

K12 INC  
Form 10-Q  
January 29, 2015  
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

(Mark One)

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

**For the quarterly period ended December 31, 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: 001-33883**

**K12 Inc.**

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(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**95-4774688**

(IRS Employer Identification No.)

**2300 Corporate Park Drive  
Herndon, VA**

(Address of principal executive offices)

**20171**

(Zip Code)

**(703) 483-7000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Accelerated filer

Smaller reporting company

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

As of January 22, 2015 the Registrant had 38,412,246 shares of common stock, \$0.0001 par value per share outstanding.

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**For the Quarterly Period Ended December 31, 2014**

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited).****K12 INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

	December 31, 2014	June 30, 2014
(In thousands, except share and per share data)		
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 124,234	\$ 196,109
Accounts receivable, net of allowance of \$4,060 and \$3,460 at December 31, 2014 and June 30, 2014, respectively	266,760	194,676
Inventories, net	19,515	33,830
Current portion of deferred tax asset	3,969	7,732
Prepaid expenses	11,610	7,356
Other current assets	29,056	25,498
<b>Total current assets</b>	<b>455,144</b>	<b>465,201</b>
Property and equipment, net	48,127	48,581
Capitalized software, net	56,884	49,920
Capitalized curriculum development costs, net	59,569	60,782
Intangible assets, net	22,464	23,708
Goodwill	67,241	58,088
Deposits and other assets	5,853	5,387
<b>Total assets</b>	<b>\$ 715,282</b>	<b>\$ 711,667</b>
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND EQUITY</b>		
<b>Current liabilities</b>		
Current portion of capital lease obligations	\$ 18,255	\$ 20,492
Accounts payable	16,633	30,976
Accrued liabilities	10,154	20,539
Accrued compensation and benefits	19,085	17,400
Deferred revenue	63,630	24,353
<b>Total current liabilities</b>	<b>127,757</b>	<b>113,760</b>
Capital lease obligations, net of current portion	14,109	16,447
Deferred rent, net of current portion	8,187	8,488
Deferred tax liability	24,218	22,478
Other long-term liabilities	7,424	4,763
<b>Total liabilities</b>	<b>181,695</b>	<b>165,936</b>
<b>Commitments and contingencies</b>		
<b>Redeemable noncontrolling interest</b>	<b>19,801</b>	<b>16,801</b>
<b>Equity:</b>		
<b>K12 Inc. stockholders equity</b>		
Common stock, par value \$0.0001; 100,000,000 shares authorized; 41,841,573 and 41,144,062 shares issued and 38,338,975 and 38,948,866 shares outstanding at December 31, 2014 and June 30, 2014, respectively	4	4

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Additional paid-in capital	645,902	639,036
Accumulated other comprehensive loss	(1,227)	(112)
Accumulated deficit	(55,893)	(61,450)
Treasury stock of 3,502,598 and 2,195,196 shares at cost at December 31, 2014 and June 30, 2014, respectively	(75,000)	(48,548)
<b>Total K12 Inc. stockholders equity</b>	<b>513,786</b>	<b>528,930</b>
<b>Total liabilities, redeemable noncontrolling interest and equity</b>	<b>\$ 715,282</b>	<b>\$ 711,667</b>

See accompanying summary of accounting policies and notes to unaudited condensed consolidated financial statements.

Table of Contents**K12 INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
	(In thousands, except share and per share data)			
<b>Revenues</b>	\$ 231,304	\$ 223,919	\$ 468,017	\$ 452,285
<b>Cost and expenses</b>				
Instructional costs and services	145,029	153,672	291,872	286,574
Selling, administrative, and other operating expenses	62,557	75,753	162,101	173,996
Product development expenses	3,245	3,402	6,727	9,086
<b>Total costs and expenses</b>	210,831	232,827	460,700	469,656
<b>Income (loss) from operations</b>	20,473	(8,908)	7,317	(17,371)
<b>Interest income (expense), net</b>	151	(28)	182	(112)
<b>Income (loss) before income tax expense and noncontrolling interest</b>	20,624	(8,936)	7,499	(17,483)
<b>Income tax (expense) benefit</b>	(8,663)	4,685	(2,125)	8,135
<b>Net income (loss)</b>	11,961	(4,251)	5,374	(9,348)
<b>Adjust net loss attributable to noncontrolling interest</b>	370	586	183	643
<b>Net income (loss) attributable to common stockholders, including Series A stockholders</b>	\$ 12,331	\$ (3,665)	\$ 5,557	\$ (8,705)
<b>Net income (loss) attributable to common stockholders per share, excluding Series A stockholders, through the conversion date September 3, 2013:</b>				
Basic	\$ 0.33	\$ (0.09)	\$ 0.15	\$ (0.22)
Diluted	\$ 0.33	\$ (0.09)	\$ 0.15	\$ (0.22)
<b>Weighted average shares used in computing per share amounts:</b>				
Basic	37,096,480	39,977,228	37,396,081	38,953,671
Diluted	37,160,829	39,977,228	37,599,930	38,953,671

See accompanying summary of accounting policies and notes to unaudited condensed consolidated financial statements.

Table of Contents**K12 INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE  
INCOME (LOSS)**

	<b>Three Months Ended December 31,</b>		<b>Six Months Ended December 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(In thousands)</b>			
Net income (loss)	\$ 11,961	\$ (4,251)	\$ 5,374	\$ (9,348)
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustment	(569)	88	(1,115)	193
Total other comprehensive income (loss), net of tax	11,392	(4,163)	4,259	(9,155)
Comprehensive loss attributable to noncontrolling interest	370	586	183	643
Comprehensive income (loss) attributable to common stockholders, including Series A stockholders	\$ 11,762	\$ (3,577)	\$ 4,442	\$ (8,512)

See accompanying summary of accounting policies and notes to unaudited condensed consolidated financial statements.

Table of Contents**K12 INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF EQUITY (DEFICIT)**

(In thousands, except share and per share data)	Common Stock		Additional	Other	Accumulated	Treasury Stock		Total
	Shares	Amount	Paid-in	Accumulated	Deficit	Shares	Amount	
			Capital	Comprehensive				
				Loss				
Balance, June 30, 2014	41,144,062	\$ 4	\$ 639,036	\$ (112)	\$ (61,450)	(2,195,196)	\$ (48,548)	\$ 528,930
Net income (1)					5,557			5,557
Foreign currency translation adjustment				(1,115)				(1,115)
Purchase of treasury stock						(1,307,402)	(26,452)	(26,452)
Stock-based compensation expense			8,969					8,969
Exercise of stock options	63,214		161					161
Excess tax benefit from stock-based compensation			(613)					(613)
Issuance of restricted stock awards	745,775							
Forfeiture of restricted stock awards	(28,151)							
Accretion of redeemable noncontrolling interests to estimated redemption value			(183)					(183)
Retirement of restricted stock for tax withholding	(83,327)		(1,468)					(1,468)
Balance, December 31, 2014	41,841,573	\$ 4	\$ 645,902	\$ (1,227)	\$ (55,893)	(3,502,598)	\$ (75,000)	\$ 513,786

(1) Net income excludes \$(0.2) million due to the redeemable noncontrolling interests related to Middlebury Interactive Languages and LearnBop, which are reported outside of permanent equity in the accompanying unaudited condensed consolidated balance sheets.

See accompanying summary of accounting policies and notes to unaudited condensed consolidated financial statements.



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## K12 INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended December 31,	
	2014	2013
	(In thousands)	
<b>Cash flows from operating activities</b>		
Net income (loss)	\$ 5,374	\$ (9,348)
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>		
Depreciation and amortization expense	34,509	51,474
Stock-based compensation expense	8,969	12,210
Excess tax benefit from stock-based compensation	613	1,217
Deferred income taxes	5,504	(8,134)
Provision for doubtful accounts	836	717
Provision for excess and obsolete inventory	459	4,124
Benefit for student computer shrinkage and obsolescence	(226)	(451)
Changes in assets and liabilities:		
Accounts receivable	(72,415)	(68,785)
Inventories	13,856	16,908
Prepaid expenses	(4,255)	1,257
Other current assets	(3,558)	(3,508)
Deposits and other assets	(466)	(227)
Accounts payable	(14,377)	(5,310)
Accrued liabilities	(10,984)	(2,484)
Accrued compensation and benefits	1,684	(1,435)
Deferred revenue	39,630	32,149
Deferred rent and other liabilities	2,476	178
<b>Net cash provided by operating activities</b>	<b>7,629</b>	<b>20,552</b>
<b>Cash flows from investing activities</b>		
Purchase of property and equipment	(6,687)	(5,329)
Capitalized software development costs	(17,093)	(10,632)
Capitalized curriculum development costs	(7,267)	(7,649)
Investment in LearnBop Inc.	(6,512)	
Mortgage note to managed school partner		(2,100)
<b>Net cash used in investing activities</b>	<b>(37,559)</b>	<b>(25,710)</b>
<b>Cash flows from financing activities</b>		
Repayments on capital lease obligations	(11,487)	(11,145)
Purchase of treasury stock	(26,452)	(5,883)
Repayments on note payable		(390)
Proceeds from exercise of stock options	161	7,617
Excess tax benefit from stock-based compensation	(613)	(1,217)
Repurchase of restricted stock for income tax withholding	(1,468)	(3,223)
<b>Net cash used in financing activities</b>	<b>(39,859)</b>	<b>(14,241)</b>
<b>Effect of foreign exchange rate changes on cash and cash equivalents</b>	<b>(2,086)</b>	<b>808</b>
<b>Net change in cash and cash equivalents</b>	<b>(71,875)</b>	<b>(18,591)</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>196,109</b>	<b>181,480</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 124,234</b>	<b>\$ 162,889</b>

See accompanying summary of accounting policies and notes to unaudited condensed consolidated financial statements.



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**K12 INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of the Business**

K12 Inc., together with its subsidiaries ( K12 or the Company ), is a technology-based education company. The Company offers proprietary curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade ( K-12 ). The Company's mission is to maximize a child's potential by providing access to an engaging and effective education, regardless of geographic location or socio-economic background. The Company's learning systems combine the Company's curriculum and offerings with an individualized learning approach well-suited for virtual and blended public schools, school district online programs, public charter schools and private schools that utilize varying degrees of online and traditional classroom instruction, and other educational applications. These unique set of products and services are provided primarily to three lines of business: Public School Programs (curriculum and services sold to managed and non-managed public schools), Institutional Sales (educational products and services provided to school districts, public schools and other educational institutions that the Company does not manage), and International and Private Pay Schools (private schools for which the Company charges student tuition and makes direct consumer sales). The Company operates Public School Programs in 33 states and the District of Columbia. In June 2014, the Company completed a sale of certain businesses, including the International School of Berne. The other businesses divested consisted of the Company's interest in an existing Middle East joint venture and its post-secondary business.

The Company also works closely as partners with a growing number of public schools, school districts, private schools and charter schools enabling them to offer their students an array of solutions, including full-time virtual programs, semester course and supplemental solutions. In addition to curriculum, systems and programs, the Company provides teacher training, teaching services and other support services.

**2. Basis of Presentation**

The accompanying condensed consolidated balance sheet as of December 31, 2014, the condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended December 31, 2014 and 2013, the condensed consolidated statements of cash flows for the six months ended December 31, 2014 and 2013, and the condensed consolidated statement of equity (deficit) for the six months ended December 31, 2014 are unaudited. The unaudited interim financial statements have been prepared on the same basis as the annual financial statements and in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company's financial position and results of operations for the periods presented. The results for the six months ended December 31, 2014 are not necessarily indicative of the results to be expected for the year ending June 30, 2015 or for any other interim period or for any other future fiscal year. The condensed consolidated balance sheet as of June 30, 2014 has been derived from the audited consolidated financial statements at that date.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities Exchange Act of 1934, as amended (the Exchange Act ). Accordingly, the Company does not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, these statements include all adjustments (consisting of normal recurring adjustments) considered necessary to present a fair statement of the Company's condensed consolidated results of operations, financial position and cash flows. Preparation of the Company's financial statements in

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conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and footnotes. Actual results could differ from those estimates. This quarterly report on Form 10-Q should be read in conjunction with the financial statements and the notes thereto included in the Company's latest annual report on Form 10-K filed with the Securities and Exchange Commission (the SEC) on August 15, 2014, which contains the Company's audited financial statements for the fiscal year ended June 30, 2014.

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The Company operates in one operating and reportable business segment as a technology-based education company providing proprietary curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade. The Chief Operating Decision Maker evaluates profitability based only on consolidated results.

**3. Summary of Significant Accounting Policies**

***Revenue Recognition***

Revenues are principally earned from long-term contractual agreements to provide online curriculum, books, materials, computers and management services to virtual and blended public schools, traditional schools, school districts, public charter schools, and private schools. In addition to providing the curriculum, books and materials, under most contracts, the Company manages virtual and blended public schools, including monitoring academic achievement, teacher hiring and training, compensation of school personnel, financial management, enrollment processing and procurement of curriculum, equipment and required services. The schools receive funding on a per student basis from the state in which the public school or school district is located. Shipments of materials for schools that occur in the fourth fiscal quarter and for the upcoming school year are recorded in deferred revenues.

Where the Company has determined that it is the primary obligor for substantially all expenses under these contracts, the Company records the associated per student revenue received by the school from its state funding school district up to the expenses incurred in accordance with Accounting Standards Codification (ASC) 605, *Revenue Recognition*. As a result of being the primary obligor, amounts recorded as revenues and school operating expenses for the three months ended December 31, 2014 and 2013 were \$84.1 million and \$67.3 million, respectively, and for the six months ended December 31, 2014 and 2013 were \$152.8 million and \$119.5 million, respectively. For contracts where the Company is not the primary obligor, the Company records revenue based on its net fees earned under the contractual agreement.

The Company generates revenues under turnkey management contracts with virtual and blended public schools which include multiple elements. These elements include providing each of a school's students with access to the Company's online school and the component of lessons; offline learning kits, which include books and materials to supplement the online lessons; the use of a personal computer and associated reclamation services; internet access and technology support services; the services of a state-certified teacher, where required; and management and technology services necessary to operate a virtual public or blended school. In certain managed school contracts, revenue is determined directly by per enrollment funding.

The Company has determined that the elements of its contracts are valuable to schools in combination, but do not have standalone value. As a result, the elements within the Company's multiple-element contracts do not qualify as separate units of accounting. Accordingly, the Company accounts for revenues under multiple element arrangements as a single unit of accounting and recognizes the entire arrangement based upon the approximate rate at which it incurs the costs associated with each element. Revenue from certain managed schools is recognized ratably over the period services are performed.

To determine the pro rata amount of revenues to recognize in a fiscal quarter, management estimates the total funds each school will receive in a particular school year. Total funds for a school are primarily a function of the number of students enrolled in the school and established per enrollment funding levels which are generally published on an annual basis by the state or school district. Management reviews its estimates of

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funding periodically, and revise as necessary, amortizing any adjustments to earned revenues over the remaining portion of the fiscal year. Actual school funding may vary from these estimates and the impact of these differences could impact the Company's results of operations. Since the end of the school year coincides with the end of the Company's fiscal year, the Company is generally able to base its annual revenues on actual school funding. The Company's schools reported results are subject to annual school district financial audits, which incorporate enrollment counts, funding and other routine financial audit considerations. The results of these audits are incorporated into the Company's monthly funding estimates and for the reported quarters and six months ended December 31, 2014 and 2013.

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Under the contracts where the Company provides turnkey management services to schools, the Company has generally agreed to absorb any operating losses of the schools in a given school year. These school operating losses represent the excess of costs incurred over revenues earned by the virtual or blended public school as reflected on its respective financial statements, including Company charges to the schools. To the extent a school does not receive funding for each student enrolled in the school, the school would still incur costs associated with serving the unfunded enrollment. If losses due to unfunded enrollments result in a net operating loss for the year that loss is reflected as a reduction in the revenue and net receivables that the Company collects from the school. A school net operating loss in one year does not necessarily mean the Company anticipates losing money on the entire contract with the school. However, a school operating loss may reduce the Company's ability to collect its management fees in full and recognized revenues are reduced accordingly to reflect the expected cash collections from such schools. The Company amortizes the estimated school operating loss against revenues based upon the percentage of actual revenues in the period to total estimated revenues for the fiscal year.

For turnkey revenue service contracts, a school operating loss may reduce the Company's ability to collect its management fees in full though as noted it does not necessarily mean that the Company incurs a loss during the period with respect to its services to that school. The Company recognizes revenue, net of its estimated portion of school operating losses, to reflect the expected cash collections from such schools. Revenue is recognized based on the Company's performance of services under the contract, which it believes is proportionate to its incurrence of costs. The Company incurs costs directly related to the delivery of services. Most of these costs are recognized throughout the year; however, certain costs related to upfront delivery of printed materials, workbooks, laboratory materials and other items are provided at the beginning of the school year and are recognized as expense when shipped.

Each state or school district has variations in the school funding formulas and methodologies that it uses to estimate funding for revenue recognition at its respective schools. As the Company builds the funding estimates for each school, it is mindful of the state definition for count dates on which reported enrollment numbers will be used for per pupil funding. The parameters the Company considers in estimating funding for revenue recognition purposes include school district count definitions, withdrawal rates, average daily attendance, special needs enrollment, student demographics, academic progress and historical completion, student location, funding caps and other state specified categorical program funding. The estimates the Company makes each period on a school-by-school basis considers the latest information available to it and considers material relevant information at the time of the estimate.

Management periodically reviews its estimates of full-year school revenues and operating expenses and amortizes the net impact of any changes to these estimates over the remainder of the fiscal year. Actual school operating losses may vary from these estimates or revisions, and the impact of these differences could have a material impact on results of operations. Since the end of the school year coincides with the end of the Company's fiscal year, annual revenues are generally based on actual school revenues and actual costs incurred (including costs for the Company's services to the schools plus other costs the schools may incur) in the calculation of school operating losses. For the three months ended December 31, 2014 and 2013, the Company's revenue included a reduction for these school operating losses of \$15.1 million and \$11.9 million, respectively, and for the six months ended December 31, 2014 and 2013, were \$32.7 million and \$25.7 million, respectively.

The Company provides certain online curriculum and services to schools and school districts under subscription and perpetual license agreements. Revenue under these agreements is recognized in accordance with the ASC 605 when all of the following conditions are met: there is persuasive evidence of an arrangement; delivery has occurred or services have been rendered; the amount of fees to be paid by the customer is fixed and determinable; and the collectability of the fee is probable. Revenue from the licensing of curriculum under subscription arrangements is recognized on a ratable basis over the subscription period. Revenue from the licensing of curriculum under non-cancelable perpetual arrangements is recognized when all revenue recognition criteria have been met. Revenue from professional consulting, training and support services are deferred and recognized ratably over the service period.

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Other revenues are generated from individual customers who prepay and have access for one to two years to company-provided online curriculum. The Company recognizes these revenues pro rata over the maximum term of the customer contract.



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Revenues from associated offline learning kits are recognized upon shipment.

During the three months ended December 31, 2014 and 2013, the Company had a contract with the Agora Cyber Charter School ( Agora ) that represented approximately 14% and 13% of revenue, respectively. During the six months ended December 31, 2014 and 2013, the Company had a contract with the Agora Cyber Charter School ( Agora ) that represented approximately 13% and 12% of revenue, respectively. Approximately 6% of accounts receivable was attributable to a contract with Agora as of December 31, 2014 and June 30, 2014, respectively.

In late fiscal year 2014, Agora commenced a request for proposal process for the services and products required to operate the school after the 2014-15 school year in connection with its charter renewal application. Agora had previously announced that it would absorb its general administrative services and certain human resources functions as well as name vendors for select services which are currently provided by the Company. On October 9, 2014, the Company entered into a three year contract with Agora for a reduced scope of services that will include providing the academic curriculum to Agora beginning in the 2015-16 school year.

***Consolidation***

The condensed consolidated financial statements include the accounts of the Company, its wholly-owned and affiliated companies that the Company owns, directly or indirectly, and all controlled subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

***Inventories***

Inventories consist primarily of textbooks and curriculum materials, a majority of which are supplied to virtual public schools and blended public schools and utilized directly by students. Inventories represent items that are purchased and held for sale and are recorded at the lower of cost (first-in, first-out method) or market value. Excess and obsolete inventory reserves are established based upon the evaluation of the quantity on hand relative to demand. During the three and six months ended December 31, 2013, the Company increased the provision for excess and obsolete inventory by \$6.1 million primarily related to the decision to discontinue certain products and excess inventory relative to anticipated demand. The excess and obsolete inventory reserve was \$6.0 million and \$9.0 million at December 31, 2014 and June 30, 2014, respectively.

***Other Current Assets***

Other current assets consist primarily of textbooks, curriculum materials and other supplies which are expected to be returned upon the completion of the school year. Materials not returned are expensed as part of instructional costs and services.

***Property and Equipment***

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation expense is calculated using the straight-line method over the estimated useful life of the asset (or the lesser of the term of the lease and the estimated useful life of the asset under capital lease). Amortization of assets capitalized under capital lease arrangements is included in depreciation expense. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful life of the asset. The Company determines the lease term in accordance with ASC 840, *Leases*, as the fixed non-cancelable term of the lease plus all periods for which failure to renew the lease imposes a penalty on the lessee in an amount such that renewal appears, at the inception of the lease, to be reasonably assured. Depreciation expense for the three and six months ended December 31, 2014 and 2013 was \$7.2 million and \$14.4 million, respectively, and \$14.6 million and \$23.4 million, respectively.

Property and equipment are depreciated over the following useful lives:

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	<b>Useful Life</b>
Student computers and tablets	3 years
Computer hardware	3 years
Computer software	3-5 years
Web site development costs	3 years
Office equipment	5 years
Furniture and fixtures	7 years
Leasehold improvements	3-12 years

During the three and six months ended December 31, 2013, the Company updated the estimate of unreturned computers based on an analysis of recent trends of returns and utilization rates, as well as information obtained from the student computer processing systems. As a result, the Company recorded accelerated depreciation of \$6.3 million for computers that were estimated would not be returned by the Company's students. During the three and six months ended December 31, 2014, the Company recorded \$1.4 million and \$2.7 million in accelerated depreciation, respectively, related to the estimate.

***Capitalized Software Costs***

The Company develops software for internal use. Software development costs incurred during the application development stage are capitalized in accordance with ASC 350, *Intangibles – Goodwill and Other*. The Company amortizes these costs over the estimated useful life of the software, which is generally three years. Capitalized software development costs are stated at cost less accumulated amortization.

Capitalized software development additions totaled \$17.1 million and \$10.6 million for the six months ended December 31, 2014 and 2013, respectively. During the three and six months ended December 31, 2013, the Company wrote down approximately \$3.8 million of capitalized software projects after determining the assets either had no future use or were being sunset. During the three and six months ended December 31, 2014, there were no such write-downs of capitalized software projects.

Amortization expense for the three months ended December 31, 2014 and 2013 was \$5.3 million and \$7.9 million, respectively. Amortization expense for the six months ended December 31, 2014 and 2013 was \$10.1 million and \$11.1 million, respectively. Amortization expense for the three and six months ended December 31, 2013 included the write down.

***Capitalized Curriculum Development Costs***

The Company internally develops curriculum, which is primarily provided as online content and accessed via the Internet. The Company also creates textbooks and other materials that are complementary to online content.

The Company capitalizes curriculum development costs incurred during the application development stage in accordance with ASC 350. The Company capitalizes curriculum development costs during the design and deployment phases of the project. Many of the Company's new courses leverage off of proven delivery platforms and are primarily content, which has no technological hurdles. As a result, a significant portion of the

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Company's courseware development costs qualify for capitalization due to the concentration of its development efforts on the content of the courseware. Capitalization ends when a course is available for general release to its customers, at which time amortization of the capitalized costs begins. The period of time over which these development costs will be amortized is generally five years.

Total capitalized curriculum development additions were \$7.3 million and \$7.6 million for the six months ended December 31, 2014 and 2013, respectively. These amounts are recorded on the accompanying condensed consolidated balance sheets net of amortization charges. In addition, for the three and six months ended December 31, 2013 the Company wrote down approximately \$2.2 million of capitalized curriculum cost due to its decision to discontinue certain curriculum. Amortization is recorded in product development expenses on the accompanying condensed consolidated statements of operations. Amortization expense for the three months ended December 31, 2014 and 2013 was \$4.5 million and \$6.4 million, respectively. Amortization expense for the six months ended December 31, 2014 and 2013 was \$8.5 million and \$10.3 million, respectively. Amortization expense for the three and six months ended December 31, 2013 included the write down. During the three and six months ended December 31, 2014, there were no such write-downs of capitalized software projects.

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***Income Taxes***

The Company accounts for income taxes in accordance with ASC 740, Income Taxes. Under ASC 740, deferred tax assets and liabilities are computed based on the difference between the financial reporting and income tax bases of assets and liabilities using the enacted marginal tax rate. ASC 740 requires that the net deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the net deferred tax asset will not be realized.

***Series A Special Stock***

The Company issued 2,750,000 shares of Series A Special stock in July 2010 in connection with an acquisition. The holders of the Series A Special stock had the right to convert those shares into common stock on a one-for-one basis and the right to vote on all matters presented to K12 stockholders, other than for the election and removal of directors, for which holders of the Series A Special stock had no voting rights. These shares were converted into common stock on September 3, 2013 and no Series A Special stock remains outstanding as of December 31, 2014 and 2013.

***Noncontrolling Interest***

Earnings or losses attributable to other stockholders of a consolidated affiliated company are classified separately as noncontrolling interest in the Company's condensed consolidated statements of operations. Net loss attributable to noncontrolling interest reflects only its share of the after-tax earnings or losses of an affiliated company. Income taxes attributable to noncontrolling interest are determined using the applicable statutory tax rates in the jurisdictions where such operations are conducted. These rates vary from country to country. The Company's condensed consolidated balance sheets reflect noncontrolling interests within the equity section of the condensed consolidated balance sheet, except for redeemable noncontrolling interests. Noncontrolling interest was classified separately in the Company's condensed consolidated statements of stockholders' equity. Except for the redeemable non-controlling interests, the businesses with non-controlling interests were sold during fiscal 2014, and therefore the Company no longer has these non-controlling interests after the sale date.

***Redeemable Noncontrolling Interests***

Noncontrolling interests in subsidiaries that are redeemable outside of the Company's control for cash or other assets are classified outside of permanent equity at redeemable value which approximates fair value. The redeemable noncontrolling interests are adjusted to their fair value at each balance sheet date. The resulting increases or decreases in the estimated redemption amount are affected by corresponding charges against retained earnings, or in the absence of retained earnings, additional paid-in-capital.

***Goodwill and Intangible Assets***

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The Company records as goodwill the excess of purchase price over the fair value of the identifiable net assets acquired. Finite-lived intangible assets acquired in business combinations subject to amortization are recorded at their fair value. Finite-lived intangible assets include trade names, acquired customers and non-compete agreements. Such intangible assets are amortized on a straight-line basis over their estimated useful lives. Amortization expense for the three months ended December 31, 2014 and 2013 was \$0.6 million and \$5.9 million, respectively. Amortization expense for the six months ended December 31, 2014 and 2013 was \$1.3 million and \$6.7 million, respectively. Future amortization of intangible assets is \$1.4 million, \$2.5 million, \$1.9 million, \$1.9 million and \$1.9 million in the fiscal years ending June 30, 2015 through June 30, 2019, respectively, and \$12.9 million thereafter. As of December 31, 2014 and June 30, 2014, goodwill balances were \$67.2 million and \$58.1 million, respectively.

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The Company reviews its recorded finite-lived intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between fair value and the carrying value of the asset.

ASC 350 prescribes a two-step process for impairment testing of goodwill and intangibles with indefinite lives, which is performed annually, as well as when an event triggering impairment may have occurred. ASC 350 also allows preparers to qualitatively assess goodwill impairment through a screening process which would permit companies to forgo Step 1 of their annual goodwill impairment process. This qualitative screening process will hereinafter be referred to as Step 0. Goodwill and intangible assets deemed to have an indefinite life are tested for impairment on an annual basis, or earlier when events or changes in circumstances suggest the carrying amount may not be fully recoverable. The Company has elected to perform its annual assessment on May 31st.

On July 31, 2014, the Company acquired a 51% majority interest in LearnBop Inc. ( LearnBop ), for \$6.5 million in cash (see Note 11). The purchase price allocation for the acquisition is preliminary; however, the Company does not expect the final purchase price allocation of LearnBop Inc. to be materially different.

The following table represents goodwill movements during the six months ended December 31, 2014:

<b>Rollforward of Goodwill</b>	<b>Amount</b>	
	<b>(\$ in millions)</b>	
Balance as of June 30, 2014	\$	58.1
Acquisition of LearnBop, Inc.		9.0
Adjustments due to foreign exchange translations		0.1
Balance as of December 31, 2014	\$	67.2

The following table represents the balance of intangible assets as of December 31, 2014 and June 30, 2014:

**Intangible Assets:**

(\$ in millions)	December 31, 2014			June 30, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Trade names	\$ 17.5	\$ (5.1)	\$ 12.4	\$ 17.5	\$ (4.6)	\$ 12.9
Customer and distributor relationships	18.2	(8.4)	9.8	18.2	(7.7)	10.5
Developed technology	1.2	(1.2)		1.2	(1.2)	
Other	0.5	(0.2)	0.3	0.5	(0.2)	0.3
	\$ 37.4	\$ (14.9)	\$ 22.5	\$ 37.4	\$ (13.7)	\$ 23.7

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As of December 31, 2013 the Company determined that based on the rebranding of the Institutional business, the Company fully amortized certain trade names that were no longer going to be used and recorded a \$5.2 million impairment charge for the three and six months ended December 31, 2013. There were no such impairment charges for the three and six months ended December 31, 2014.

### *Impairment of Long-Lived Assets*

Long-lived assets include property, equipment, capitalized curriculum and software developed or obtained for internal use. In accordance with ASC 360, *Property, Plant and Equipment*, management reviews the Company's recorded long-lived assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. The Company determines the extent to which an asset may be impaired based upon its expectation of the asset's future usability as well as on a reasonable assurance that the future cash flows associated with the asset will be in excess of its carrying amount.



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If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between fair value and the carrying value of the asset. There were no such impairment charges for the three and six months ended December 31, 2014 and 2013.

***Fair Value Measurements***

ASC 820, *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants at the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

ASC 820 describes three levels of inputs that may be used to measure fair value:

Level 1: Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instrument's valuation.

The carrying values reflected in the accompanying condensed consolidated balance sheets for cash and cash equivalents, receivables and short and long term debt approximate their fair values.

The redeemable noncontrolling interest is a result of the Company's joint venture with Middlebury College to form Middlebury Interactive Languages (MIL) and the Company's acquisition of LearnBop, Inc. Under the agreement, Middlebury College has an irrevocable election to sell all (but not less than all) of its membership interest to the Company (put right). As part of the acquisition agreement, LearnBop, Inc. has an irrevocable election to sell all (but not less than all) of its ownership interest to the Company (put right). The fair value of the redeemable noncontrolling interests reflects management's best estimate of the redemption value of the put rights.

The following table summarizes certain fair value information at December 31, 2014 for assets and liabilities measured at fair value on a recurring basis:

Description	Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Input (Level 2)	Significant Unobservable Inputs (Level 3)
		(In thousands)		
Redeemable Noncontrolling Interest in Middlebury Joint Venture	\$ 16,801	\$	\$	\$ 16,801
Redeemable Noncontrolling Interest in LearnBop, Inc.	\$ 3,000	\$	\$	\$ 3,000
<b>Total</b>	<b>\$ 19,801</b>	<b>\$</b>	<b>\$</b>	<b>\$ 19,801</b>

The following table summarizes certain fair value information at June 30, 2014 for assets and liabilities measured at fair value on a recurring basis:

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Description	Fair Value	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Input (Level 2)	Significant Unobservable Inputs (Level 3)
(In thousands)				
Redeemable Noncontrolling Interest in Middlebury Joint Venture	\$ 16,801	\$	\$	\$ 16,801
Total	\$ 16,801	\$	\$	\$ 16,801

The following table summarizes the activity during the six months ended December 31, 2014 for assets and liabilities measured at fair value on a recurring basis:

Description	Fair Value June 30, 2014	Six Months Ended December 31, 2014		Fair Value December 31, 2014
		Purchases, Issuances, and Settlements	Unrealized Gains/(Losses)	
(In thousands)				
Redeemable Noncontrolling Interest in Middlebury Joint Venture	\$ 16,801	\$	\$	\$ 16,801
Redeemable Noncontrolling Interest in LearnBop, Inc.			3,000	3,000
Total	\$ 16,801	\$	\$ 3,000	\$ 19,801

The fair values of the redeemable noncontrolling interests in the Middlebury Joint Venture and LearnBop, Inc. were measured in accordance with ASC 480-10-S99, *Accounting for Redeemable Equity Instruments*. The fair value of the Middlebury Joint Venture was based upon a valuation from a third-party valuation firm as of June 30, 2014. As of December 31, 2014, the Company performed an internal analysis and determined there was no underlying change in the estimated fair market value for both Middlebury and LearnBop, Inc. This analysis incorporated a number of assumptions and estimates including the financial results of the joint venture to date.

***Net Income (Loss) Per Common Share***

The Company calculates net income (loss) per share in accordance with ASC 260, *Earnings Per Share*. Under ASC 260, basic net income (loss) per common share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. The weighted average number of shares of common stock outstanding includes vested restricted stock awards. Diluted net income (loss) per share (EPS) reflect the potential dilution that could occur assuming conversion or exercise of all dilutive unexercised stock options. The dilutive effect of stock options and restricted stock awards was determined using the treasury stock method. Under the treasury stock method, the proceeds received from the exercise of stock options and restricted stock awards, the amount of compensation cost for future service not yet recognized by the Company and the amount of tax benefits that would be recorded in additional paid-in capital when the stock options become deductible for income tax purposes are all assumed to be used to repurchase shares of the Company's common stock. Stock options and restricted stock awards are not included in the computation of diluted net income (loss) per share when they are antidilutive. Common stock outstanding reflected in the Company's condensed consolidated balance sheets include restricted stock awards outstanding. Securities that may participate in undistributed net income with common stock are considered participating securities.



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Basic and dilutive income (loss) per share:	Three Months Ended December 31,		Six Months Ended December 31,	
	2014	2013	2014	2013
	(In thousands except shares and per share data)		(In thousands except shares and per share data)	
Net income (loss) attributable to common stockholders, including Series A stockholders	\$ 12,331	\$ (3,665)	\$ 5,557	\$ (8,705)
Weighted average common shares basic	37,096,480	39,977,228	37,396,081	38,953,671
Weighted average common shares diluted	37,160,829	39,977,228	37,599,930	38,953,671
Basic net income (loss) per share	\$ 0.33	\$ (0.09)	\$ 0.15	\$ (0.22)
Diluted net income (loss) per share	\$ 0.33	\$ (0.09)	\$ 0.15	\$ (0.22)

For the three months ended December 31, 2014 and December 31, 2013, the dilutive shares totaled 64,349 and zero, respectively. For the six months ended December 31, 2014 and December 31, 2013, the dilutive shares totaled 203,849 and zero, respectively. At December 31, 2014, the Company had 41,841,573 shares issued and 38,338,975 outstanding.

The basic and diluted weighted average common shares were the same for the three and six months ended December 31, 2013 as the inclusion of dilutive securities and Series A special stock prior to the conversion date would have been anti-dilutive.

***Recent Accounting Pronouncements***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), which supersedes most existing revenue recognition guidance under US GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is currently evaluating the impact of the pending adoption of ASU 2014-09 on its consolidated financial statements and has not yet determined the method by which the Company will adopt the standard in 2017.

**4. Income Taxes**

The benefit (expense) for income taxes is based on income (loss) reported in the condensed consolidated financial statements. A deferred income tax asset or liability is determined by applying currently enacted tax laws and rates to the expected reversal of the cumulative temporary differences between the carrying value of assets and liabilities for financial statement and income tax purposes. Deferred income tax expense or benefit is measured by the change in the deferred income tax asset or liability during the period. For the three months ended December 31, 2014 and 2013, the Company's effective income tax rate was 42.0% and 52.4%, respectively. For the six months ended December 31, 2014 and 2013, the Company's effective income tax rate was a 28.3% and 46.5%, respectively. The effective income tax rate differs from the statutory federal income tax rate primarily due to the effects of foreign operations, state taxes, non-controlling interests, prior year favorable adjustments related to tax elections on the sale of certain businesses in June 2014 and current year permanent differences between book and tax treatment.



Table of Contents**5. Long-term Obligations***Capital Leases*

The Company incurs capital lease obligations for student computers under a lease line of credit with PNC Equipment Finance, LLC with annual borrowing limits. The Company had annual borrowing availability under the lease line of credit of \$35.0 million as of December 31, 2014 and June 30, 2014, respectively. As of December 31, 2014 and June 30, 2014, the aggregate outstanding balance under the lease line of credit, including balances from prior years, was \$32.4 million and \$36.9 million, respectively, with lease interest rates ranging from 2.49% to 3.08%. Individual leases under the lease line of credit include 36-month payment terms with a \$1 purchase option at the end of each lease term. The Company has pledged the assets financed to secure the outstanding leases. The lease line of credit was subject to cross default compliance provisions in the Company's line of credit agreement with PNC Bank, N.A. (see Note 6). The net carrying value of leased student computers as of December 31, 2014 and June 30, 2014 was \$23.8 million and \$20.9 million, respectively.

In July 2014, the Company extended its leasing agreement with an annual borrowing limit of \$35 million for fiscal year 2015. This availability expires in July 2015 and interest rates on the new borrowings are based upon an initial rate of 2.34% modified by changes in the three year interest rate swaps rate as published in the Federal Reserve Statistical Release H.15, Selected Interest Rates, between June 25, 2014 and the Lease Commencement Date, as defined in the lease line of credit.

The following is a summary as of December 31, 2014 of the present value of the net minimum payments due on outstanding capital leases under the Company's commitments:

<b>As of June 30,</b>	<b>Capital Leases (\$ in thousands)</b>
2015	\$ 10,483
2016	14,404
2017	7,063
2018	1,312
Total minimum payments	33,262
Less amount representing interest (imputed weighted average capital lease interest rate of 2.73%)	(898)
Net minimum payments	32,364
Less current portion	(18,255)
Present value of minimum payments, less current portion	\$ 14,109

**6. Line of Credit**

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The Company had a \$35 million unsecured line of credit that expired on December 31, 2013 with PNC Bank, N.A. which was available for general corporate operating purposes. On January 31, 2014, the Company executed a \$100 million unsecured line of credit with Bank of America, N.A. to be used for general corporate operating purposes. The line has a five year term and bears interest at the higher of the banks Prime Rate, the Federal Funds Rate plus 0.50% or the LIBOR Rate plus 1.00%; plus the applicable rate. The Credit Agreement includes a \$10 million letter of credit facility. Issuance of letters of credit reduces the availability of permitted borrowings under the Credit Agreement. The Company had no amounts outstanding on the line of credit and \$0.2 million outstanding on the letter of credit facilities during the six month period ended December 31, 2014.

The Credit Agreement contains a number of financial and other covenants that, among other things; restrict the Company and its subsidiaries ability to incur additional indebtedness, grant liens or other security interests, make certain investments, make specified restricted payments including dividends, dispose of assets or stock including the stock of its subsidiaries, make capital expenditures above specified limits and engage in other matters customarily restricted in senior credit facilities. The agreement incorporates



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customary financial and other covenants, including but not limited to maximum debt leverage and minimum fixed charge coverage ratios. As of December 31, 2014 and June 30, 2014, the Company was in compliance with these covenants.

**7. Equity Transactions*****Stock Options***

Stock option activity during the six months ended December 31, 2014 was as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding, June 30, 2014	2,578,401	\$ 21.44	4.57	\$ 42,754
Granted	454,485	13.97		
Exercised	(63,214)	2.55		
Forfeited or canceled	(92,206)	27.33		
Outstanding, December 31, 2014	2,877,466	\$ 20.49	4.79	\$ 79
Stock options exercisable at December 31, 2014	1,867,447	\$ 20.48	3.64	\$ 66

The aggregate intrinsic value of options exercised during the six months ended December 31, 2014 was \$0.3 million. The weighted-average grant date fair value of options granted during the six months ended December 31, 2014 was \$7.20.

As of December 31, 2014, there was \$7.1 million of total unrecognized compensation expense related to unvested stock options granted. The cost is expected to be recognized over a weighted average period of 2.7 years. During the three and six months ended December 31, 2013 the Company recorded additional stock-based compensation of \$1.5 million associated with the accelerated vesting of option awards to its former Chief Executive Officer and other employees upon termination of employment. During the three months ended December 31, 2014 and December 31, 2013, the Company recognized \$0.9 million and \$2.7 million, respectively, of stock-based compensation expense related to stock options. During the six months ended December 31, 2014 and 2013, the Company recognized \$2.0 million and \$3.7 million, respectively, of stock-based compensation expense related to stock options.

***Restricted Stock Awards***

Restricted stock award activity during the six months ended December 31, 2014 was as follows:

	Shares		Weighted-Average Fair Value
Outstanding, June 30, 2014	979,595	\$	22.97
Granted	745,775		18.14
Vested	(235,600)		25.88
Forfeited or canceled	(28,151)		23.15
Outstanding, December 31, 2014	1,461,619	\$	23.31

As of December 31, 2014, there was \$22.0 million of total unrecognized compensation expense related to unvested restricted stock awards granted. The cost is expected to be recognized over a weighted average period of 2.0 years. The total fair value of shares vested during the six months ended December 31, 2014 was \$4.2 million. During the three and six months ended December 31, 2013 the Company recorded additional stock-based compensation of \$2.5 million associated with the accelerated vesting of equity awards to its former Chief Executive Officer and other employees upon termination of employment.

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During the three months ended December 31, 2014 and December 31, 2013, the Company recognized \$3.8 million and \$5.8 million, respectively, of stock-based compensation expense related to restricted stock awards. During the six months ended December 31, 2014 and 2013, the Company recognized \$6.9 million and \$8.5 million, respectively, of stock-based compensation expense related to restricted stock awards.

**8. Related Party Transactions**

During the six months ended December 31, 2013, in accordance with the original terms of the joint venture agreement, the Company loaned \$1.0 million to its 60% owned joint venture, MIL. At December 31, 2014 and June 30, 2014, the loan totaled \$4.0 million and was repayable under terms and conditions specified in the loan agreement. The loan balance and related interest are eliminated since MIL is consolidated in the Company's financial statements; however, repayment of the loan is dependent on the continued liquidity of MIL.

On September 11, 2013, the Company issued a mortgage note ( Mortgage ) lending \$2.1 million to a managed school partner. The note bears interest at a fixed rate of 5.25% per year and has a term of five years. Monthly principal and interest payments began in October 2013 with a final balloon payment of \$1.8 million at the term of the loan. The Mortgage is primarily secured by the underlying property.

**9. Commitments and Contingencies**

*Litigation*

In the ordinary conduct of business, the Company is subject to lawsuits, arbitrations and administrative proceedings from time to time. The Company expenses legal costs as incurred.

*IpLearn*

On October 26, 2011, IpLearn, LLC ( IpLearn ) filed a complaint for patent infringement against the Company in the United States District Court for the District of Delaware, *IpLearn, LLC v. K12 Inc.*, Case No. 1:11-1026-RGA, which it subsequently amended on November 18, 2011. IpLearn is a privately-held technology development and licensing company for web and computer-based learning technologies. On December 17, 2014, the Court granted the Company's motion for summary judgment on the basis that the asserted patent was invalid. On January 16, 2015, the Court approved a Stipulation of Dismissal whereby all counts in IpLearn's amended complaint have been dismissed with prejudice and the appeal period was concluded.

*Oklahoma Firefighters Complaint*

On January 30, 2014, a securities class-action lawsuit captioned *Oklahoma Firefighters Pension & Retirement System v. K12 Inc., et al.*, was filed against the Company, four of its officers and directors, and a former officer, in the United States District Court for the Eastern District of Virginia, *In re K12 Inc. Securities Litigation*, Case No. 1:14-CV-108-AJT-JFA. On June 24, 2014 the Court appointed the Oklahoma Firefighters Pension and Retirement System as lead plaintiff, and on May 23, 2014 the lead plaintiff filed an amended class action complaint ( Amended Complaint ). On November 5, 2014, the Court granted the Company's motion to dismiss the Amended Complaint and the deadline for the plaintiff to appeal the Court's decision has expired.

## 10. Investments

### *Investment in Web International Education Group, Ltd.*

In January 2011, the Company invested \$10.0 million to obtain a 20% minority interest in Web International Group, Ltd. ( Web ), a provider of English language learning centers in cities throughout China. From January 2011 through May 2013, the Company recorded its investment in Web as an available for sale debt security because of the ability to put the investment to other Web shareholders in return for the original \$10.0 million investment plus interest. The Company's option to purchase no less than 51% of

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Web expired on March 31, 2013 and on May 6, 2013, the Company exercised its right to put its investment back to Web for return of its original \$10.0 million investment plus interest of 8%, which Web was contractually required to pay by May 31, 2014, as amended. The Company reclassified this \$10.0 million investment plus accrued interest of \$3.2 million to a receivable, which is included in other current assets. The receivable is due and continues to accrue interest while Web works to administratively process the payment. During the three months ended December 31, 2014 and 2013, the Company recorded interest income of \$0.2 million and \$0.2 million, respectively, associated with Web. During the six months ended December 31, 2014 and 2013, the Company recorded interest income of \$0.4 million and \$0.4 million, respectively.

*Investment in School Mortgage*

On September 11, 2013, the Company issued a mortgage note ( Mortgage ) lending \$2.1 million to a managed school partner. The note bears interest at a fixed rate of 5.25% per year and has a term of five years. Monthly principal and interest payments will be made beginning October 2013 with a final balloon payment of \$1.8 million at the term of the loan. The Mortgage is primarily secured by the underlying property.

The Mortgage and ancillary documents include customary affirmative and financial covenants for secured transactions of this type. The Company has recorded this as a held to maturity investment and the current amounts are included in other current assets while the non-current amounts are included in deposits and other assets on the condensed consolidated balance sheets.

In January 2015, a Delaware judge's ruling affirmed that the school's charter would be revoked effective June 30, 2015. Therefore, the Company anticipates the school closing unless there is a change in current circumstances. The Company will exercise its rights under the existing arrangement.

**11. Redeemable Noncontrolling Interest**

*Investment in LearnBop Inc.*

On July 31, 2014, the Company acquired a majority interest in LearnBop Inc. ( LearnBop ), for \$6.5 million in cash in return for a 51% interest in LearnBop. The purpose of the acquisition is to complement the Company's K-12 math curriculum as LearnBop has developed an adaptive math curriculum learning software. As part of this transaction, the non-controlling shareholders have a non-transferable put option, which is exercisable between July 31, 2018 and December 31, 2018 for the remaining minority interest. The price of the put option will be determined based on the trailing twelve month revenue and contribution margin as defined in the Stockholders' Agreement between the Company and LearnBop. Additionally, the Company has a non-transferable call option for the remaining minority interest at a price of \$3.0 million, which becomes exercisable January 1, 2019 or thereafter. Acquisition costs incurred by the Company related to this transaction included in selling, administrative and other operating expenses were \$0.1 million.

The purchase price of \$6.5 million was preliminarily allocated to the underlying assets and liabilities based on their estimated fair value at the date of acquisition. The Company is still evaluating the fair value of assets acquired and liabilities assumed, and the Company expects to finalize

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these amounts in a subsequent period. The Company preliminarily recorded goodwill of \$9.0 million, which will be non-deductible for tax purposes. Recognition of goodwill is largely attributed to the value paid for LearnBop's capabilities in providing adaptive learning software for math curriculum to K-12 students. The Company has not disclosed current period or pro-forma revenue and earnings attributable to LearnBop as they are immaterial.

The following table represents the preliminary purchase price allocation for LearnBop in millions:

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As of July 31, 2014	Amount
Current assets	\$ 0.2
Property and equipment, net	0.4
Goodwill	9.0
Current liabilities	(0.1)
Redeemable noncontrolling interest	(3.0)
Fair value of total consideration transferred	\$ 6.5

***Middlebury College Joint Venture***

In April 2010, a subsidiary of the Company entered into an agreement to establish a venture with Middlebury College (Middlebury) to form a new entity named Middlebury Interactive Languages LLC (MIL) effective May 2010. The Company's investment into this venture consisted of \$4.0 million in cash and contributed assets, including substantially all of its foreign languages subsidiary, in return for a 60% ownership interest. Middlebury's investment in the venture consisted of \$4.0 million in cash, \$0.6 million in assumed liabilities and contributed assets, including a license to use its trademark and a foreign language instruction summer camps business, in return for a 40% ownership interest. The purpose of the venture is to create and distribute innovative, high-quality online language courses under the trademark Middlebury and other marks. Transaction expenses incurred by the Company related to this transaction included in selling, administrative and other operating expenses were \$0.2 million.

At any time after the fifth (5th) anniversary of the agreement, Middlebury may give written notice of its irrevocable election to sell all (but not less than all) of its Membership Interest to the Company (put right). The purchase price for Middlebury's Membership Interest shall be its fair market value and the Company may, in its sole discretion, pay the purchase price in cash or shares of the Company's common stock. At June 30, 2014, MIL had not met certain milestones associated with its Language Academy summer camp programs. As such, Middlebury may exercise its option to either repurchase the camp programs at fair market value along with other contractual rights. Middlebury has neither exercised nor expressed an intent to exercise the option.

Given the provision of the put rights, the redeemable noncontrolling interests are redeemable outside of the Company's control and are recorded outside of permanent equity at their redemption value fair value in accordance with ASC 480-10-S99, *Accounting for Redeemable Equity Instruments*. The Company will adjust the redeemable noncontrolling interests to redemption value on each balance sheet date with changes in redemption values recognized as an adjustment to retained earnings, or in the absence of retained earnings, by adjustment to additional paid-in-capital.

Table of Contents**12. Supplemental Disclosure of Cash Flow Information**

	2014	Six Months Ended December 31, (In thousands)	2013
Cash paid for interest	\$	428	\$ 569
Cash paid for taxes, net of refunds	\$	8,188	\$ 2,747
Supplemental disclosure of non-cash financing activities:			
New capital lease obligations	\$	6,912	\$ 17,290
Supplemental disclosure of non-cash investing activities:			
Business Combinations:			
Current assets	\$	27	\$
Property and equipment	\$	350	\$
Intangible assets	\$	27	\$
Goodwill	\$	8,982	\$
Assumed liabilities	\$	(50)	\$
Deferred revenue	\$	(23)	\$

**13. Common Stock Repurchases**

On November 4, 2013, the Board of Directors authorized the repurchase of up to \$75 million of the Company's outstanding common stock over a two year period. The stock purchases under the buyback were dependent upon business and market conditions and other factors. The stock purchases were made from time to time and may be made through a variety of methods including open market purchases and in accordance with the SEC's Rule 10b5-1. For the six months ended December 31, 2014, the Company paid approximately \$26.5 million for the repurchase of 1,307,402 shares, at an average cost of \$20.21 per share. As of December 31, 2014 total shares purchased under the plan were 3,502,598, at an average cost of \$21.41 per share, and there were no shares remaining to be repurchased under the plan.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*Certain statements in Management's Discussion and Analysis or MD&A, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These forward-looking statements generally are identified by the words believe, project, expect, anticipate, estimate, intend, strategy, plan, may, should, will, would, will be, will continue, will likely result, and similar expressions. Historical results may not indicate future performance. Our forward-looking statements reflect our current views about future events, are based on assumptions and are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those contemplated by these statements. Factors that may cause differences between actual results and those contemplated by forward-looking statements include, but are not limited to, those discussed in Risk Factors in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended June 30, 2014, which we refer to as our Annual Report. We undertake no obligation to publicly update or revise any forward-looking statements, including any changes that might result from any facts, events or circumstances after the date hereof that may bear upon forward-looking statements. Furthermore, we cannot guarantee future results, events, levels of activity, performance or achievements.*



*This MD&A is intended to assist in understanding and assessing the trends and significant changes in our results of operations and financial condition. As used in this MD&A, the words, we, our and us refer to K12 Inc. and its consolidated subsidiaries. This MD&A should be read in conjunction with our*

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*condensed consolidated financial statements and related notes included in this report, as well as the consolidated financial statements and MD&A of our Annual Report. The following overview provides a summary of the sections included in our MD&A:*

- *Executive Summary* a general description of our business and key highlights of the six months ended December 31, 2014.
- *Critical Accounting Policies and Estimates* a discussion of critical accounting policies requiring critical judgments and estimates.
- *Results of Operations* an analysis of our results of operations in our condensed consolidated financial statements.
- *Liquidity and Capital Resources* an analysis of cash flows, sources and uses of cash, commitments and contingencies, seasonality in the results of our operations and quantitative and qualitative disclosures about market risk.

**Executive Summary**

We are a technology-based education company. We offer proprietary curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade, or K-12. Our mission is to maximize a child's potential by providing access to an engaging and effective education, regardless of geographic location or socio-economic background. Since our inception, we have invested to develop and acquire curriculum and online learning platforms that promote mastery of core concepts and skills for students of all abilities. K12 provides a continuum of technology-based educational products and solutions to school districts, public schools, private schools, charter schools and families as we strive to transform the educational experience into one that delivers individualized education on a highly scalable basis.

We believe that the acceptance of online education in grades K-12 continues to grow, and anticipate that this trend will translate into stronger demand for both our Non-Managed Programs and Institutional Sales line of business (sold under the brand names FuelEducation or FuelEd). At the same time, the Managed Program business, which serves primarily virtual charter schools, is maturing. Regulatory requirements related to academic performance and accountability are expanding, and the governing boards of the virtual charter schools that contract with us are exercising their independent authority to modify their approach to virtual education depending upon their own charter school goals. This in turn may alter the nature of the agreements we have with those boards and the level of management services that meet their needs. For example, the Agora Cyber Charter School recently renegotiated its service agreement at renewal and entered into a three-year contract with us to provide Agora students with the K12 curriculum starting in the 2015-2016 school year, and with the school board deciding to self-manage its operations. Conversely, as more states and charter schools offer an online public school option, we expect that many customers may prefer the option of contracting with us for a fully integrated, virtual school turn-key operation that we manage. To reflect these developments, we have therefore updated the classification of our previously described Managed Public Schools to a new classification of Public School Programs, which is described in greater detail below.

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Public School Programs accounted for approximately 90% of our revenue in the six months ended December 31, 2014. Public School Programs include both Managed and Non-managed Programs. Managed Programs include schools where K12 provides substantially all of the management, technology and academic support services in addition to curriculum, learning systems and instructional services. Non-managed Programs include schools where K12 provides curriculum and technology, and the school can also contract for instruction or other educational services. Non-managed programs, however, do not offer primary administrative oversight. We currently operate Public School Programs in 33 states and the District of Columbia.

Through our Institutional Sales business, we sell online curriculum programs, courses, teacher and administrative support as well as tools and platforms (see description of PEAK below) to a growing number of schools and school districts. In addition to curriculum, systems and programs, we also provide teacher training, teaching services and other support services.

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The services we provide to these schools and school districts are designed to assist them in launching their own online learning programs which vary according to the needs of the individual school and school district and may include teacher training programs, administrator support and our PEAK management system. PEAK (Personalize, Engage and Achieve) is a platform designed to centrally manage multiple online solutions across a school or district through one application. With our array of services, schools and districts can offer programs that allow students to participate part-time, supplementing their education with core courses, electives, credit recovery options, remediation and supplemental content options. We continue to provide these services to school districts or individual schools in all 50 states and the District of Columbia.

We operate three online private schools in which parents can enroll students on a tuition basis for a full-time online education or individual courses to supplement their children's traditional instruction. These schools are: (1) K12 International Academy, an online private school that enables us to offer students worldwide the same full-time education programs and curriculum that we provide to the virtual and blended public schools, (2) The Keystone School, a private school that offers online and correspondence courses, and (3) the George Washington University Online High School, a school that offers college preparatory curriculum and is designed for high school students who are seeking a challenging academic experience. In addition, during the past year, we owned and operated the International School of Berne, a traditional private school located in Berne, Switzerland and a recognized IB school serving students in grades Pre-K through 12. In June 2014, we completed a sale of certain businesses, including the International School of Berne. The other businesses divested consisted of our interest in an existing Middle East joint venture and our post-secondary business.

For the six months ended December 31, 2014, we increased revenues to \$468.0 million from \$452.3 million in the same period in the prior year, a growth rate of 3.5%. Over the same period, we had operating income of \$7.3 million versus an operating loss of \$17.4 million in the prior year period, and net income to common stockholders of \$5.6 million, as compared to net loss to common stockholders in the prior year period of \$8.7 million. The operating and net loss for the six months ended December 31, 2013 included \$31.2 million of severance and related stock-based compensation, accelerated depreciation and amortization for certain curriculum, learning systems, trade names, and other fixed assets that will no longer be used or developed and additional provisions for inventory that we previously anticipated using.

## **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with Generally Accepted Accounting Principles requires us to make estimates and assumptions about future events that affect the amounts reported in our condensed consolidated financial statements and accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our consolidated financial statements. Critical accounting policies are disclosed in our Annual Report. There have been no significant updates to our critical accounting policies disclosed in our Annual Report.

## **Results of Operations**

We have three lines of business: Public School Programs (includes both Managed and Non-managed Programs, which includes the previously disclosed Managed Public School line of business), Institutional Sales (educational products and services provided to school districts, public schools and other educational institutions that we do not manage), and International and Private Pay Schools (private schools for which we charge student tuition and make direct consumer sales).

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**Public School Programs  
(Managed and Non-managed)**

**Institutional Sales**

**International and Private Pay Schools**

• Virtual public schools	• K12 curriculum	• Managed private schools
• Blended public schools	• FuelEd Online Courses	• K12 International Academy
Hybrid schools	• FuelEd Anywhere Learning System	• George Washington University Online HS
Flex schools		• The Keystone School
Passport schools	• Middlebury Interactive Languages	• Independent course sales (Consumer)
	• Pre-kindergarten	

Table of Contents**Enrollment Data**

The following table provides detail on student enrollments in Public School Programs as of the October count date. Public School Programs include both virtual and blended schools where a district or independent board has contracted with K12 to provide a full-time program of educational products and services. Enrollments are classified into Managed Programs and Non-managed Programs. Managed Programs include schools where K12 provides substantially all of the management, technology and academic support services in addition to curriculum, learning systems and instructional services. Non-managed Programs include schools where K12 provides curriculum and technology, and the school can also contract for instruction or other educational services. Non-managed Programs, however, do not offer primary administrative oversight.

	Three Months Ended December 31,				Six Months Ended December 31,			
	2014	2013	Change	Change %	2014	2013	Change	Change %
<b>Public School Programs</b>								
Managed Programs (1)	116,258	120,994	(4,736)	-3.9%	116,850	121,856	(5,006)	-4.1%
Non-managed Programs (1)	20,249	14,330	5,919	41.3%	20,472	14,463	6,009	41.5%
<b>Total Public School Programs (2) (3)</b>	<b>136,507</b>	<b>135,324</b>	<b>1,183</b>	<b>0.9%</b>	<b>137,322</b>	<b>136,319</b>	<b>1,003</b>	<b>0.7%</b>

(1) If a school changes from a Managed to a Non-managed Program, the corresponding enrollment classification would change in the period in which the contract arrangement changed.

(2) Public School Programs include enrollments for which K12 receives no public funding or revenue.

(3) Public School Program enrollments are equal to the official count date number, which is the first Wednesday after the end of the first quarter of fiscal year 2015, or October 1, 2014 for the three months ended December 31, 2014 and October 2, 2013 for the three months ended December 31, 2013.

Also provided for reference are the disclosures for the lines of business consistent with the disclosure provided in previous years.

	Three Months Ended December 31,				Six Months Ended December 31,			
	2014	2013	Change	Change %	2014	2013	Change	Change %
<b>Managed Public Schools</b>								
Average Student Enrollments (1)	122,019	125,053	(3,034)	-2.4%	122,655	125,927	(3,272)	-2.6%
<b>International and Private Pay Schools</b>								
Total Student Enrollments	4,423	4,135	288	7.0%	17,433	17,419	14	0.1%
Total Semester Course Enrollments	12,708	12,815	(107)	-0.8%	48,588	50,442	(1,854)	-3.7%

(1) The Managed Public Schools average enrollments include enrollments for which we may receive no public funding. Additionally, Managed Public Schools enrollments include all programs which have been classified as turn-key programs or where substantial management

services are performed in accordance with the contract.

***Revenue by Business Lines***

Revenue is captured by business line based on the underlying customer contractual agreements. The Company is expanding its disclosure on revenue for fiscal year 2015. The following table provides detail on student enrollments revenue in Public School Programs as of the October count date. The following represents our revenue for these lines of business for the three and six months ended December 31, 2014 and 2013.

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(\$ in thousands)	Three Months Ended December 31,		Change 2014 / 2013		Six Months Ended December 31,		Change 2014 / 2013	
	2014	2013	\$	%	2014	2013	\$	%
<b>Public School Programs</b>								
Managed Programs	\$ 196,735	\$ 192,939	\$ 3,796	2.0%	\$ 399,114	\$ 386,497	\$ 12,617	3.3%
Non-managed Programs	11,440	6,940	4,500	64.8	21,685	15,537	6,148	39.6
<b>Public School Programs</b>	<b>208,175</b>	<b>199,879</b>	<b>8,296</b>	<b>4.2</b>	<b>420,799</b>	<b>402,034</b>	<b>18,765</b>	<b>4.7</b>
<b>Institutional Sales</b>	<b>11,833</b>	<b>11,968</b>	<b>(135)</b>	<b>(1.1)</b>	<b>24,716</b>	<b>26,466</b>	<b>(1,750)</b>	<b>(6.6)</b>
<b>International and Private Pay Schools</b>	<b>11,296</b>	<b>12,072</b>	<b>(776)</b>	<b>(6.4)</b>	<b>22,502</b>	<b>23,785</b>	<b>(1,283)</b>	<b>(5.4)</b>
<b>Total</b>	<b>\$ 231,304</b>	<b>\$ 223,919</b>	<b>\$ 7,385</b>	<b>3.3%</b>	<b>\$ 468,017</b>	<b>\$ 452,285</b>	<b>\$ 15,732</b>	<b>3.5%</b>

Also provided for reference is the revenue disclosure for the lines of business consistent with the disclosure provided in previous years.

(\$ in thousands)	Three Months Ended December 31,		Change 2014 / 2013		Six Months Ended December 31,		Change 2014 / 2013	
	2014	2013	\$	%	2014	2013	\$	%
<b>Managed Public Schools</b>	\$ 200,651	\$ 195,265	\$ 5,386	2.8%	\$ 406,623	\$ 392,208	\$ 14,415	3.7%
<b>Institutional Sales</b>	19,357	16,582	2,775	16.7	38,892	36,292	2,600	7.2
<b>International and Private Pay Schools</b>	11,296	12,072	(776)	(6.4)	22,502	23,785	(1,283)	(5.4)
<b>Total</b>	<b>\$ 231,304</b>	<b>\$ 223,919</b>	<b>\$ 7,385</b>	<b>3.3%</b>	<b>\$ 468,017</b>	<b>\$ 452,285</b>	<b>\$ 15,732</b>	<b>3.5%</b>

The following table sets forth statements of operations data in dollars and as a percentage of revenues for each of the periods indicated:

	Three Months ended December 31,		Three Months ended December 31,		Six Months ended December 31,		Six Months ended December 31,	
	2014	2013	2014	2013	2014	2013	2014	2013
	(\$ in thousands)				(\$ in thousands)			
<b>Revenues</b>	\$ 231,304	100.0%	\$ 223,919	100.0%	\$ 468,017	100.0%	\$ 452,285	100.0%
<b>Cost and expenses</b>								
Instructional costs and services	145,029	62.7	153,672	68.6	291,872	62.4	286,574	63.4
Selling, administrative, and other operating expenses	62,557	27.0	75,753	33.8	162,101	34.6	173,996	38.4
Product development expenses	3,245	1.4	3,402	1.5	6,727	1.4	9,086	2.0
<b>Total costs and expenses</b>	<b>210,831</b>	<b>91.1</b>	<b>232,827</b>	<b>104.0</b>	<b>460,700</b>	<b>98.4</b>	<b>469,656</b>	<b>103.8</b>
<b>Income (loss) from operations</b>	<b>20,473</b>	<b>8.8</b>	<b>(8,908)</b>	<b>(4.0)</b>	<b>7,317</b>	<b>1.5</b>	<b>(17,371)</b>	<b>(3.8)</b>
<b>Interest income (expense), net</b>	<b>151</b>	<b>0.1</b>	<b>(28)</b>		<b>182</b>	<b>0.1</b>	<b>(112)</b>	
<b>Income (loss) before income tax expense and noncontrolling interest</b>	<b>20,624</b>	<b>8.9</b>	<b>(8,936)</b>	<b>(4.0)</b>	<b>7,499</b>	<b>1.6</b>	<b>(17,483)</b>	<b>(3.8)</b>
<b>Income tax (expense) benefit</b>	<b>(8,663)</b>	<b>(3.7)</b>	<b>4,685</b>	<b>2.1</b>	<b>(2,125)</b>	<b>(0.5)</b>	<b>8,135</b>	<b>1.8</b>



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<b>Net income (loss)</b>	11,961	5.2	(4,251)	(1.9)	5,374	1.1	(9,348)	(2.0)
<b>Adjust net loss attributable to noncontrolling interest</b>	370	0.1	586	0.3	183	0.1	643	0.1
<b>Net income (loss) attributable to common stockholders, including Series A stockholders</b>	\$ 12,331	5.3%	\$ (3,665)	(1.6)%	\$ 5,557	1.2%	\$ (8,705)	(1.9)%

Table of Contents**Comparison of the Three Months Ended December 31, 2014 and December 31, 2013**

*Revenues.* Our revenues for the three months ended December 31, 2014 were \$231.3 million, representing an increase of \$7.4 million, or 3.3%, from \$223.9 million for the same period in the prior year. Public School Program revenue increased \$8.3 million, or 4.2%, year over year. The growth in Public School Program revenue was primarily attributable to increases in funding in certain states, among other factors. Overall, Public School Program student enrollment increased 0.9% from prior year. Institutional Sales revenue remained flat year over year. Excluding the effect from the sale of certain businesses that were included in the prior period revenue, Institutional Sales increased \$0.9 million or 8.4%. International and Private Pay Schools revenue decreased \$0.8 million, or 6.4%, from the prior year due to the sale of certain businesses which contributed \$3.7 million in revenue in the previous quarter, offset by higher enrollments in the remaining schools.

*Instructional costs and services expenses.* Instructional costs and services expenses for the three months ended December 31, 2014 were \$145.0 million, representing a decrease of \$8.7 million, or 5.7%, from \$153.7 million for the three months ended December 31, 2013. During the three months ended December 31, 2013, there was \$18.6 million of expense related to accelerated depreciation and amortization for certain curriculum, learning systems and other fixed assets that were to no longer be used or developed, computers that we estimated would not be returned and additional provisions for the decision to discontinue certain products and for excess inventory relative to anticipated demand. Excluding the impact of these charges, instructional costs and services would have increased \$9.9 million, or 7.3%. This increase in expense was primarily associated with the increased hiring of teachers, increases in salary and other personnel benefits to teachers and increased special education and other related service fees in our Managed Programs as part of our initiatives to improve the student experience and academic outcome. Instructional costs and services expenses were 62.7% of revenue during the three months ended December 31, 2014, a decrease from 68.6% for the three months ended December 31, 2013. Excluding the impact of the charges noted above, instructional costs and services were 60.3% of revenue for the three months ended December 31, 2013.

*Selling, administrative, and other operating expenses.* Selling, administrative, and other operating expenses for the three months ended December 31, 2014 were \$62.6 million, representing a decrease of \$13.2 million, or 17.4% from \$75.8 million for the three months ended December 31, 2013. Included in expense during the three months ended December 31, 2013 was \$7.4 million related to severance and accelerated stock compensation costs for the termination of employment of our former Chief Executive Officer and other employees, and \$5.2 million related to an impairment charge on trade names that were to no longer be used. Excluding these charges, selling, administrative, and other operating expenses for the three months ended December 31, 2014 decreased \$0.6 million, or 0.9%, as compared to the three months ended December 31, 2013. Selling, administrative, and other operating expenses were 27.0% of revenue during the three months ended December 31, 2014, a decrease from 33.8% for the three months ended December 31, 2013. Excluding the impact of the charges noted above, selling, administrative, and other operating expenses were 28.2% of revenue for the three months ended December 31, 2013. The reduction as a percentage of revenue primarily reflects our overall cost savings initiatives.

*Product development expenses.* Product development expenses for the three months ended December 31, 2014 were \$3.2 million, representing a decrease of \$0.2 million, or 5.9% from \$3.4 million for the three months ended December 31, 2013. As a percentage of revenues, product development expenses decreased to 1.4% for the three months ended December 31, 2014, as compared to 1.5% for the same period in the prior year. The decrease was primarily a result of increased capitalized costs for development projects and an overall decrease in employee related costs supporting product development activities.

*Interest income (expense), net.* Net interest income for the three months ended December 31, 2014 was \$0.2 million as compared to net interest expense of (\$0.03) million in the same period in the prior year. Net interest income is primarily associated with approximately \$0.3 million and \$0.2 million in interest income during the periods ended December 31, 2014 and 2013, respectively, associated primarily with our investment in Web International Education Group, Ltd., offset by interest expense on our student computer capital leases.

*Income tax (expense) benefit.* We had income tax expense of (\$8.7) million for the three months ended December 31, 2014, or 42.0% of income before taxes, as compared to an income tax benefit of \$4.7 million, or 52.4% of our loss before taxes for the three months ended December 31, 2013.

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Excluding the impact of the accelerated depreciation and amortization, severance and inventory excess reserves of \$31.2 million during the three months ended December 31, 2013, the income tax expense would have been (\$9.2) million, an estimated 41.0% of income before taxes for the three months ended December 31, 2013.

*Net income (loss).* Net income was \$12.0 million for the three months ended December 31, 2014, compared to a net loss of (\$4.3) million for the three months ended December 31, 2013, representing an increase of \$16.3 million. During the fiscal year ended June 30, 2014, the Company sold certain businesses which were approximately break-even. The change from net loss to net income is a result of the factors discussed above.

*Noncontrolling interest.* Net loss attributable to noncontrolling interest for the three months ended December 31, 2014 was \$0.4 million as compared to net loss attributable to noncontrolling interest of \$0.6 million for the same period in the prior year. Noncontrolling interest reflects the after-tax income (losses) attributable to minority interest owners in our investments.

**Comparison of the Six Months Ended December 31, 2014 and December 31, 2013**

*Revenues.* Our revenues for the six months ended December 31, 2014 were \$468.0 million, representing an increase of \$15.7 million, or 3.5%, from \$452.3 million for the same period in the prior year. Public School Program revenue increased \$18.8 million, or 4.7%, year over year. The growth in Public School Program revenue was primarily attributable to increases in funding in certain states, among other factors. Overall, Public School Program student enrollment increased 0.7% from the prior year. Institutional Sales revenue decreased \$1.7 million, or 6.6% from the prior year. Excluding the effect from the sale of certain businesses that were included in the prior period revenue, Institutional Sales increased \$0.2 million, or 0.8%. International and Private Pay Schools revenue decreased \$1.3 million, or 5.4%, from the prior year due to the sale of certain businesses which contributed \$6.2 million in revenue in the previous six months, offset by higher enrollments in the remaining schools.

*Instructional costs and services expenses.* Instructional costs and services expenses for the six months ended December 31, 2014 were \$291.9 million, representing an increase of \$5.3 million, or 1.8%, from \$286.6 million for the six months ended December 31, 2013. During the six months ended December 31, 2013, there was \$18.6 million of expense related to accelerated depreciation and amortization for certain curriculum, learning systems and other fixed assets that were to no longer be used or developed, computers that we estimated would not be returned and additional provisions for the decision to discontinue certain products and for excess inventory relative to anticipated demand. Excluding the impact of these charges, instructional costs and services would have increased \$23.9 million, or 8.9%. The increase in expense was primarily associated with the increased hiring of teachers, increases in salary and other personnel benefits to teachers and increased special education and other related service fees in our Managed Programs as part of our initiatives to improve the student experience and academic outcome. Instructional costs and services expenses were 62.4% of revenue during the six months ended December 31, 2014, a decrease from 63.4% for the six months ended December 31, 2013. Excluding the impact of the charges noted above, instructional costs and services were 59.2% of revenue for the six months ended December 31, 2013.

*Selling, administrative, and other operating expenses.* Selling, administrative, and other operating expenses for the six months ended December 31, 2014 were \$162.1 million, representing a decrease of \$11.9 million, or 6.8%, from \$174.0 million for the six months ended December 31, 2013. Included in expense during the six months ended December 31, 2013 was \$7.4 million related to severance and accelerated stock compensation costs for the termination of employment of our former Chief Executive Officer and other employees, and \$5.2 million related to an impairment charge on trade names that were to no longer be used. Excluding these charges, selling, administrative, and other operating expenses increased \$0.7 million, or 0.4% for the six months ended December 31, 2014. Selling, administrative, and other operating expenses were 34.6% of revenue during the six months ended December 31, 2014, a decrease from 38.4% for the six months ended

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December 31, 2013. Excluding the impact of the charges noted above, selling, administrative, and other operating expenses were 35.7% of revenue for the six months ended December 31, 2013. The reduction as a percentage of revenue primarily reflects our overall cost savings initiatives.

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*Product development expenses.* Product development expenses for the six months ended December 31, 2014 were \$6.7 million, representing a decrease of \$2.4 million, or 26.4% from \$9.1 million for the six months ended December 31, 2013. As a percentage of revenues, product development expenses decreased to 1.4% for the six months ended December 31, 2014, as compared to 2.0% for the same period in the prior year. The decrease was primarily a result of increased capitalized costs for development projects and an overall decrease in employee related costs supporting product development activities.

*Interest income (expense), net.* Net interest income for the six months ended December 31, 2014 was \$0.2 million as compared to net interest expense of (\$0.1) million in the same period in the prior year. Net interest income is primarily associated with approximately \$0.6 million and \$0.4 million in interest income during the periods ended December 31, 2014 and 2013, respectively, associated primarily with our investment in Web International Education Group, Ltd., offset by interest expense on our student computer capital leases.

*Income tax (expense) benefit.* We had an income tax expense of (\$2.1) million for the six months ended December 31, 2014, or 28.3% of income before taxes, as compared to income tax benefit of \$8.1 million, or 46.5% of our loss before taxes for the six months ended December 31, 2013. Excluding the impact of the accelerated depreciation and amortization, severance and inventory excess reserves of \$31.2 million during the six months ended December 31, 2013, the income tax expense would have been (\$5.8) million, or an estimated 42.0% of income before taxes for the six months ended December 31, 2013. The remaining decrease in the effective tax rates for the six months ended December 31, 2014 is primarily due to the impact of domestic manufacturing activity deduction and income tax benefit recognized in the current year related to the tax elections on the sale of certain foreign operations in June 2014.

*Net income (loss).* Net income was \$5.4 million for the six months ended December 31, 2014, compared to net loss of (\$9.3) million for the six months ended December 31, 2013, an increase of \$14.7 million. During the fiscal year ended June 30, 2014, the Company sold certain businesses which were approximately break-even. The change from net loss to net income is a result of the factors discussed above.

*Noncontrolling interest.* Net loss attributable to noncontrolling interest for the six months ended December 31, 2014 was \$0.2 million as compared to net loss attributable to noncontrolling interest of \$0.6 million for the same period in the prior year. Noncontrolling interest reflects the after-tax income (losses) attributable to minority interest owners in our investments.

**Liquidity and Capital Resources**

As of December 31, 2014, we had net working capital, or current assets minus current liabilities, of \$327.4 million. Our working capital includes cash and cash equivalents of \$124.2 million, including \$2.7 million associated with our two joint ventures, and accounts receivable of \$266.8 million. Our working capital provides a significant source of liquidity for our normal operating needs. Our accounts receivable balance fluctuates throughout the fiscal year based on the timing of customer billings and collections and tends to be highest in our first fiscal quarter as we begin billing for students. In addition, our cash and accounts receivable were significantly in excess of our accounts payable and short-term accrued liabilities at December 31, 2014.

On January 31, 2014, we executed a \$100 million unsecured line of credit to be used for general corporate operating purposes with Bank of America, N.A. The line has a five-year term and bears interest at the higher of the bank's Prime Rate, the Federal Funds Rates plus 0.50% or the LIBOR Rate plus 1.00%; plus the applicable rate and incorporates customary financial and other covenants, including but not limited to

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maximum debt leverage and minimum fixed charge coverage ratios. As of December 31, 2014 and June 30, 2014, we were in compliance with these covenants and we had no borrowings outstanding on the line of credit and \$0.2 million outstanding on the letters of credit.

We incur capital lease obligations for student computers under a lease line of credit with PNC Equipment Finance, LLC with annual lease availability limits. In July 2014, we extended our leasing agreement with an annual borrowing limit of \$35 million for fiscal year 2015. This availability expires in July 2015 and interest rates on the new borrowings are based upon an initial rate of 2.34% modified by changes in the three year interest rate swaps rate as published in the Federal Reserve Statistical Release H.15, Selected

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Interest Rates, between June 25, 2014 and the Lease Commencement Date, as defined in the lease line of credit.

As of December 31, 2014, the aggregate outstanding balance under the lease lines of credit was \$32.4 million. Borrowings bore interest at rates ranging from 2.49% to 3.08% and included a 36-month payment term with a \$1 purchase option at the end of the term. We have pledged the assets financed to secure the outstanding leases. We may extend our lease line of credit for additional periods, or consider alternative arrangements for financing student computers.

On November 4, 2013, the Board of Directors authorized the repurchase of up to \$75 million of our outstanding common stock over a two year period. Any purchases under this buyback were dependent upon business and market conditions and other factors. The stock purchases were made from time to time and may be made through a variety of methods including open market purchases and in accordance with the SEC's Rule 10b5-1. The Company completed the purchases under the buyback plan in September 2014.

Our cash requirements consist primarily of day-to-day operating expenses, capital expenditures and contractual obligations with respect to office facility leases, capital equipment leases and other operating leases. We expect to make future payments on existing leases from cash generated from operations. We believe that the combination of funds to be generated from operations, net working capital on hand and access to our line of credit will be adequate to finance our ongoing operations for the foreseeable future. In addition, to a lesser degree, we continue to explore acquisitions, strategic investments and joint ventures related to our business that we may acquire using cash, stock, debt, contribution of assets or a combination thereof.

***Operating Activities***

Net cash provided by operating activities for the six months ended December 31, 2014 was \$7.6 million compared to \$20.6 million for the six months ended December 31, 2013. The \$13.0 million decrease in cash provided by operations between periods was primarily attributable to the change in working capital for the six months ended December 31, 2014.

***Investing Activities***

Net cash used in investing activities for the six months ended December 31, 2014 was \$37.6 million compared to \$25.7 million for the six months ended December 31, 2013, an increase of \$11.9 million. This increase was due primarily to the \$6.5 million investment in LearnBop Inc. and a \$7.4 million increase in capital expenditures for property and equipment, capitalized software and curriculum, offset by the investment in a mortgage note to a managed school partner for \$2.1 million that was made in the prior year.

***Financing Activities***



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Net cash used in financing activities for the six months ended December 31, 2014 was \$39.9 million compared to \$14.2 million during the six months ended December 31, 2013. Our primary use of cash in financing activities was in connection with our share repurchase program for the purchase of treasury stock, and the payment of capital lease obligations incurred for the acquisition of student computers. For the six months ended December 31, 2014, the Company purchased treasury stock which totaled approximately \$26.5 million. The Company made \$5.9 million in treasury stock purchases during the six months ended December 31, 2013. At December 31, 2014, there were no shares remaining under the plan for repurchase. The six months ended December 31, 2014 included approximately \$7.5 million less in proceeds from the exercise of stock options than in the prior year period. The timing of cash from the exercise of options impacts our net cash provided by financing activities.

### **Off Balance Sheet Arrangements, Contractual Obligations and Commitments**

We have provided guarantees of approximately \$8.9 million related to long-term lease commitments on the buildings for certain of our flex schools. We contractually guarantee that certain schools under our management will not have cumulative operating losses over the contract period and our management fees

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from these schools may be reduced accordingly. Other than these lease and operating deficit guarantees, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

**Item 3.            *Quantitative and Qualitative Disclosures About Market Risk.***

*Interest Rate Risk*

At December 31, 2014 and June 30, 2014, we had cash and cash equivalents totaling \$124.2 million and \$196.1 million, respectively. Our excess cash has been invested primarily in U.S. Treasury money market funds although we may also invest in money market accounts, government securities, corporate debt securities and similar investments. Future interest and investment income is subject to the impact of interest rate changes and we may be subject to changes in the fair value of our investment portfolio as a result of changes in interest rates. At December 31, 2014, a 1% gross increase in interest rates earned on cash would result in a \$1.2 million annualized increase in interest income.

Our short-term debt obligations under our revolving credit facility are subject to interest rate exposure; however, as we had no outstanding balance on this facility during the six months ended December 31, 2014, fluctuations in interest rates had no impact on our interest expense.

*Foreign Currency Exchange Risk*

We currently operate in several foreign countries, but we do not transact a material amount of business in a foreign currency. At December 31, 2014, a 1% change in exchange rates would result in an approximate impact of \$0.1 million on our financial statements. If we enter into any material transactions in a foreign currency or establish or acquire any subsidiaries that measure and record their financial condition and results of operation in a foreign currency, we will be exposed to currency transaction risk and/or currency translation risk. Exchange rates between U.S. dollars and many foreign currencies have fluctuated significantly over the last few years and may continue to do so in the future. Accordingly, we may decide in the future to undertake hedging strategies to minimize the effect of currency fluctuations on our financial condition and results of operations.

**Item 4.            *Controls and Procedures.***

*Evaluation of Disclosure Controls and Procedures*

We maintain disclosure controls and procedures (as defined in Rule 13a-15(f) of the Exchange Act) that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management,

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including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures.

We carried out an evaluation, required by paragraph (b) of Rule 13a-15 or Rule 15d-15 under the Exchange Act, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) of the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this review, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2014.

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*Changes to Internal Control over Financial Reporting*

There have been no changes in our internal controls over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**Part II. Other Information**

**Item 1.           *Legal Proceedings.***

In the ordinary conduct of our business, we are subject to lawsuits, arbitrations and administrative proceedings from time to time.

***IpLearn***

On October 26, 2011, IpLearn, LLC ( IpLearn ) filed a complaint for patent infringement against the Company in the United States District Court for the District of Delaware, *IpLearn, LLC v. K12 Inc.*, Case No. 1:11-1026-RGA, which it subsequently amended on November 18, 2011. IpLearn is a privately-held technology development and licensing company for web and computer-based learning technologies. On December 17, 2014, the Court granted the Company's motion for summary judgment on the basis that the asserted patent was invalid. On January 16, 2015, the Court approved a Stipulation of Dismissal whereby all counts in IpLearn's amended complaint have been dismissed with prejudice and the appeal period was concluded.

***Oklahoma Firefighters Complaint***

On January 30, 2014, a securities class-action lawsuit captioned *Oklahoma Firefighters Pension & Retirement System v. K12 Inc., et al.*, was filed against the Company, four of its officers and directors, and a former officer, in the United States District Court for the Eastern District of Virginia, *In re K12 Inc. Securities Litigation*, Case No. 1:14-CV-108-AJT-JFA. On June 24, 2014 the Court appointed the Oklahoma Firefighters Pension and Retirement System as lead plaintiff, and on May 23, 2014 the lead plaintiff filed an amended class action complaint ( Amended Complaint ). On November 5, 2014, the Court granted the Company's motion to dismiss the Amended Complaint and the deadline for the plaintiff to appeal the Court's decision has expired.

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**Item 1A.**            *Risk Factors.*

There have been no material changes to the risk factors disclosed in *Risk Factors* in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended June 30, 2014 as filed with the SEC on August 15, 2014.

**Item 2.**            *Issuer Purchases of Equity Securities.*

On November 4, 2013, the Board of Directors authorized the repurchase of up to \$75.0 million of the Company's outstanding common stock over a two year period. Any purchases under the buyback were dependent upon business and market conditions and other factors. The stock purchases were made from time to time and may be made through a variety of methods including open market purchases and in accordance with the SEC's Rule 10b5-1. For the six months ended December 31, 2014, the Company paid approximately \$26.5 million in cash to redeem 1,307,402 shares of common stock at an average price of \$20.21 per share. As of December 31, 2014 total shares purchased under the plan were 3,502,598, at an average cost of \$21.41 per share, and there were no shares remaining to be repurchased under the plan.

**Item 3.**            *Defaults Upon Senior Securities.*

None.

**Item 4.**            *Mine Safety Disclosures.*

None.

**Item 5.**            *Other Information.*

None.

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**Item 6. Exhibits**

(a) Exhibits.

<b>Number</b>	<b>Description</b>
10.1	Second Amendment to Employment Agreement of Timothy L. Murray, effective November 24, 2014.
31.1	Certification of Principal Executive Officer Required Under Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer Required Under Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Principal Executive Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
32.2	Certification of Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350.
101	The following financial statements and footnotes from the K12 Inc. Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets (unaudited), (ii) Condensed Consolidated Statements of Operations (unaudited), (iii) Condensed Consolidated Statement of Comprehensive Loss (unaudited), (iv) Condensed Consolidated Statement of Equity (Deficit) (unaudited), (v) Condensed Consolidated Statements of Cash Flows (unaudited), and (vi) Notes to Condensed Consolidated Financial Statements (unaudited).

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

K12 Inc.

Name:	/s/ JAMES J. RHYU
Title:	James J. Rhyu Chief Financial Officer, Principal Accounting Officer and Authorized Signatory

Date: January 29, 2015