350)	$7,912	(108)%

Interest expense, net decreased by $1.2 million during the three months ended September 30, 2014 and $3.4 million during the nine months ended September 30, 2014 primarily due to the pay-off of our outstanding loan balance in 2013.

Other income (expense), net was a net income during the three and nine months ended September 30, 2014 primarily due to the interest earned on our investments compared to a net expense during the three and nine months ended September 30, 2013 which resulted from an increase in the fair value of our preferred stock warrants prior to their conversion into common stock warrants.

Provision for (Benefit from) Income Taxes

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

	Three Months Ended September 30,		Change	
	2014	2013	$	%
Provision from income taxes	$281	$205	$76	37%

	Nine Months Ended September 30,		Change	
	2014	2013	$	%
Provision from (benefit for) income taxes	$(869)	$542	$(1,411)	n/m

n/m – Not meaningful

We recorded an income tax provision of approximately $0.3 million and an income tax benefit of $0.9 million for the three and nine months ended September 30, 2014, respectively and an income tax provision of $0.2 million and $0.5 million, for the three and nine months ended September 30, 2013, respectively. The income tax provision in the three months ended September 30, 2014 was the result of state and foreign income taxes. The income tax benefit of $0.9 million in the nine months ended September 30, 2014 was primarily the result of the release of valuation allowance resulting from our acquisition of InstaEDU, offset by foreign and state income taxes. The income tax expense in the three and nine months ended September 30, 2013 was due to state and foreign income tax expense.

Liquidity and Capital Resources

As of September 30, 2014, our principal sources of liquidity were cash, cash equivalents and investments totaling $97.3 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 have $40.0 million available for draw down under our Revolving Credit Facility with an accordion feature subject to certain financial criteria that would allow us to draw down to $75.0 million in total, which expires in August 2016. As of September 30, 2014, we were in compliance with all financial covenants.

Our print textbook business is highly capital intensive, and we typically use cash for our investing activities while we generate positive cash flows from operations. We capitalize the investment in our print textbook library and depreciate the value of our textbooks over their useful life as cost of revenues. During the nine months ended September 30, 2014 and 2013, our investment in print textbooks, net of proceeds from textbook liquidations, was $59.3 million and $75.9 million, respectively. To the extent our business continues to grow, or as new textbook versions are published, we anticipate we will continue to purchase additional textbooks, resulting in a use of cash from investing activities. As of September 30, 2014, we have incurred cumulative losses of $271.6 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. However, our future capital requirements will depend on many factors, including the level of investment in textbooks to support our print textbook business and our ability to recover our source costs through the rental of textbooks and as we liquidate textbooks at the end of their lifecycle, our rate of revenue growth, our sales and marketing activities and the timing and extent of our spending to support our technology and development efforts. 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.

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

	Nine Months Ended September 30,	
	2014	2013
Consolidated Statements of Cash Flows Data:		
Net cash provided by operating activities	$68,002	$72,141
Net cash used in investing activities	(89,907)	(81,141)
Net cash (used in) provided by financing activities	(1,773)	3,897

Cash Flows from Operating Activities

Although we incurred net losses during the nine months ended September 30, 2014 and 2013, we generated positive cash flows from operating activities, which was primarily the result of our increased textbook and digital offerings revenue. 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, and our accounts payable 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 stock-based compensation expense. During the nine months ended September 30, 2014 and 2013, our non-cash operating expenses and changes in operating assets and liabilities more than offset our net loss.

Net cash provided by operating activities during the nine months ended September 30, 2014 was $68.0 million. However, we incurred a net loss of $66.4 million, our net loss was more than offset by significant non-cash operating expenses, including textbook library depreciation expense of $54.2 million, other depreciation and amortization expense of $7.8 million, stock-based compensation expense of $27.2 million and loss from write-offs of textbooks of $10.1 million.

Net cash provided by operating activities in the nine months ended September 30, 2013 was $72.1 million. Although we incurred a net loss of $50.4 million, our net loss was more than offset by a $52.1 million increase in deferred revenue and significant non-cash operating expenses, including textbook library depreciation expense of $45.3 million, other depreciation and amortization expense of $9.6 million, stock-based compensation expense of $11.9 million and loss from write-offs of textbooks of $3.3 million.

Cash Flows from Investing Activities

Cash flows from investing activities have been primarily related to the acquisition of businesses, purchase of textbooks, investments and property and equipment, offset by proceeds from the sale or maturity of investments and the proceeds from the liquidation of textbooks. Net cash used in investing activities during the nine months ended September 30, 2014 was $90.0 million and was primarily used for the acquisition of businesses of $43.9 million, purchases of textbooks of $99.5 million, purchases of investments of $63.9 million and purchases of property and equipment of $3.8 million, partially offset by proceeds from the sale or maturity of investments of $80.9 million and proceeds from the liquidation of textbooks of $40.2 million.

Net cash used in investing activities in the nine months ended September 30, 2013 was $81.1 million and was primarily used for purchases of textbooks of $108.5 million and purchases of property and equipment of $5.2 million, partially offset by proceeds from liquidation of textbooks of $32.6 million.

Cash Flows from Financing Activities

Net cash used in financing activities during the nine months ended September 30, 2014 was $1.8 million and was primarily related to the payment of $3.8 million in taxes related to the net share settlement of RSUs which became fully vested during the period off set by the issuance of common stock from our 2013 ESPP and proceeds from the exercise of stock options totaling $2.0 million.

Net cash provided by financing activities in the nine months ended September 30, 2013 was $3.9 million and was related to proceeds from the exercise of stock options and net proceeds from the issuance of long-term debt.

Contractual Obligations and Other Commitments

There were no material changes in our commitments under contractual obligations, as disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in our Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

Through September 30, 2014, 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.

There have been no material changes in our critical accounting policies and estimates during the nine months ended September 30, 2014 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

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (ASU 2014-09). This standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. ASU 2014-09 provides companies with two implementation methods. Companies can choose to apply the standard retrospectively to each prior reporting period presented (full retrospective application) or retrospectively with the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings of the annual reporting period that includes the date of initial application (modified retrospective application). We are currently in the process of evaluating this new guidance. This guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is not permitted.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

There have been no material changes in our market risk during the nine months ended September 30, 2014, compared to the disclosures in "Quantitative and Qualitative Disclosures about Market Risk" in Part II, Item 7A of 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.

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 Tax Authority of approximately $150,000, excluding tax and penalties, an amount that we have accrued using similar rates for the two years under audit. We appealed to the Commonwealth of Kentucky Board of Tax Appeals on July 23, 2013 and the Board issued a ruling in favor of the Kentucky Department of Revenue on January 13, 2014. On February 7, 2014, we filed an appeal to the Franklin Circuit Court in Kentucky and on June 17, 2014 the court held in abeyance our motion to appeal. On October 29, 2014 the Franklin Circuit Court in Kentucky issued its opinion and order in Chegg's challenge in the Kentucky Board of Tax Appeals decision regarding Chegg's property tax assessment. The Circuit Court ruling reversed the Board of Tax Appeal's decision setting aside the Kentucky Department of Revenue's tax assessments against Chegg and further vacated all penalties and interest. The Kentucky Department of Revenue has 30 days to file an appeal to the Circuit Court ruling. Due to the preliminary status and uncertainties related to this matter, 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. Since July 2010, we have expanded our free and paid offerings, in many instances through the acquisition of other companies, to include digital textbooks (eTextbooks), supplemental materials in digital and print form, multiplatform eTextbook Reader software, Chegg Study, on-line tutoring, College Admissions and Scholarship Services, purchases of used textbooks, internships, careers, college counseling, on-campus advertising, enrollment marketing services and brand advertising. We cannot assure you that our newer products and services, or any other products and services we may introduce or acquire, will 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 these new products and services with our textbook offerings 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 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.

You should consider our business and prospects in light of 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, which we refer to collectively as "colleges," 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 publishers, wholesalers, distributors, colleges and brands;
- integrate and realize synergies of 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 September 30, 2014 and 2013 were $32.4 million and $29.3 million, respectively and for the nine months ended September 30, 2014 and 2013 our net losses were $66.4 million and $50.4 million, respectively. As of September 30, 2014, we had an accumulated deficit of $271.6 million. We expect to make significant investments in the development and expansion of our business and anticipate that our cost of revenues and operating expenses will increase. We may not succeed in increasing our revenue sufficiently to offset these higher expenses, and our efforts to grow the business may prove more expensive than we currently anticipate. We may incur significant losses in the future for a number of reasons, including slowing demand for print textbook rentals, 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 cannot assure you that we will be able to achieve profitability. To achieve profitability, we may need to change our operating infrastructure and scale our operations more efficiently. For example, we may need to reduce our costs or implement changes in our print textbook and digital offerings models to improve the predictability of our revenue. 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 and nine months ended September 30, 2014, this business accounted for 68% and 71% of our revenue, respectively. The print textbook rental business is highly capital intensive and presents both business planning and logistical challenges that are complex. In part to address the highly capital intensive nature of the print textbook rental business, we recently entered into an agreement whereby a third party will own and provide the fulfillment services for a portion of the books that we rent for an initial period of eight months. This program may not be successful or the third party may not elect to extend the program beyond the initial period.

Our investments in and the growth of our print textbook rental business are subject to risks as a result of changes taking place 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 utilize our print textbook library and could decrease revenue. 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.

In recent years 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, universities or other academic institutions 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.

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 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-to-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 are relatively new and, as a result, we have limited experience with forecasting revenues from them. If we fail to meet our forecasts or investor expectations regarding these future results, the value of your investment could decline.

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. 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. 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.

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 to consistently provide students with a convenient, high quality experience for selecting, receiving and returning print textbooks;
our 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 the digital offerings that we offer to students compared to those of our competitors;
our ability to engage high school students with our College Admissions, College Counseling and Scholarship Services;