

INSTRUCTURE INC
Form 10-Q
May 01, 2019

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 March 31, 2019

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: 001-37629

Instructure, Inc.

(Exact name of registrant as specified in its charter)

Delaware 26-3505687
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

6330 South 3000 East, Suite 700

Salt Lake City, UT 84121

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(Address of principal executive offices, including zip code)

(800) 203-6755

(Registrant's telephone number, including area code)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value \$0.0001 per share	INST	New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 April 26, 2019, there were 36,582,747 shares of the registrant's common stock outstanding.

Instructure, Inc.

Quarterly Report on Form 10-Q

For the Quarter Ended March 31, 2019

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In this Quarterly Report on Form 10-Q, “we,” “our,” “us,” “Instructure,” and the “Company” refer to Instructure, Inc. and its wholly-owned subsidiaries.

PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements
INSTRUCTURE, INC.

Consolidated Balance Sheets

(in thousands)

(unaudited)

	March 31, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$49,339	\$ 94,320
Short-term marketable securities	41,824	58,630
Accounts receivable—net of allowance of \$824 and \$1,092 at March 31, 2019 and December 31, 2018, respectively	26,694	35,514
Prepaid expenses	28,568	13,918
Deferred commissions	8,710	8,226
Other current assets	1,667	2,019
Total current assets	156,802	212,627
Property and equipment, net	28,276	27,388
Right-of-use assets	38,085	—
Goodwill	38,532	12,354
Intangible assets, net	26,340	6,262
Noncurrent prepaid expenses	6,053	3,516
Deferred commissions, net of current portion	11,458	11,404
Other assets	552	446
Total assets	\$306,098	\$ 273,997
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$6,050	\$ 3,581
Accrued liabilities	11,526	9,809
Deferred rent	—	1,329
Lease liabilities	5,552	—
Deferred revenue	89,635	117,298
Total current liabilities	112,763	132,017
Deferred revenue, net of current portion	2,807	3,372
Lease liabilities, net of current portion	43,923	—
Deferred rent, net of current portion	—	10,150
Other long-term liabilities	806	20
Total liabilities	160,299	145,559
Stockholders' equity:		
Common stock	3	3
Additional paid-in capital	429,349	395,865
Accumulated other comprehensive loss	11	(8)

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Accumulated deficit	(283,564)	(267,422)
Total stockholders' equity	145,799	128,438
Total liabilities and stockholders' equity	\$306,098	\$ 273,997

See accompanying notes.

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INSTRUCTURE, INC.

Consolidated Statements of Operations

(in thousands, except per share amounts)

(unaudited)

	Three months ended March 31,	
	2019	2018
Revenue:		
Subscription and support	\$53,201	\$43,200
Professional services and other	4,875	4,791
Total revenue	58,076	47,991
Cost of revenue:		
Subscription and support	13,921	10,391
Professional services and other	4,236	3,594
Total cost of revenue	18,157	13,985
Gross profit	39,919	34,006
Operating expenses:		
Sales and marketing	27,925	23,188
Research and development	18,939	14,660
General and administrative	12,514	8,291
Total operating expenses	59,378	46,139
Loss from operations	(19,459)	(12,133)
Other income (expense):		
Interest income	649	238
Interest expense	(5)	(9)
Other income (expense), net	(80)	175
Total other income, net	564	404
Loss before income taxes	(18,895)	(11,729)
Income tax benefit (expense)	2,753	(139)
Net loss	\$(16,142)	\$(11,868)
Net loss per common share, basic and diluted	\$(0.45)	\$(0.37)
Weighted average common shares used in computing basic and		
diluted net loss per common share	35,729	32,370

See accompanying notes.

INSTRUCTURE, INC.

Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three months ended	
	March 31,	
	2019	2018
Net loss	\$(16,142)	\$(11,868)
Other comprehensive gain:		
Net change in unrealized gains on marketable securities	19	1
Comprehensive loss	\$(16,123)	\$(11,867)

See accompanying notes.

INSTRUCTURE, INC.

Consolidated Statements of Stockholders' Equity

(in thousands)

(unaudited)

	Common Stock, \$0.001 Par Value		Additional Paid-In Capital	Accumulated Other Comprehensive Income		Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount		Income	Deficit		
Balances at December 31, 2018	35,386	3	395,865	(8)	(267,422)		128,438
Exercise of common stock options	188	—	1,514	—	—		1,514
Vesting of restricted stock units, net	288	—	—	—	—		—
Stock-based compensation	—	—	14,396	—	—		14,396
Common stock and options issued in acquisition	400	—	17,849	—	—		17,849
Unrealized gain on marketable securities	—	—	—	19	—		19
Shares withheld for tax withholding on vesting of restricted stock	—	—	(275)	—	—		(275)
Net loss	—	—	—	—	(16,142)		(16,142)
Balances at March 31, 2019	36,262	\$ 3	\$ 429,349	\$ 11	\$ (283,564)		\$ 145,799

	Common Stock, \$0.001 Par Value		Additional Paid-In Capital	Accumulated Other Comprehensive Income		Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount		Income	Deficit		
Balances at December 31, 2017	30,860	3	250,899	(1)	(223,957)		26,944
Exercise of common stock options	455	—	2,832	—	—		2,832
Vesting of restricted stock units, net	120	—	—	—	—		—
Stock-based compensation	—	—	4,840	—	—		4,840
Secondary offering	2,875	—	109,803	—	—		109,803
Unrealized gain on marketable securities	—	—	—	1	—		1
Shares withheld for tax withholding on vesting of restricted stock	—	—	(127)	—	—		(127)
Net loss	—	—	—	—	(11,868)		(11,868)
Balances at March 31, 2018	34,310	\$ 3	\$ 368,247	\$ —	\$ (235,825)		\$ 132,425

See accompanying notes.

INSTRUCTURE, INC.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three months ended March 31,	
	2019	2018
Operating activities:		
Net loss	\$(16,142)	\$(11,868)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property and equipment	2,320	2,013
Amortization of intangible assets	1,208	763
Amortization of deferred financing costs	5	7
Change in fair value of mark-to-market liabilities	—	(122)
Stock-based compensation	13,938	4,744
Other	(219)	65
Changes in assets and liabilities:		
Accounts receivable, net	9,106	8,720
Prepaid expenses and other assets	(19,927)	2,623
Deferred commissions	(538)	212
Right-of-use assets	1,145	—
Accounts payable and accrued liabilities	3,126	2,068
Deferred revenue	(29,763)	(22,555)
Lease liabilities	(1,234)	—
Deferred rent	—	1,372
Other liabilities	786	(389)
Net cash used in operating activities	(36,189)	(12,347)
Investing activities:		
Purchases of property and equipment	(2,336)	(4,847)
Proceeds from sale of property and equipment	24	26
Purchases of marketable securities	(15,394)	—
Maturities of marketable securities	32,500	5,700
Business acquisition, net of cash received	(24,829)	—
Net cash provided by (used in) investing activities	(10,035)	879
Financing activities:		
Proceeds from common stock offerings, net of offering costs	—	109,803
Proceeds from issuance of common stock from employee equity plans	1,518	2,832
Shares repurchased for tax withholdings on vesting of restricted stock	(275)	(127)
Net cash provided by financing activities	1,243	112,508
Net increase (decrease) in cash and cash equivalents	(44,981)	101,040
Cash and cash equivalents, beginning of period	94,320	35,693
Cash and cash equivalents, end of period	\$49,339	\$136,733
Supplemental cash flow disclosure:		
Cash paid for taxes	\$61	\$61
Non-cash investing and financing activities:		

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Capital expenditures incurred but not yet paid	\$482	\$275
Acquisition consideration not yet paid	\$149	\$-
Issuance of common stock for acquisition	\$17,848	\$-

See accompanying notes.

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INSTRUCTURE, INC.

Notes to Unaudited Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Organization

Instructure provides innovative applications for learning, assessment and talent management. We enable organizations worldwide to develop, deliver, manage and track engaging academic and employee development programs. We offer our platform through a Software-as-a-Service, or SaaS, business model. We were incorporated in the State of Delaware in September 2008. We are headquartered in Salt Lake City, Utah, and have wholly-owned subsidiaries in the United Kingdom, Australia, the Netherlands, Hong Kong, Sweden, Brazil, Mexico and Hungary.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) applicable to interim periods, under the rules and regulations of the United States Securities and Exchange Commission (“SEC”). In the opinion of management, we have prepared the accompanying unaudited financial statements on a basis substantially consistent with the audited consolidated financial statements of the Company as of and for the fiscal year ended December 31, 2018, and these financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods presented. All intercompany balances and transactions have been eliminated in consolidation. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2019. The year-end balance sheet data was derived from audited financial statements, but this Form 10-Q does not include all disclosures required under GAAP. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted under the rules and regulations of the SEC.

These interim financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company’s Annual Report on Form 10-K filed with the SEC on February 20, 2019.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Such estimates, which we evaluate on an on-going basis, include allowances for doubtful accounts, useful lives for property and equipment and intangible assets, valuation of marketable securities, valuation allowances for net deferred income tax assets, valuation of stock-based compensation and common stock, the standalone selling price (“SSP”) of performance obligations and the determination of the period of benefit for deferred commissions. We base our estimates on historical experience and on various other assumptions which we believe to be reasonable.

Segment Information

We operate in a single operating segment, cloud-based learning management systems. Operating segments are defined as components of an enterprise for which separate financial information is regularly evaluated by the chief operating decision makers, or CODMs, which are our chief executive officer and chief financial officer, in deciding how to allocate resources and assess performance. Our CODMs evaluate our financial information and resources and assess the performance of these resources on a consolidated basis. Since we operate in one operating segment, all required financial segment information can be found on the consolidated financial statements.

Summary of Significant Accounting Policies

Except for the accounting policies for leases that were updated as a result of adopting ASU No. 2016-02, Leases (“Topic 842”) described below, there have been no changes to our significant accounting policies described in the Annual Report on Form 10-K as of and for the year ended December 31, 2018, filed with the SEC on February 20, 2019, that have had a material impact on our condensed consolidated financial statements and related notes.

Revenue Recognition

We generate revenue primarily from two main sources: (1) subscription and support revenue, which is comprised of SaaS fees from customers accessing our learning, assessment and talent management systems and from customers purchasing additional support beyond the standard support that is included in the basic SaaS fees; and (2) related professional services revenue, which is comprised of training, implementation services and other types of professional services. Revenue is recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

We determined revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, we satisfy a performance obligation

The following describes the nature of our primary types of revenue and the revenue recognition policies and significant payment terms as they pertain to the types of transactions we enter into with our customers.

Subscription and Support

Subscription and support revenue is derived from fees from customers to access our learning, assessment and talent management systems and support beyond the standard support that is included with all subscriptions. The terms of our subscriptions do not provide customers the right to take possession of the software. Subscription and support revenue is generally recognized on a ratable basis over the contract term. Payments from customers are primarily due annually in advance.

Professional Services and Other

Professional services revenue is derived from implementation, training, and consulting services. Our professional services are typically considered distinct from the related subscription services as the promise to transfer the subscription can be fulfilled independently from the promise to deliver the professional services (i.e., customer receives standalone functionality from the subscription and the customer obtains the intended benefit of the subscription without the professional services). Professional services revenue is typically recognized over time as the services are rendered, using an efforts-expended (labor hours) input method. Implementation services also include nonrefundable upfront setup fees, which are allocated to the remaining performance obligations.

Contracts with Multiple Performance Obligations

Many of our contracts with customers contain multiple performance obligations. We account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. We determine the standalone selling prices based on our overall pricing objectives by reviewing our significant pricing practices, including discounting practices, the size and volume of our transactions, the customer type, price lists, our pricing strategy, and historical stand-alone sales. SSP is

analyzed on a periodic basis to identify if we have experienced significant changes in our selling prices.

Accounts Receivable

Accounts receivable, net is comprised of trade receivables that are recorded at the invoice amount, net of an allowance for doubtful accounts, and other receivables, which represents unbilled receivables related to subscription and professional services contracts. Unbilled receivable balances as of March 31, 2019 and December 31, 2018 were \$6,339,000 and \$6,032,000, respectively.

Standard payment terms to customers range from 30 to 90 days; however, payment terms and conditions in our customer contracts may vary. In some cases, customers prepay for products and services in advance of our delivery of the related products or services; in other cases, payment is due as services are performed or in arrears following the delivery of the related products or services. The unbilled receivable primarily relates to revenue recognized when transferred services are more than amounts billable to customers.

Deferred Commissions

Sales commissions earned by our sales force, as well as related payroll taxes, are considered incremental and recoverable costs of obtaining a contract with a customer. These costs are deferred and then amortized on a straight-line basis over a period of benefit that we have determined to be generally four years. We determined the period of benefit by taking into consideration our customer contracts, our technology and other factors. Amortization of deferred commissions is included in sales and marketing expenses in the accompanying consolidated statements of operations.

Recent Accounting Pronouncements

Adopted accounting pronouncements

In February 2016, the FASB issued Topic 842, which establishes a comprehensive new lease accounting model. Under the new guidance, at the commencement date, lessees are required to recognize a lease liability with a corresponding right-of-use (“ROU”) asset.

On January 1, 2019, the Company adopted Topic 842 using the modified retrospective approach with the effective date as of the date of initial application. Consequently, results for the three months ended March 31, 2019 are presented under Topic 842. No prior period amounts were adjusted and continue to be reported in accordance with previous lease guidance, ASC Topic 840, Leases. The Company elected to apply the package of practical expedients to not reassess under the new standard prior conclusions about lease identification, lease classification, and initial direct costs in relation to its leases in effect as of January 1, 2019. The Company also elected the practical expedient allowing the use of hindsight in determining the lease term and assessing impairment of right-of-use assets based on all facts and circumstances through the effective date of the new standard.

Adoption of the new standard resulted in recording operating lease right-of-use assets and operating lease liabilities of approximately \$34,726,000 and \$46,205,000, respectively, on our consolidated balance sheets as of January 1, 2019. Adoption of the standard did not have an impact on the Company’s beginning accumulated deficit, results from operations or cash flows.

Effective January 1, 2019, the Company adopted ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of current stock compensation recognition standards to include share-based payment transactions for acquiring goods and services from nonemployees. The adoption of this guidance did not have a significant impact on our condensed consolidated financial statements and related notes.

Effective January 1, 2019, the Company early adopted ASU 2018-15, Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (“ASU 2018-15”) using a prospective approach. This guidance aligns the accounting for implementation costs related to a hosting arrangement that is a service contract with the guidance on capitalizing costs associated with developing or obtaining internal-use software. The adoption of this guidance did not have a significant impact on our condensed consolidated financial statements and related notes.

Issued accounting pronouncements

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses, a new standard to replace the incurred loss impairment methodology under current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The new standard will require the use of a forward-looking expected credit loss model for accounts receivables, loans and other financial instruments. Credit losses relating to available-for-sale debt securities will also be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. The standard will be effective for us beginning January 1, 2020. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

2. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Diluted net loss per share is computed by giving effect to all potential dilutive common stock equivalents outstanding for the period. For purposes of the diluted net loss per share calculation, options to purchase common stock and restricted stock units are considered to be common stock equivalents.

A reconciliation of the denominator used in the calculation of basic and diluted loss per share is as follows (in thousands, except per share amounts):

	Three months ended March 31,	
	2019	2018
Numerator:		
Net loss	\$(16,142)	\$(11,868)
Denominator:		
Total weighted average common shares		
outstanding—basic	35,729	32,370
Dilutive effect of share equivalents resulting from stock		
options and restricted stock units	—	—
Weighted average common shares outstanding-diluted	35,729	32,370
Net loss per common share, basic and diluted	\$(0.45)	\$(0.37)

For all periods presented, we incurred net losses and, therefore, the effect of our outstanding stock options and restricted stock units were not included in the calculation of diluted loss per share as the effect would be anti-dilutive. The following table contains share totals with a potentially dilutive impact (in thousands):

	As of March 31,	
	2019	2018
Options to purchase common stock	1,146	1,683
Restricted stock units	3,154	1,884
Total	4,300	3,567

3. Acquisition

On February 21, 2019, we acquired all outstanding shares of Portfolium, Inc. (“Portfolium”), for the purpose of enhancing our learning management system and human capital management offerings. We have included the operating results of the business combination in our consolidated financial statements since the date of the acquisition. The acquisition did not have a material effect on the revenue or earnings on the consolidated statement of operations for the reporting periods presented. The pro forma results as if the acquisition had taken place on the first day of 2018 were not materially different from the amounts reflected in the accompanying consolidated financial statements.

The following table summarizes the estimated fair values of the consideration transferred, assets acquired and liabilities assumed as of the date of acquisition (in thousands):

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Consideration transferred	
Cash paid	\$25,882
Common stock	17,133
Fair value of assumed Portfolium awards attributable to pre-combination services	715
Total purchase consideration	\$43,730
Identifiable assets acquired	
Cash	\$604
Accounts receivable	273
Other assets	31
Intangible assets: developed technology	10,016
Intangible assets: customer relationships	8,560
Intangible assets: trade name	2,710
Total assets acquired	\$22,194
Liabilities assumed	
Accounts payable and accrued liabilities	\$115
Deferred revenue	1,535
Deferred tax liability, net	2,992
Total liabilities assumed	\$4,642
Goodwill	26,178
Total purchase consideration	\$43,730

The excess of purchase consideration over the fair value of net tangible and identifiable intangible assets acquired was recorded as goodwill, none of which is expected to be deductible for tax purposes. The goodwill generated from this transaction is attributable to the expected synergies to be achieved upon consummation of the business combination and the assembled workforce value. The fair values assigned to tangible and identifiable intangible assets acquired and liabilities assumed are based on management's estimates and assumptions.

Developed technology represents the estimated fair value of the acquired existing technology and is being amortized over its estimated remaining useful life of five years. Amortization of developed technology is included in subscription and support cost of revenue expenses in the accompanying consolidated statements of operations. Customer relationships represents estimated fair value of the acquired customer base and is amortized over the estimated remaining useful life of four years. The trade name acquired is amortized over the estimated remaining useful life of four years. Amortization of customer relationships and trade name is included in sales and marketing expenses in the accompanying consolidated statements of operations.

The net deferred tax liability from this acquisition provided a source of additional income to support the realizability of our pre-existing deferred tax assets and as a result, we released a portion of our valuation allowance. This resulted in a provisional income tax benefit of \$3.0 million and an increase to goodwill of the same amount.

4. Property and Equipment

Property and equipment consisted of the following (in thousands):

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	March 31, 2019	December 31, 2018
Computer and office equipment	\$ 6,552	\$ 6,204
Purchased software	1,071	1,071
Capitalized software development costs	24,227	22,181
Furniture and fixtures	4,901	4,688
Leasehold improvements and other	16,147	15,632
Total property and equipment	52,898	49,776
Less accumulated depreciation and amortization	(24,622)	(22,388)
Total	\$ 28,276	\$ 27,388

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Accumulated amortization for capitalized software development costs was \$10,324,000 and \$9,035,000 at March 31, 2019 and December 31, 2018, respectively. Amortization expense for capitalized software development costs was \$1,289,000 and \$940,000 for the three months ended March 31, 2019 and 2018, respectively. Amortization expense for capitalized software development costs is recorded within cost of revenue on the consolidated statements of operations.

5. Goodwill and Intangible Assets

Goodwill was \$38,532,000 and \$12,354,000 as of March 31, 2019 and December 31, 2018, respectively.

Intangible assets consisted of the following (in thousands):

	Average Remaining Useful Life	March 31, 2019	December 31, 2018
Domain names	2 Months	\$ 1,268	\$ 1,268
Trademarks	53 Months	120	120
Software	6 Months	620	620
Capitalized learning content	31 Months	400	400
Trade names			