

K12 INC  
Form 10-K  
August 04, 2015

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

**Form 10-K**

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

For the fiscal year ended June 30, 2015

o 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.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**95-4774688**  
(I.R.S. Employer  
Identification No.)

**2300 Corporate Park Drive  
Herndon, VA 20171**

**(703) 483-7000**  
(Registrant's telephone number, including area code)

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

**Title of each class**  
Common Stock, \$0.0001 par value  
Securities registered pursuant to Section 12(g) of the Act:

**Name of each exchange on which registered**  
New York Stock Exchange (NYSE)

**None**  
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

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

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

(Do not check if a  
smaller reporting company)

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

The aggregate market value of the registrant's voting and non-voting stock held by non-affiliates of the registrant as of December 31, 2014 was approximately \$343,512,091. Aggregate market value excludes an aggregate of approximately 9,399,456 shares of common stock held by officers and directors and by each person known by the registrant to own 5% or more of the outstanding common stock on such date. Exclusion of shares held by any of these persons should not be construed to indicate that such person possesses the power, direct or indirect, to direct or cause the direction of the management or policies of the registrant, or that such person is controlled by or under common control with the registrant.

The number of shares of the registrant's common stock outstanding as of July 31, 2015 was 38,304,395.

### **DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the registrant's definitive proxy statement for its 2015 annual meeting of stockholders to be filed pursuant to Regulation 14A with the Securities and Exchange Commission not later than 120 days after the registrant's fiscal year ended June 30, 2015, are incorporated by reference into Part III of this Form 10-K.

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**CERTAIN DEFINITIONS**

Unless the context requires otherwise, all references in this Annual Report on Form 10-K (the "Annual Report") to "K12," "K12," "Company," "we," "our" and "us" refer to K12 Inc. and its consolidated subsidiaries.

**SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS**

This Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve substantial risks and uncertainties. All statements other than statements of historical facts contained in this Annual Report on Form 10-K are forward-looking statements. We have tried, whenever possible, to identify these forward-looking statements using words such as "anticipates," "believes," "estimates," "continues," "likely," "may," "opportunity," "potential," "projects," "will," "expects," "plans," "intends" and similar expressions to identify forward-looking statements, whether in the negative or the affirmative. These statements reflect our current beliefs and are based upon information currently available to us. Accordingly, such forward-looking statements involve known and unknown risks, uncertainties and other factors which could cause our actual results, performance or achievements to differ materially from those expressed in, or implied by, such statements. These risks, uncertainties, factors and contingencies include, but are not limited to:

reduction of per pupil funding amounts at the schools we serve;

inability to achieve a sufficient level of new enrollments to sustain our business model;

failure to enter into new managed school contracts or renew existing contracts, in part or in their entirety;

failure of the schools we serve or us to comply with federal, state and local regulations, resulting in a loss of funding, an obligation to repay funds previously received, or contractual remedies;

declines or variations in academic performance outcomes of the students and schools we serve as curriculum and testing standards evolve;

harm to our reputation resulting from poor performance or misconduct by operators or us in any school in our industry and/or in any school in which we operate;

legal and regulatory challenges from opponents of virtual public education or for-profit education companies;

discrepancies in interpretation of legislation by regulatory agencies that may lead to payment or funding disputes;

termination of our contracts with schools due to a loss of authorizing charter;

entry of new competitors with superior technologies and lower prices;

unsuccessful integration of mergers, acquisitions and joint ventures;

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failure to further develop, maintain and enhance our technology, products, services and brands;

inadequate recruiting, training and retention of effective teachers and employees;

infringement of our intellectual property; and

disruptions to our Internet-based learning and delivery systems resulting from cyber-attacks.

Forward-looking statements reflect our management's expectations or predictions of future conditions, events or results based on various assumptions and management's estimates of trends and economic factors in the markets in which we are active, as well as our business plans. They are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and

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uncertainties. Our actual results and financial conditions may differ, possibly materially, from the anticipated results and financial conditions indicated in these forward-looking statements. There are a number of factors that could cause actual conditions, events or results to differ materially from those described in the forward-looking statements contained in this Annual Report. A discussion of factors that could cause actual conditions, events or results to differ materially from those expressed in any forward-looking statements appears in "Part 1 Item 1A Risk Factors."

Readers are cautioned not to place undue reliance on forward-looking statements in this Annual Report or that we make from time to time, and to consider carefully the factors discussed in "Part 1 Item 1A Risk Factors" of this Annual Report in evaluating these forward-looking statements. These forward-looking statements are representative only as of the date they are made, and we undertake no obligation to update any forward-looking statement as a result of new information, future events or otherwise.

Table of Contents**PART I****ITEM 1. BUSINESS****Company Overview**

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. We provide a continuum of technology-based educational products and solutions to public school districts, public schools, virtual charter schools, private schools and families as we strive to transform a student's learning experience into one that delivers individualized education on a highly scalable basis. In 2013, AdvancEd, a non-profit international accreditation agency for schools and school systems, renewed our five year quality assurance accreditation.

As an innovator in K-12 online education, we believe we have attained distinctive core competencies that allow us to meet the varied needs of our school customers and students. These core competencies include our ability to create engaging curriculum, train teachers to be effective in online instruction, provide turn-key management services to online schools, customize online learning programs for school districts, develop innovative new offerings, and assist legislators and policy makers in understanding the many benefits of virtual and blended learning to complement and transform traditional schools. These strengths enable us to provide a unique set of products and services primarily to three lines of business that share many common attributes, including curriculum, learning systems, management expertise, logistical systems and marketing. These businesses are: Public School Programs, which is comprised of Managed Programs and Non-managed Programs (as more fully described below), Institutional Sales (educational products and services sold 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).

<b>Public School Programs (Managed and Non-managed)</b>	<b>Institutional Sales</b>	<b>International and Private Pay Schools</b>
Virtual public schools	K <sup>12</sup> curriculum	Managed private schools K <sup>2</sup> International Academy
Blended public schools Hybrid schools	FuelEd Online Courses  FuelEd Anywhere Learning System	George Washington University Online HS
Flex schools	Middlebury Interactive Languages	The Keystone School
Passport schools	Pre-kindergarten	Independent course sales (Consumer)

**Public School Programs**

In fiscal year 2015 ("FY2015"), we revised the description of the line of business previously known as Managed Public Schools due to the changing nature of some customer contracts. Specifically, we now describe the line of business as Public School Programs which includes both virtual and blended public schools where a district or independent charter board contracts with K12 to provide a full-time program of educational products and services. The Public School Programs are classified as Managed Programs and Non-managed Programs. Managed Programs are 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 are where K12 provides curriculum and technology, and the school has an option to contract for instruction or other services. Non-managed Programs

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do not offer primary administrative oversight. In FY2015 our Public School Programs accounted for approximately 90% of our revenue.

*Virtual Public Schools.* In full-time virtual public schools, students receive online lessons over the Internet, utilize offline learning materials that we supply, and receive instruction from state certified teachers. In addition to providing our course catalog, course materials and, in certain cases,



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student computers, we also offer these schools a variety of management, technology and academic support services. The majority of our revenue is derived from long-term service agreements with the governing authorities of these virtual public schools.

*Blended Public Schools.* In addition to providing services to full-time virtual public schools, we also sell our products and services to blended public schools that combine online and face-to-face instruction in many different arrangements with varying amounts of time spent in a physical learning center.

For both virtual and blended Managed Programs, the governing authority with control over the schools negotiates contractual terms with us for all aspects of the management of the schools, including monitoring academic achievement, teacher recruitment and training, student enrollment and marketing, compensation recommendations for school personnel, financial management, procurement of curriculum, computers and other required services and equipment. The scope of services we provide may also vary in accordance with applicable state regulations and each governing authority's policies. Funding is provided primarily by state governments. For the 2014-15 school year, we provided these turn-key management services to Managed Programs in 32 states and the District of Columbia.

**Institutional Sales**

We work closely as partners with a growing number of school districts and individual schools, enabling them to offer their students an array of online education solutions, including full-time virtual and blended programs, semester courses and supplemental offerings. In addition to curriculum, systems and programs, we provide teacher training, teaching services and other support services. Our Institutional Sales customers include public schools, school districts, private schools, charter schools and early childhood learning centers. Additionally, we operate Middlebury Interactive Languages LLC ("MIL"), which was created as a joint venture with Middlebury College to develop and market online foreign language courses (see Notes to Consolidated Financial Statements, Note 10). For the 2014-15 school year, we served school districts or individual schools in all 50 states and the District of Columbia, including those where the regulatory environment restricts or prohibits statewide online programs.

**International and Private Pay Schools**

We operate three online private schools: The K<sup>12</sup> International Academy, the George Washington University Online High School and the Keystone School. We also have entered into agreements which enable us to distribute our products and services to students from more than 100 countries. We pursue international opportunities where we believe there is significant demand for quality online education. Our principal customers are U.S. students, including those who reside in states where the online public school option is not available, as well as expatriate families and foreign students who wish to study in English. Additionally, our curriculum is sold to end user customers who desire to educate their children outside of the traditional school system or to supplement their child's traditional education.

We continue to make significant capital investments in our infrastructure and resources intended to improve student academic outcomes, including: (i) the ongoing development and enhancement of our curriculum and software; (ii) implementation of a new learning management platform for our high school students; (iii) corporate and school infrastructure to improve scalability, increase security, and attain cost savings; (iv) purchase and delivery of student computers and (v) conversion of interactive instructional products to enable delivery through tablets and mobile devices.

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**Our History**

We were founded in 2000 to utilize advances in technology to provide children with access to a high-quality public school education regardless of their geographic location or socioeconomic background. Given the geographic flexibility of technology-based education, we believed that the pursuit of this mission could help address the growing concerns regarding the regionalized disparity in the quality of public school education, both in the United States and abroad. The convergence of these factors and rapid advances in Internet networks created the opportunity to make a significant impact by deploying online learning software and systems on a flexible, online platform.

In September 2001, we introduced our kindergarten through 2nd grade offering in Pennsylvania and Colorado, serving approximately 900 students in the two states combined. We subsequently added new grades and new schools in additional states. We also launched blended public schools that combine face-to-face time in the classroom with online instruction and opened an online private school to reach students worldwide. In school year 2014-15, we served virtual public schools with Managed Programs in 32 states and the District of Columbia, specifically: Alaska, Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New Mexico, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin and Wyoming. We also serve schools in all 50 states through our Institutional Sales business.

**Our Market**

The U.S. market for K-12 education is large and online learning is gaining greater acceptance. For example:

According to the National Center for Education Statistics ("NCES"), a division of the U.S. Department of Education, over 48 million students attended K-12 public schools in the 2012-13 school year, and nearly five million students enrolled in private schools in the 2012-13 school year. In addition, according to a report by National Home Education Research Institute, there are approximately two million home-educated students in the United States. Many of these students took an online course and a small percentage enrolled in a full-time online program. As of July 2015, five states mandated the completion of an online course prior to high school graduation (Keeping Pace Report, 2014). Multi-district fully online schools served an estimated 315,000 students in 30 states during the 2013-14 school year. Eleven states have enacted online course choice laws as of October 2014.

According to the NCES, the public school system alone encompassed more than 98,800 schools and approximately 14,000 districts during the 2012-13 school year.

The NCES estimates that total spending in the K-12 market was projected to be \$563 billion for the 2012-13 school year, and that public school spending will increase by 24 percent, to \$699 billion, by 2022-23.

According to the International Association for K-12 Online Learning ("iNACOL"), in 2013, all 50 states had established a significant form of online learning initiative. In addition, according to iNACOL, 1.82 million K-12 students participated in a formal online learning program.

Many parents and educators are seeking alternatives to traditional classroom-based education for a variety of reasons. Demand for these alternatives is evident in the expanding number of choices available to parents and students. For example, public charter schools emerged in 1988 to provide an alternative to traditional public schools and, have seen enrollments grow by 225% over the past 10 years according to the Center for Education Reform. As of June 2015, more than 1 million students are on waiting lists to attend a charter school, and there are approximately 6,400 public charter schools operating in 42 states and the District of Columbia with an estimated enrollment of over 2.5 million students. Similarly, acceptance of

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online learning initiatives, including not only virtual and blended public schools, but also online courses, credit recovery, remediation, testing and Internet-based professional development, has continued to grow. Districts are also rapidly adopting online learning to expand course offerings, provide schedule flexibility, increase graduation rates and lower the cost to deliver education.

**Demand for Education Alternatives: The Market Opportunity and the K12 Solutions**

As evidenced by the varying options being utilized by K-12 students, no single educational model works equally well for all students. Children today utilize technology in all aspects of their lives, and we expect them to extend their use of technology to their educational needs and choices. Our business is modeled on the premise that every student has the right to an education that is individualized and available anywhere at any time. We also believe all students can benefit from more rigorous and engaging content.

We anticipate that full-time virtual schools will meet the needs of a small percentage of the overall K-12 student population, but do represent and will continue to represent a large and growing opportunity in absolute terms. Across our educational programs, families come from a broad range of social, economic and academic backgrounds. They share the desire for individualized instruction to maximize their children's potential. Examples of students for whom this solution fits include, but are not limited to, families with: (i) students seeking to learn at their own pace; (ii) students with safety, social and health concerns about their local school; (iii) students with disabilities who are underserved in traditional classrooms; (iv) students for whom the local public school is not meeting their needs; (v) students who seek more flexibility than traditional brick and mortar schools can provide, such as student-athletes and performers who are not able to attend regularly-scheduled classes; (vi) college-bound students who want to bolster their college readiness and application appeal by taking additional Advanced Placement ("AP"), honors and/or elective courses; (vii) students seeking career and technical skills; (viii) high school dropouts; and (ix) students of military families who desire high quality, consistent education across moves. Our individualized learning approach allows students to optimize their educational experience and, therefore, their chances of achieving their goals. Our Public School Programs, which generated the majority of our revenue (approximately 90% in fiscal 2015), serve this demand.

Most students in the United States will continue to be educated in school buildings and classrooms. However we also believe that the academic benefits for certain student segments, combined with the significant savings for taxpayers, will continue to drive states and districts to incorporate online solutions into their school-based programs. One of the challenges traditional schools continue to face is adoption of technology and innovative new learning devices. Our Managed Programs offer a complete solution for districts and schools that need a turn-key option and we also offer, through our Non-managed Programs and our Institutional Sales business, online curriculum and services on a solutions-oriented, individualized basis for those customers who need less than a full-service offering. We believe this range of options creates the opportunity for us to serve the majority of students who will learn within school buildings. Therefore, we continue to invest significant resources, organically and through licensing or acquisitions, in developing product offerings that afford us the flexibility to serve different types of customers with varying value propositions and price points that are adaptable to an institution's capabilities and needs. Moreover, we have and will continue to pursue selected markets outside the United States where we believe our curricula can address local market needs.

We believe that our core competencies, coupled with the substantial investments we have made in our infrastructure and our prior strategic acquisitions and partnerships, position us to offer educational resources for all types of students. Regardless of whether a student chooses to remain in a classroom or seeks an alternative educational setting, attends public or private school, lives in the United States or abroad, wants to take online classes on a full or part-time basis or is an advanced or remedial student, our products and services offer students expanded educational opportunities.

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**Our Business Lines**

***Public School Programs***

In 2015 we redefined the Managed Public School line of business to what we now describe as Public School Programs to reflect different contractual arrangements requested by our customers and to correspondingly improve the description of our business. As previously discussed, our Public School Programs are comprised of (i) Managed Programs where we provide substantially all of the management, technology and academic support services in addition to curriculum, learning systems and instructional services, and (ii) Non-managed Programs where we provide curriculum and technology, and offer contractual options for instruction or other services. We provide our Managed Programs and our Non-managed Programs to both virtual and blended public school customers.

We believe that the acceptance of online education in grades K-12 continues to grow, and anticipate that increased overall demand for virtual options in education will translate into increased demand for both our Non-managed Programs and our Institutional Sales business (sold under the brand names Fuel Education or FuelEd). At the same time, the Managed Programs business, which serves primarily virtual charter schools, is maturing. Regulatory requirements related to academic performance and accountability are expanding and the independent governing authorities of the virtual charter schools that contract with us are taking different approaches 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, during recent contract renewal negotiations for fiscal year 2016 and beyond, some of our managed public school customers decided to transition to a self-managed model. While these schools continued to purchase our curriculum and some of our management and technology services, they assumed more of the daily operational responsibilities for themselves. Conversely, as new states offer an online public school option, we believe that contracting with us for a fully integrated, virtual school turn-key operation that we manage remains attractive. For the 2015-16 school year, customers in states that recently authorized virtual public schools and then opted for a Managed Program include the North Carolina Virtual Academy and Maine Virtual Academy.

***Virtual Public Schools***

The majority of our revenue is derived from long-term service agreements with the governing authorities of the virtual public schools we serve. In addition to a comprehensive course catalog, related books and physical materials and, in certain cases, student computers, we also offer these schools a variety of management, technology and academic support services. Full-time virtual public school students receive online lessons over the Internet and utilize offline learning materials we provide. Students receive assignments, complete lessons, and obtain instruction from certified teachers with whom they interact online, telephonically, in synchronous virtual classroom environments, and sometimes face-to-face. In a Non-managed virtual public school, the level of instructional and/or academic support service varies or may not be provided depending on the needs of the school. In either case, for parents who believe their child is not thriving in their current public school or for students and families who require time or location flexibility in their schooling, virtual and blended public schools can provide a compelling choice.

Virtual public school students are also provided the opportunity to participate in a wide variety of school activities, including outings and clubs. In addition to school-level activities, we sponsor a wide variety of extracurricular activities on a national basis, such as clubs, contests and college and career planning sessions.

Virtual public schools managed by K12 (often named virtual academies) serve K-8 or K-12 students, principally utilize the K<sup>12</sup> curriculum and attract both mainstream and academically at-risk students. These virtual academies also include Insight schools, which serve middle school and high school students and tend to focus on academically at-risk students, and iQ Academies, which also are for middle school and high school students.

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*Blended Public Schools*

In addition to our full-time virtual public schools, we offer a variety of management and support services and sell our products to blended public schools, which are public schools that combine online and face-to-face instruction for students in a variety of ways with varying amounts of time spent in a physical learning center. For the 2014-15 school year, we managed blended public schools in California, Illinois, Indiana, Minnesota, New Jersey and Pennsylvania.

In contrast to a typical brick and mortar public school, blended public schools can provide a greater selection of available courses, increased opportunities for self-paced, individualized instruction and greater scheduling flexibility. We manage three types of blended public schools hybrid schools, Flex schools and Passport schools. These blended schools bring students and teachers physically together more often than a purely online program.

In the hybrid schools we manage, such as the Chicago Virtual Charter School, students attend a learning center on a part-time basis, where they receive face-to-face instruction, in addition to their online virtual curriculum and instruction.

Our Flex school model is a unique blended school model, where middle and high school students attend a learning center five full days per week and access and engage in their individualized online lessons in an open study lab while receiving face-to-face direct instruction in areas of particular need from onsite, state certified teachers. Flex schools leverage many of the capabilities of a virtual school with the advantages of a physical school environment. One example of this model is the Silicon Valley Flex School in California.

Another type of blended school option is the Passport school which utilizes a similar instructional model as a Flex school but is especially designed for academically at-risk students, particularly those who have previously dropped out of high school, and therefore includes more counseling and support services. Due to the reality that many Passport students have work and/or child care responsibilities, most students spend half of each day on-site, working on-line and face to face with teachers, and complete the remainder of their daily work away from the learning center. The Hill House Passport Academy in Pennsylvania is an example of a Passport school.

*Institutional Sales*

Public schools and school districts are increasingly adopting online solutions to cost-effectively expand course offerings, provide schedule flexibility, improve student engagement, increase graduation rates, replace textbooks and retain students. State education funds traditionally allocated for textbook and print materials are now also being authorized for the purchase of digital content, including online courses, and in some cases mandated for access to online courses. To address these growing needs, our Institutional Sales business provides curriculum and technology solutions, packaged in a portfolio of flexible learning and delivery models mapped to specific student and/or district needs. This portfolio provides a continuum of delivery models, from full and part-time virtual, to blended learning and other options that can be used in traditional classrooms to differentiate instruction. The goal of the Institutional Sales business is to partner with public schools and school districts to provide more options and better tools to empower teachers to improve student achievement through personalized learning. Our FuelEd suite of offerings has grown and includes K<sup>12</sup> curriculum, FuelEd Online Courses, FuelEd Anywhere Learning Systems ("ALS") and Middlebury Interactive Languages curriculum. Our extensive catalog of online curricula can address specific student needs, including AP, honors programs, world languages, remediation, credit recovery, alternative education, career and technology electives and college readiness. In connection with these solutions, we also offer highly qualified state-certified teachers, training for school personnel in online instruction methods, and professional development and other support services as needed by our customers.

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In addition to our extensive curricula catalog, Institutional Sales offers the Personalize, Engage and Achieve platform ("PEAK") and PEAK Library. PEAK is a proprietary software system designed to centrally manage in a single-user interface, multiple, independent online school-based functions. Schools can enroll students, assign courses and teachers, and then manage the learning experience with easy to use reporting and analytics on student progress. The PEAK Library currently supports the majority of the K<sup>12</sup> curriculum portfolio and teachers can build and modify assignments, assessments and courses to augment classroom instruction and develop lessons for sharing across the school district. PEAK also has the capability to support other third-party solutions, open educational resources and district and teacher-created content. For students, teachers and administrators, PEAK eliminates the complexity of managing multiple accounts and roles and provides a consistent online environment for full-time, credit recovery, world languages or blended classroom programs. We believe increasing ease-of-use for administrators and teachers is a critical factor in improving student support and therefore, improving student outcomes. PEAK addresses this need by serving all of the online instructional needs of a school or district in an integrated, data-driven manner.

In FY2015, we increased our focus on our Institutional Sales business and augmented our capabilities by continued investment in our direct and indirect sales network and our product offerings. We added supplemental math and English language learner products and delivered a new middle school curriculum that is modular and mobile compatible with a variety of tools to enhance the learning experience. We have also expanded our customer services team to support our growing relationships and employ teachers across the United States to serve students and train school administrators and teachers.

For the 2014-15 school year, we served school districts or individual schools in all 50 states and the District of Columbia through our Institutional Sales business, including those where the legal framework restricts or prohibits state-wide online public school programs. Based upon school districts' and academic administrators' growing acceptance of online learning and desire for cost efficient, integrated and flexible educational solutions, we believe that the direct-to-district distribution channel offers further significant growth potential.

***International and Private Pay Schools***

We operate a variety of private schools that meet the needs of students ranging from simple correspondence courses to challenging college preparatory programs. Beyond our business in the United States, we are pursuing international opportunities where we believe there is significant demand for a quality online education. Our international customers are typically expatriate families and foreign students who desire a U.S. high school diploma and wish to study in English. For the 2014-15 school year, we served students in more than 100 countries. In addition, we have entered into agreements which enable us to distribute our products and services to our international school partners who use our courses to provide broad elective offerings and dual diploma programs.

We operate the K<sup>12</sup> International Academy, an online private school that serves students in both the United States and overseas. Through the K<sup>12</sup> International Academy, students may study in an academic program that ultimately leads to an accredited U.S. high school diploma. Students may also enroll in individual courses on a part-time basis. The K<sup>12</sup> International Academy utilizes the same curriculum, systems and teaching practices that we provide to the virtual public schools we manage in the United States. In addition, this school provides a unique international community including clubs and events that enrich the student experience by allowing students to interact with peers in other countries. The school is accredited by AdvancED, and is recognized by the Commonwealth of Virginia as a degree granting institution of secondary learning.

The Keystone School ("Keystone") is a private school that has been an innovator in home education and distance learning for over 35 years. Students attend Keystone for middle and high school on a full or part-time basis. It serves students through online courses with teacher support as well as print

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correspondence course programs. Keystone primarily uses our FuelEd curriculum and provides a lower-cost option to families than either of our other two private schools. Keystone is accredited by the Middle States Association Commission on Elementary and Secondary Schools and AdvancED.

The George Washington University Online High School is operated in cooperation with the George Washington University. The program, which launched in the 2011-12 school year, offers K12's college preparatory curriculum and is designed for high school students who are seeking a challenging academic experience and aspire to attend top colleges and universities. The school also provides extensive counseling throughout the high school years to help students make academic and extracurricular choices and maximize their future potential. The school is accredited by the Middle States Association Commission on Elementary and Secondary Schools.

***Consumer Sales***

We also sell individual online courses directly to families. These purchasers desire to educate their children outside of the traditional public school system or to supplement their child's existing public school education without the aid of an online teacher. Customers of our consumer products have the option of purchasing a complete grade-level curriculum or individual subjects depending on their child's needs. Typical applications include summer school course work, home schooling and educational supplements.

**Our Business Strategy**

Our business strategy is driven by our mission to maximize every child's potential by transforming the educational experience, delivering a quality education to schools and their students, and supporting our customers in their quest to improve academic outcomes. In furtherance of those objectives, we plan to leverage the investments we have already made in our curriculum and learning systems. These investments include initiatives to improve the effectiveness of our school workforce, develop new instructional approaches to increase student and parental engagement, and enhance our curriculum and systems architecture. This strategy, intended to align with education industry trends, consists of the following:

*Deliver better student outcomes.* We are committed to improving student outcomes for every student in the schools we serve. To achieve this goal we will continue to (i) invest in training and professional development for our teachers and school leaders, (ii) develop programs and initiatives designed to improve the learning experience, such as our interactive media projects, virtual science labs, AP test prep, specialized cohort academies and Family Academic Support Team initiatives, (iii) enhance our curriculum to make it more engaging, adaptive and accessible to all students anywhere, and (iv) update our content as state standards and state assessments change. We will also focus our marketing and enrollment efforts on educating students and families on the unique demands of the online learning environment to position students enrolled in our virtual schools for success.

*Improve student retention in our virtual schools.* To ensure the best outcomes for students, we have partnered with the school boards we serve to make a concerted effort to enroll and retain students who are truly engaged and ready to learn. Research shows that students who remain in the same school setting longer generally perform better academically, and retention is especially challenging with virtual schools because they are designed as an alternative public school option. We therefore refined our marketing programs to attract students who are most likely to succeed in a non-classroom based environment with the expectation of increasing academic success and student retention, while all students are eligible to enroll consistent with state requirements (e.g. enrollment caps, prior public student). Once students are enrolled, programs such as the Family Academic Support Team affect early intervention and focused engagement strategies, strive to help students stay on track, improve engagement and ultimately give students a better chance at academic success.

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*Introduce New and Improved Products and Services.* We intend to continue to expand our product line and offerings, both internally and through licensing or strategic acquisitions of product portfolios, including pursuing greater use of and access to tablet and mobile technology and adaptive learning technologies and solutions. In addition, we are endeavoring to serve new charter schools that attract students who are seeking career and technical education and schools with deep science, technology, engineering and math ("STEM") offerings.

*Increase Enrollments at Existing Virtual and Blended Public Schools.* In the 2015-16 school year, we will manage virtual and blended public schools in 32 states and the District of Columbia. While we plan to increase enrollments at these schools, some state regulations and school governing authorities and districts still limit or cap student enrollment or enrollment growth. We intend to work with schools, legislators, state departments of education, educators and parents to find solutions that will remove enrollment restrictions and allow access for every child who is interested in attending a virtual or blended public school.

*Expand Virtual and Blended Public School Presence into Additional States and Cities.* The flexibility and comprehensiveness of our learning systems allows us to efficiently adapt our curriculum to meet the individual educational standards of any state or school district with limited capital investment. We will continue to work with states and school districts to authorize and establish new virtual and blended public schools and to contract with them to provide our curriculum, online learning platform, management services, and other related offerings.

*Accelerate Institutional Sales.* The breadth of our FuelEd catalog, now ranging from pre-K to 12<sup>th</sup> grade, our instructional capabilities and our capacity to simplify a school district's management of multiple digital programs and vendors through our PEAK technology platform are the key drivers for Institutional Sales growth. We will continue to work to accelerate the market adoption of these solutions and services as school districts partner with us to address a variety of academic needs and personalized learning for their students.

*Add Enrollments in Our Private Schools.* We currently operate three online private schools that we believe appeal to a broad range of students and families. We look to drive increased enrollments in these schools by increasing awareness, through targeted marketing programs and by solicitation of partnerships with traditional brick and mortar private schools.

*Pursue International Opportunities to Offer Our Learning Systems.* We believe there is strong worldwide demand for high-quality, online education from U.S. families living abroad and foreign students who seek a U.S.-style of education and the schools and school systems that serve them in their local market. Our ability to operate virtually is not constrained by the need for a physical classroom or local teachers, which makes our learning systems ideal for use internationally.

*Develop Additional Channels through Which to Deliver Our Learning Systems.* We plan to evaluate other delivery channels on a routine basis and to pursue opportunities where we believe there is likely to be significant demand for our offering, such as direct classroom instruction, blended classroom models, supplemental educational offerings and individual products packaged and sold directly to consumers.

*Pursue Strategic Partnerships and Acquisitions.* We may pursue opportunities with highly-respected institutions where we can be a valued-added partner or contribute our expertise in curriculum development and educational services to serve more students. We may also pursue selective acquisitions at attractive valuations that complement our existing educational offerings and business capabilities, and that are natural extensions of our core competencies.



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**Products and Services**

***Educational Philosophy***

The primary focus of our educational philosophy is to make the academic performance of students our first priority. We are committed to continuously improving the quality of our curriculum and academic programs, including alignment with states that have adopted the Common Core State Standards ("CCSS") and the Common Core Assessments. We also continue to evaluate and use innovative technologies to deliver engaging and effective learning experiences for all students. We seek to leverage our product portfolios across our educational solutions and distribution channels and to invest in our content portfolio to ensure our students receive a meaningful learning experience that is individualized, engaging, accessible and effective.

The design, development and delivery of our products and services are grounded in the following set of guiding principles:

*Apply "Tried and True" Educational Approaches for Instruction through Technology; Employ Technology Appropriately to Deliver and Enhance Those Approaches.* Our learning systems are designed to utilize both "tried and true" methods to drive academic success. "Tried" methodologies are those that have been experientially tested and proven to be effective. "True" methodologies are those based on more recent cognitive research regarding the way in which individuals learn. "Tried" methodologies employed by K12 must also pass through the "true" litmus test; the two criteria are not antagonistic. This "tried and true" philosophy allows us to benefit from both decades of research about learning and over a century of published analysis of effective methods of teaching.

*Employ Technology Appropriately for Learning.* All of our courses are delivered primarily through an online platform and generally include a significant amount of online content. We employ technology where we feel it is appropriate and can enhance the learning process, with the offline:online ratio changing appropriately for advancing developmental levels in students. In addition to online content, our curriculum includes a rich mix of course materials, including engaging textbooks and hands-on materials such as instructional kits, scientific and musical instruments, art supplies and science specimens. Furthermore, our teachers utilize telephonic contact as well as email and virtual electronic classrooms. We believe our balanced use of technology and more traditional approaches helps to maximize the effectiveness of our learning systems.

*Base Learning Objectives on "Big Ideas".* We use the expression "big ideas" for the key, subconscious frameworks that serve as the foundation to a student's future understanding of a subject matter. For example, an understanding of waves is fundamental to a physicist's understanding of quantum mechanics; for that reason, we teach 1st graders the fundamentals of waves in an age-appropriate form. We use "big ideas" in every subject area to organize the explicit learning objectives for each course we develop.

*Assess Every Objective to Ensure Mastery.* Ongoing assessments are the most effective way to evaluate a student's mastery of a lesson or concept. To facilitate effective assessment, our curriculum states clear objectives for each lesson. Throughout a course, every student's progress is assessed at a point when each objective is expected to be mastered, providing direction for appropriate pacing. These periodic and well-timed assessments reinforce learning and promote mastery of a topic before a student moves to the next lesson or course.

*Individualized Learning.* We seek to create engaging curriculum content to capture a student's attention to make learning more interesting and effective. It is our fundamental belief that each student learns in a highly individualized manner. Our instructional system allows students to learn from a curriculum that caters to their unique learning style and offers a high degree of program flexibility. Certain adaptive learning features being integrated into some curricular products can individualize lessons based on the level of student comprehension.

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*Prioritize Important, Rigorous Objectives.* Our content experts have developed a clear understanding of those subjects and concepts that are difficult for students, from both historical and cognitive points of view (that is, from both the "tried" and the "true" perspective described earlier). Greater instructional effort is focused on the most important concepts (the biggest ideas) and on the most challenging concepts and skills (as revealed by experience and research). We use existing research, feedback from parents and students, and experienced teacher judgments to determine these priorities, and to modify our learning systems to guide the allocation of each student's time and effort.

*Facilitate Flexibility to Accommodate Variations in Ability.* We believe that each student should be challenged appropriately, where "challenge" is both a matter of the difficulty inherent in the subject matter, and also the pace at which the subject matter is presented. Generally, adequate progress for most students is to complete one academic year's curriculum within a traditional school year. Each individual student may take greater or fewer instructional hours and make more or less effort than the average student to achieve this progress. Our learning systems are designed to facilitate this flexibility in order to ensure that the appropriate amount of time and effort is allocated to each lesson.

*Ensure Fundamental Content Soundness.* Our highly credentialed subject matter experts or "Content Specialists" bring their own scholarly and teaching backgrounds to course design and development and are required to maintain relationships with and awareness of guidelines from nearly 40 national and international subject-area associations.

*Integrate Curriculum, Teachers and Technology to Maximize Student Learning.* We believe students learn better not just with great curriculum, but also great teachers and technology that allows them to access the content and teachers in a way that makes learning more engaging and effective.

***Academic Performance***

Our fundamental goal for every child who enrolls in a virtual public or private school managed by us, or a program offered through a school district, is to improve his or her academic performance. In 2015, we published our annual academic report that examines achievement in our managed public school programs measured against both state tests (which vary widely) and a nationally normed adaptive test which provides a common measure of academic growth across all of the managed schools we serve. By analyzing and communicating the results of our efforts, we aim to provide data for school boards and parents as they exercise school choice options, and to help educators working to improve academic achievement for every child in our increasingly diverse schools. The 2015 K12 Annual Academic Report ("2015 Academic Report") can be found online at <http://www.k12.com/what-is-K12/results>. It is significantly more comprehensive than the 2014 Academic Report and, among other improvements, has been expanded to: (i) cover all the managed public school programs, (ii) contain individual school academic profiles on student performance on state assessments in grades 3-8 for reading and mathematics and high school (end-of-course/graduation tests), (iii) provide persistence data for each school (the relationship between length of enrollment and performance on state assessments), and (iv) include percentages of students eligible for free or reduced-price lunch who achieve state proficiency levels. The 2015 Academic Report also continues to provide the results for each school on the Scantron Performance Series ("Scantron") tests, which measures annual student academic growth compared to the growth achieved by a national norm group, as explained further below. We believe that none of our competitors serving virtual public schools publishes this volume or depth of academic performance data and analytics.

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Each of the 32 states and the District of Columbia in which we manage virtual public schools measures academic performance using different state accountability methods. Under the No Child Left Behind Act ("NCLB"), each state was required to adopt its own annual measurable objectives ("AMOs") for the percentage of students expected to score at or above a pre-set proficiency level or "cut" score on state reading and math tests, with the requirement that 100% proficiency be achieved by the overall student population and defined subgroups by the end of the 2013-2014 school year. Failure to make adequate yearly progress ("AYP") triggers a variety of corrective actions for such schools in need of improvement. According to a November 2012 report by the Center for Education Policy, nearly half of the nation's public schools (48%) did not achieve AYP in 2011, with some states exceeding that AYP failure rate and others falling below. Recognizing the limitations in the NCLB approach for measuring academic performance, the U.S. Department of Education began formally granting waivers from some requirements of NCLB, and as of February 2015, 42 states, the District of Columbia and 8 school districts in California have been granted waivers. In connection with these waivers, most states have replaced AYP tied to fixed proficiency levels and are using alternative state accountability systems to measure academic performance. Only four states in which we manage public schools have not received waivers under NCLB.

The disparate state accountability systems under the NCLB waivers are also in flux as states transition to new college and career-ready standards and assessments for curriculum content, which is a condition for the grant of an NCLB waiver. To meet that condition, most states have adopted the Common Core State Standards ("CCSS") and one of the two online assessment methods aligned to those standards, the Smarter Balanced Assessment Consortium ("Smarter Balanced") or the Partnership for Assessment of Readiness for College and Careers ("PARCC"). Most recently, some states in which we operate, such as South Carolina and Indiana, that originally adopted CCSS have withdrawn from using CCSS and announced they will rely on their own state-developed standards and assessments, while others have decided not to use the PARCC or Smarter Balanced assessments and develop their own assessment aligned with CCSS, such as Ohio. Still other states in which we operate never adopted the CCSS, including Virginia and Texas.

As noted, states with NCLB waivers generally no longer make AYP determinations and are using alternative accountability measures, including various "growth model" assessments. While these growth models can have different assumptions, methodologies and analytics from state-to-state, their primary purpose is to determine how much a student learns over the course of a school year by measuring actual learning gains. For example, a growth model may reveal that a student who enrolled two years behind grade level in math realized a full year of improvement; but still falls below the cut score proficiency level used with AYP measures.

During this period of NCLB waivers and CCSS transition, we share the view taken by many states that assessing a student's academic performance by his or her learning growth is a more accurate measure of a school's effectiveness than attaining a static proficiency score. Therefore, in addition to reporting state assessment outcomes in our 2015 Academic Report, many of the schools we manage also measure academic performance using a nationally normed computer adaptive testing program provided by Scantron, an independent provider of web-based K-12 assessments. With the Scantron testing, we believe we obtain reliable and comparable pre- and post-test results to assess the efficacy of our programs that have been implemented across multiple states with different standards and accountability systems. The Scantron testing also gives us a common measure of academic growth for every student, whether below, at or above grade level. As an adaptive test, Scantron also adjusts in real time in response to a student's answers, and thus more accurately reveals the student's level of mastery.

The Scantron adaptive assessment tests are taken by virtual school students from their homes at the beginning and end of the school year. The percentage of students who took these tests during the 2013-2014 school year at each of our managed public schools is reported in the 2015 Academic Report. While we recognize that students may be unsupervised while taking Scantron tests, the score trends from such tests relative to scores from state tests (which in most cases are closely proctored, including for the

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students in the managed public schools we serve) are similar, suggesting that the un-proctored approach for the Scantron test does not affect the accuracy of the Scantron results. In addition, the Scantron test results for an individual student are used to measure his or her performance over the school year, and thus are given twice each year in the early fall and late spring. Teachers and staff use the test results to develop an education plan for each student, where appropriate, and to guide teachers to tailor their instructions to the student's needs and relative strengths. The test results are not used to grade or "place" students relative to their age group, and thus students and their parents have no incentive to cheat or seek outside help on an un-proctored test. More fundamentally, the Scantron tests are adaptive and proactive. That is, if the program senses that the student is answering questions too rapidly or is answering questions of increasing difficulty well beyond his or her grade level, the program will report the test results as "spoiled" to the teacher assigned to that student, and the test will be administered again with different questions. For these reasons, we believe the Scantron test results are a reliable indicator of the student's progress in proficiency in reading and mathematics over the course of a school year.

We recognize that as state-specific accountability models continue to evolve, the virtual public schools we manage in those states will be measured for academic performance against those frameworks and may yield different results than the Scantron nationally normed tests. As a result, we are continuously evaluating our approach to instruction and assessment. Accordingly, to adjust to the developing state accountability models, going forward we may use multiple informative assessments together with or in lieu of Scantron. We anticipate that this new approach ultimately will better prepare the students for success in our managed public schools as measured by their state assessment requirements.

In addition to the complexities involved in measuring academic performance of students, the statewide virtual public schools we serve face unique challenges impacting academic success not necessarily encountered to the same extent by traditional brick and mortar schools. These challenges include high percentages of students who enter behind grade level or under-credited, high student mobility, high enrollment growth rates, lack of control over the student learning environment and higher than average percentages of students in student populations eligible for free or reduced-price lunch. With rare exceptions, the data shows that students identified as eligible for free lunch had lower percentages at or above proficiency than students eligible for reduced-price lunch, and both groups underperformed students identified as not eligible for subsidized meals. We provide proficiency information in reading and mathematics for grades 3-8 at our managed public schools for students that are free lunch eligible, reduced price eligible, and not eligible for subsidized lunches in our 2015 Academic Report.

In addition, for decades, educational research has shown that persistence remaining and proceeding at pace in the same school setting can benefit academic performance, while mobility moving from one school setting to another can have a destabilizing influence, causing students to struggle and lapse in academic performance. Our analysis and data in our 2015 Academic Report confirm this research and provides tables comparing the performance of students in grades 3-8 who have been enrolled in our managed schools for less than one year, enrolled for at least one year but less than two, enrolled for two years but less than three, and enrolled for three years or more. Further, for high school, our 2015 Academic Report shows end of course (EOC) proficiency assessment, as well as high school graduation test (HSGT) proficiency, comparing students who were enrolled for less than a year, for one year, for two years and for three years or more. The 2015 Academic Report also provides proficiency and enrollment persistency data on a school by school basis where data is available.

While measuring academic performance is necessary, taking meaningful steps to improve student outcomes is an integral part of our mission. Accordingly, we continually strive to achieve that objective by undertaking new initiatives and improving existing programs, such as Strong Start, our Family Academic Support Teams and Embark<sup>12</sup> (described below under "*Our Products*"). To monitor student learning progress during the school year, we are adding multiple equivalent assessments at the lesson, unit and semester level to ensure that our measurement of mastery is reliable and valid, as well as adopting data driven instruction that provides for targeted teacher intervention to assist students with lesson challenges.

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We also began to use a diagnostic assessment tool in some schools to be able to develop individualized learning plans for new students who often start school before their academic records are provided to us from their previous school.

In furtherance of our goal to improve academic performance, in fiscal year 2014 we established an Academic Committee of the K12 Board of Directors comprised of three members. The primary role of the Academic Committee is to make recommendations and assist management in discharging its responsibility to ensure continuous improvement in academic outcomes for the public and private schools served by the K12. With input and oversight from the Academic Committee, the education experts who are members of our K12 Educational Advisory Committee ("EAC"), formed in 2013, will further improve our focus on academic achievement and growth goals as well as advising us on specific tactics to be successful in these areas. The EAC met four times in FY 2015. The members of our EAC are:

Dr. Andrew Porter, former Dean of the Graduate School of Education, University of Pennsylvania

Dr. Elanna Yalow, CEO of Knowledge Universe Early Learning Programs

Dr. Beverly Hutton, Executive Director of the National Association of Secondary School Principals

Dr. David Driscoll, former Commissioner of Education, Commonwealth of Massachusetts

Ms. Ann Foster, former Senior Vice President Strategy, Business Development and Connected Learning for Harcourt Education Group

Ms. Millie Fornell, former Chief of Staff, Miami-Dade School District

Ms. Jessie Woolley-Wilson, President, CEO and Chairman of the Board of DreamBox Learning, Inc.

### ***Our Products***

Our product approach is to continue investing in systems and technology to educate students more effectively and efficiently. Much of our investment has been in the development of K-12 online courses and management systems. We are planning specialized courses and programs designed to remediate the rapidly increasing number of students who are enrolling in schools behind grade level. Specifically, we are making, licensing or acquiring more individualized learning programs for students using adaptive learning technology, which requires a significant financial commitment to license or acquire, integrate and develop a specialized curriculum and a complex database.

As school districts confront the same issues that we are experiencing in the managed public schools, we believe that our solutions could gain widespread acceptance. During the past few fiscal years, we built a new K-6 math curriculum, a new K-3 English language arts curriculum, and a remedial reading course, all based on the latest educational research and pedagogical methods. In addition, our PEAK system provides school districts and administrators a better way to manage their online education programs and content. In 2014, we entered into an agreement to transition our high school learning management system to Desire2Learn, a pioneer in next-generation digital education systems. The Desire2Learn platform is used by over 100 K-12 organizations, and provides an industry-leading student experience which should help us improve student engagement, retention and outcomes for our managed schools. It is expected to also significantly advance our efforts to deliver a more mobile-ready curriculum because of its mobile-ready capabilities which exceed the capabilities of our current systems. We expect to complete our transition to the Desire2Learn platform for high school by the fall of 2015.

Just as we pioneered the development of virtual schools, we are resolved to address the most challenging educational needs facing schools and districts. Our goal is to assist teachers, schools and districts in implementing individualized education programs to better serve their students. This can take a

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variety of forms including turn-key solutions, partnerships, vendor relationships, enterprise licenses, and purchases of curriculum and services.

Our investment strategy is not limited, however, to curriculum and systems. We are also making substantial investments in our service offerings to improve student outcomes. For example, as part of our Strong Start student onboarding program, we implemented a diagnostic assessment tool that allows us to create individualized learning plans for new students who often start school with us before their academic records arrive. We are also offering Family Academic Support Teams ("FAST") in many of our schools. The purpose of the FAST program is to ensure students are ready to engage in their learning experience by helping them overcome non-academic barriers, including family, health, psychological, or social issues that create obstacles to achieving academic success for some students. Additionally, we continue to invest in improving the quality of our teachers and school leaders through professional development efforts.

*Curriculum*

K12 has one of the largest digital curriculum portfolios for the K-12 online education industry. The K<sup>12</sup> curriculum consists of online lessons, offline instructional kits and materials and lesson guides. We offer an extensive catalog of proprietary courses designed to teach concepts to students from pre-kindergarten through 12th grade. A single year-long K<sup>12</sup> course generally consists of 120 to 180 unique instructional lessons. Each lesson is designed to last approximately 45 to 60 minutes, although students are able to work at their own pace. We have more than 700 courses across kindergarten, elementary, middle and high school, including world languages. This combined portfolio contains over 108,000 hours of instructional content and over one million visual, audio and interactive instructional elements in our asset repository.

Since our inception, we have built core courses in English language arts, mathematics, science and history on a foundation of rigorous standards, following the guidance and recommendations of leading educational organizations at the national and state levels. For this reason, our K<sup>12</sup> curriculum was well positioned to satisfy the requirements of the CCSS when they were published in June 2010. Since then, we have been in the process of fully aligning our existing and new courses to the CCSS. As the CCSS landscape is continually changing, we will monitor the decisions that states are making with regard to CCSS adoption and the associated assessments of the CCSS or other standards the states may adopt, which in turn may require further adjustments. We have and will continue to invest in and update our curriculum to stay current with emerging and developing standards like CCSS.

*Online Lessons.* Our K<sup>12</sup> online lessons or curricula are accessed through a proprietary learning management platform, which we call our Online School ("OLS") for K-8 students and the eCollege platform for high school students, as well as a number of other common industry platforms for students who access our FuelEd Online Courses and our FuelEd ALS. Each online lesson provides the roadmap for the entire lesson, including direction to specific online and offline materials, summaries of major objectives for the lesson and the actual lesson content with assessments. Digital versions of documents, readings, labs and other activities may also be included. Lessons utilize a combination of innovative technologies, including animations, demonstrations, audio, video and other graphic/digital interactivity, educational games and individualized feedback, all coordinated with offline textbooks and hands-on materials, to create an engaging, responsive and highly-effective curriculum. The formative and periodic summative, online assessments ensure that students have mastered the material and are ready to proceed to the next lesson, allowing them to work at their own pace. Pronunciation guides for key words and references to suggested additional resources, specific to each lesson and each student's assignments and assessments, are also included.

*Learning Kits.* Many of our courses utilize learning kits in conjunction with the online lessons to maximize the effectiveness of our learning systems. In addition to receiving access to our online lessons through the Internet, each K-8 student receives a shipment of materials, including award-winning

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textbooks, art supplies, laboratory supplies (e.g., microscopes, scales, science specimens) and other reference materials which are referred to and incorporated in instruction throughout our curriculum. This approach is consistent with our guiding principle to utilize technology where appropriate for our learning systems, and combine it with other effective instructional methods. Most of the textbooks we use are proprietary, written by K12 to be verbally engaging and visually appealing to students, with careful control of reading levels, and to complement the online experience. Through fiscal year 2015, we also created and/or converted additional K<sup>12</sup> textbooks used across our courses into an electronic format, enabling us to offer options to enhance the student experience without physical books. We believe that our ability to effectively combine online lessons and materials to develop, deliver and implement them together for instruction is a competitive advantage.

*Lesson Guides.* Our courses are generally paired with a lesson guide. Lesson guides work in coordination with the online lessons and include the following: overview information for learning coaches, lesson objectives, lesson outlines and activities, answer keys to student exercises and suggestions for explaining difficult concepts to students.

### *Pre-K and K-8 Courses*

From pre-kindergarten through 8th grade, our courses are generally categorized into seven major subject areas: English language arts, mathematics, science, history, art, music and world languages. Our proprietary curriculum includes all of the courses that students need to complete their core kindergarten through 8th grade education; our pre-K offering, which we refer to as EmbarK<sup>12</sup>, introduces students to core subjects through cross-curricular thematic units, building initial and fundamental relationships among concepts. Courses focus on developing fundamental skills and teaching the key knowledge building blocks or schemas the "big ideas" that each student will need to master the major subject areas, meet state standards, including those formulated as the CCSS, and complete more advanced coursework. Unlike a traditional classroom education, our learning systems offer the flexibility for each student to take courses at different grade levels in a single academic year, providing flexibility for students to progress at their own level and pace within each subject area.

Our K<sup>12</sup> second generation elementary language arts program is designed to deliver increased interactivity and make instruction even more engaging and efficient while integrating rewards, interactive practice and a virtual world. Our Fundamentals of Geometry and Algebra course completes our proprietary K-8 math offering. These courses support students at various skill levels via targeted, timely remediation, embody CCSS and include significant media integration. In addition, the flexibility of our learning systems allows us to tailor our curriculum to state specific requirements. For example, we have developed 114 courses specifically created for the public school standards in 16 states; we are aligning our courses to the CCSS and the Common Core Assessments; and in addition to the ongoing evolution of our K-5 Math+ program, we have also created over 85 custom Math+ sequences to serve specific state needs.

### *High School Courses*

The curriculum available to high school students is much broader and varies from student to student, largely as a result of the increased flexibility in course selection available to high school students. Students also are able to select from a wide range of electives. We have augmented our lab program for lab science courses with the creation of alternate kit-free science labs as an augmentation or alternative for our formerly kit-based high school science labs in order to provide a more flexible and robust lab program across our physical science, earth science, biology, chemistry and physics courses. Our overall lab program now includes traditional kit-based labs based on either shipped-in or household materials, virtual labs, video-based labs, data-collection and data-manipulation labs, and field studies. This array provides schools with additional materials flexibility, and integrates diverse modalities directly into our science curriculum to promote conceptual mastery. Across all subject areas, the K<sup>12</sup> proprietary core curriculum accounts for

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approximately 90% of our high school course enrollments. We are aligning our courses to the CCSS and the Common Core Assessments.

*FuelEd Online Courses.* We also offer curriculum to schools and school districts marketed as our FuelEd Online Courses product line. FuelEd Online Courses are aligned to state and national standards, including many to the CCSS, and include more than 180 courses for middle and high school students, featuring core, AP, elective and credit recovery courses. FuelEd's Online Courses are developed by subject matter experts, designed by multimedia teams and delivered by highly qualified instructors. FuelEd classes are primarily delivered over the Internet in a classroom or virtual setting, and use a variety of interactive elements to keep students engaged throughout. A deep understanding of K-12 pedagogy, as well as the human factors associated with online technology, is integrated into FuelEd's courses.

*FuelEd Anywhere Learning System ("FuelEd ALS").* Our FuelEd ALS courseware is currently in use in almost 5,000 public and private K-12 schools, public charter schools, colleges, correctional institutions, centers of adult literacy, military education programs and after-school learning centers. FuelEd ALS provides an integrated offering of instructional software and assessment for reading, mathematics, language arts, science, writing, history, government, economics and geography for grade levels K-12. In addition, we also provide assessment testing and instructional content for the General Educational Development ("GED") test. These products are designed to provide for LAN, WAN and Internet delivery in schools and support Windows and Macintosh platforms. Spanish-language versions are available for mathematics and language arts in grade levels 1-6.

*Middlebury Interactive Languages ("MIL").* We offer digital world language courses and residential summer language academies through MIL. These offerings include immersive language courses for K-12 students based on Middlebury College's pedagogy to help students gain a stronger base of comprehension and accelerate language acquisition. The age-appropriate language courses, which can be implemented fully online, in a blended learning environment or as supplemental material, use instructional tools such as animation, music, videos and other authentic materials to immerse students in the language and culture of study. We offer Chinese, French, German and Spanish courses for elementary, middle and high school students. In addition, MIL has developed a summer English language learner ("ELL") curriculum and new, digital, supplemental ELL courses for middle school student to be used in a blended environment. MIL also operates summer residential language academies, an immersive program for middle and high school students. Academy students live in language by taking the Language Pledge, a promise to communicate solely in their language of study for four weeks. Instruction is offered in Arabic, Chinese, French, German and Spanish at multiple college campuses in Vermont and internationally in Quebec, Spain and China.

*Innovative Learning Applications*

In order to continue to enhance the user experience and instructional methods of our learning systems, we strive to develop new technologies and learning applications and adapt our curriculum to new technology devices and platforms.

*Mobile Learning:* We have created a number of mobile tools and applications. We currently offer a total of 47 applications now available for download. As of June 30, 2015, these "apps" have been downloaded over 2.3 million times since 2012. We continue to deploy innovative educational tools for the mobile environment. With the increase in the use of mobile devices, we expect our mobile applications will create the ability for a student to learn "on-the-go," allowing for more continuous learning, engagement and mastery of content. We offer certain applications for both phones and tablets available via Apple iTunes, Google Play and Amazon marketplaces, adapting many of our award-winning curriculum features for the mobile application space. In addition, we rolled out our first fully mobile-enabled courseware in the fall of 2014, consisting of nine courses at the middle



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school level utilizing the Blackboard Mobile Learn app. These courses feature more than 9,000 mobile friendly interactives.

*Interactive Games:* An active educational games initiative is delivering new methods for engagement, practice and review of K-12 concepts, including: narrative/immersive styles, rewards, persistent data, and complex algorithms. These games make use of extensive research and educational best practices and address targeted learning objectives. Our offering includes nine interactive games and an innovative review and practice portal called Noodleverse. Noodleverse includes approximately 3,000 activities and is designed for K-3 students in conjunction with the K<sup>12</sup> language arts program.

*Virtual Labs:* We have delivered alternatives for our educational partners who desire materials-free curriculum. This includes converting over 60 existing materials-based high school science labs into highly interactive virtual labs and video lab simulations that meet state standards and still maintain teaching the original learning objectives. For example, in high school chemistry we have developed a virtual laboratory on chromatography, in which students separate a number of inks into their component pigments. This laboratory is performed at a virtual lab bench with all the materials and with the same procedures high school students would use in a physical chemistry laboratory.

*eBook and Digital Book Distribution:* Through fiscal year 2015, we have created or converted additional K<sup>12</sup> textbooks (now totaling 93) used across our courses into an electronic format, including textbooks, reference guides, literature readers and lab manuals. This digital delivery ability enables us to offer options to our customers via interactive online books that enhance the student's reading experience, reinforce the student's learning approach and create a new method for delivering book and print materials. Each offline book is converted into an electronic book format with a custom user interface to be viewed via a standard web browser or a commercially available electronic reader (e.g. Kindle, Nook). Web accessibility features for disabled students are made use of where currently possible.

*Adaptive Learning:* We have learning management systems and can now build courses that are adaptive, which enable individualized learning experiences as the course "adapts" at key points to student behavior and input. Based on assessment results or individual activity, these courses can automatically route students to an alternate explanation, additional practice or remediation on a prerequisite skill or crucial concept. In addition to remediation, the capability allows students to accelerate past previously mastered concepts, giving skillful students time for more challenging work. Our MARK<sup>12</sup> reading remediation product captures individual students' successes and challenges as they practice phonemic awareness, alphabetic principles, accuracy and fluency, vocabulary and comprehension. The program serves the individual student more exercises, practice and review in areas of difficulty. Adaptation in this way tailors the instruction automatically for each student, making learning experiences more efficient and effective by building into the course the logic an expert teacher or tutor uses to differentiate instruction.

*National Math Lab:* The National Math Lab program has been designed to address students' math needs and to help them develop the necessary skills to succeed in math. The program works with students in grades 5 through 10 across all of the K12 network schools, who experience challenges in math and need supplemental support. National Math Lab provides nearly twice the usual amount of math instruction to students and in addition to their regular online math coursework, students attend targeted synchronous mathematical instruction sessions provided by highly-trained math teachers four days per week.

*Engaging Videos:* We continue to explore opportunities to enhance student engagement through strategic use of relevant multimedia. Multimedia is specifically used as appropriate for the subject matter. For example, our video on photosynthesis for high school biology allows students to witness the setup, procedure and data in a classic experiment in which an aquatic plant is exposed to light

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and produces oxygen bubbles. The high definition video and the presentation to the student of real data (which they then use in their analysis) make this video lab a multimedia experience that is coupled with a scientific method. Transcripts and captioning enhance accessibility where currently feasible.

*Online School Platform-Learning Management System*

For our K<sup>12</sup> curriculum users in grades K-8, we provide a proprietary learning management system, our OLS platform. The OLS is a significant part of our ongoing effort to provide the most engaging and productive learning experience for students. The OLS platform is an adaptive, intuitive, web-based software platform that provides access to our online lessons, our lesson planning and scheduling tools, and our progress tracking tool which serves a key role in assisting parents and teachers in managing each student's progress. The OLS is also the central system through which students, parents, teachers and administrators interact using Kmail and Class Connect (our integrated synchronous session scheduler). During fiscal year 2015, we completed a number of major releases of our platform intended to enhance the capabilities available to our learning coaches, increase teacher efficiency and drive overall academic achievement. In 2014, we entered into an agreement to transition our high school learning management system to Desire2Learn, a pioneer in next-generation digital education systems. The Desire2Learn platform is used by over 100 K-12 organizations, and provides an industry-leading student experience which should help us improve student engagement, retention and outcomes for the managed schools we serve. It is expected to also significantly advance our efforts to deliver a more mobile-ready and accessible curriculum because of its capabilities. We completed our pilot program during the 2014-15 school year and will transition to the Desire2Learn platform for high school in the fall of 2015.

*Lesson Planning and Scheduling Tools.* During a school year, a typical student will complete between 800 and 1,200 lessons across six or more subject areas. Our lesson planning and scheduling tools enable teachers and parents to establish an individualized plan for each student to complete his or her lessons. These tools are designed to dynamically update the lesson plan as a student progresses through each lesson and course, allowing flexibility to increase or decrease the pace at which the student advances through the curriculum while ensuring that the student progresses towards completion in the desired time frame. For example, the schedule can easily be adapted to accommodate a student who desires to attend school six days a week, a student who is interested in studying more during the winter holidays to take time off during the spring, or a student who chooses to complete two math lessons a day for the first month of the school year and delay art lessons until the second month of the school year. Moreover, changes can be made to the schedule at any point during the school year and the remainder of the student's schedule will automatically be adjusted in the OLS. Unlike a traditional classroom education, our learning systems offer the flexibility for each student to take courses at different grade levels in a single academic year, providing flexibility for students to progress at their own level and pace within each subject area. The curriculum includes assessments built into every lesson to guide and tailor the pace of progress to each child's needs.

*Progress Tracking Tools.* Once a schedule has been established, the OLS delivers lessons based upon the specified parameters of the school and the teacher. Each day, a student is initially directed to a home page listing the schedule for that particular day and begins the school day by selecting one of the listed lessons. As each lesson is completed, the student returns to the day's schedule to proceed to the next subject. If a student does not complete a lesson by the end of the day on which it was originally scheduled, the lesson will be rescheduled to the next day and will resume at the point where the student left off. Our progress tracking tool allows students, parents, learning coaches and teachers to monitor student progress. In addition, information collected by our progress tracking tool regarding student performance, attendance and other data are transferred to our proprietary TotalView for use in providing administrative support services. This instructional program includes

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several processes and educational techniques that embrace proactive intervention. As a result, we can provide high quality instruction and intervention equal to student needs.

*Assessment Tracking Tools:* Meaningful assessments and feedback are critical to efficient and successful learning. Assessments embedded into our lessons help the parent, teacher, and student verify that the student is achieving important learning objectives. A student does not progress to the next lesson in a course until he has mastered the assessment at the end of the previous lesson. Teachers can easily view assessment data for their students in the OLS so that they can proactively provide additional instruction to students when needed. Our assessment tools also help us improve the program by providing information on the effectiveness of specific instructional activities and the curriculum.

Our learning systems make use of a variety of formative and summative assessment instruments:

Lesson assessments are used to verify mastery of the objectives for that lesson and to determine whether further study of the lesson is necessary.

Unit assessments show whether or not the student has retained key learning objectives for the unit, and identify specific objectives students may need to review before progressing.

Semester assessments verify student mastery of key learning objectives for the semester.

Independent third-party assessments are used in most of our managed schools to pinpoint specific individual student strengths and weaknesses relative to state standards. These results enable the teacher to develop a highly individualized learning plan for each student. Students are tested via an online, adaptive test at the beginning and end of the school year to provide a measure of individual student growth demonstrating the value-added gains of the school program.

*TotalView*

TotalView is our proprietary student information system. TotalView is integrated with the OLS and several other proprietary systems including our online enrollment system that allows parents to complete school enrollment forms online and our Order Management System that generates orders for learning kits and computers to be delivered to students. TotalView stores student specific data and is used for a variety of functions, including enrolling students in courses, assigning progress marks and grades, tracking student demographic data, and generating student transcripts. The TotalView suite of online applications provides administrators, teachers, parents and students a unified view of student progress, attendance, communications, and learning kit shipment tracking. TotalView includes a sophisticated means of documenting student engagement in required classroom activities, identification of those students struggling with grade level state content standards, and previous year's performance on state tests. TotalView also includes Kmail, our internal communications system. Through Kmail, administrators and teachers can communicate electronically with learning coaches and students. TotalView also includes an enrollment processing and tracking tool that allows us to closely monitor and manage the enrollment process for new students. Over the past several years, we have enhanced TotalView with additional functionality to better support the operation of the virtual and blended public schools.

*PEAK*

Institutional Sales offers an innovative platform called PEAK and the PEAK Library. PEAK is a proprietary software system designed to centrally manage in a single-user interface multiple, independent online school-based functions. Schools can enroll and activate students, assign courses and teachers, and then manage the learning experience with easy to use reporting and analytics on student progress. In addition, through the PEAK library, teachers can build and modify assignments, assessments and courses and can augment classroom instruction and develop lessons for sharing across the school district. PEAK also has the capability to support other third-party solutions, open educational resources and district and

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teacher-created content. In fiscal year 2015, PEAK served nearly 900 school districts and school partners and more than 300,000 student enrollments. As more districts adopt online learning, they are demanding more control and flexibility in running their programs. PEAK provides unparalleled capabilities for districts wanting to operate multiple solutions or catalogs from a single application and offers rich personalization features that can be managed at the district, school or teacher level.

*Our Services*

We offer a comprehensive suite of services to students and their families as well as directly to virtual and blended public schools, traditional schools and school districts. Our services can be categorized broadly into academic support services and management and technology services.

*Academic Support Services*

*Teachers and Related Services.* Teachers are critical to students' educational success. Teachers in the virtual and blended public schools that we manage are typically employed by the school, with the ultimate authority over these teachers residing with the school's governing body. As part of our service agreements, we typically contract to recruit, train and provide management support for these teachers. Historically, we have seen significant demand for teaching positions in the virtual and blended public schools that we manage. For our Institutional Sales customers, we provide instructors as needed using our staff of highly qualified and state-certified teachers and trainers.

We use a rigorous evaluation process for making teacher hiring recommendations to the schools we manage. We generally recruit teachers who, at a minimum, are state certified and meet each state's requirements for designation as a "Highly Qualified Teacher." We also seek to recruit teachers who have the skill set necessary to be successful in a virtual environment. Teaching in a virtual or blended public school is characterized by enhanced one-on-one student-teacher and parent-teacher interaction, so these teachers must have strong interpersonal communications skills. Additionally, a virtual or blended public school teacher must be creative in finding ways to effectively connect with their students and integrate themselves into the daily lives of the students' families. We assess these teacher characteristics using a customized online assessment as part of the hiring process. Throughout a teacher's employment in a managed program, we provide tools for teacher management and evaluation. When appropriate, we also provide recommendation to the schools boards and partners we serve regarding teacher personnel decisions.

New teachers participate in our comprehensive training program during which, among other things, they are introduced to our educational philosophy, our curriculum and our OLS and other technology applications, and are provided strategies for communicating and connecting with students and their families in a virtual environment. We also provide ongoing professional development opportunities for teachers so that they may stay abreast of changing educational standards, key learning trends, and sound pedagogical strategies which we believe enhance their teaching abilities and effectiveness.

*Advanced and Special Education Services.* We believe that our learning systems are able to effectively address the educational needs of both advanced and special education students because they employ flexible teaching methods and students can use them at their own pace. For students requiring special attention, we employ a national director who is an expert on the delivery of special education services in a virtual or blended public school environment and who oversees the special education programs at the schools we serve. We assist and facilitate the development and implementation of "individualized education plans" for students with special needs, and each school's special education program is designed to be compliant with the federal Individuals with Disabilities Education Act and all state special education requirements. Each special needs student is assigned a certified special education teacher and the school arranges for any required ancillary services, including speech and occupational therapy, and any required assistive technologies, such as special computer displays or speech recognition software. We support

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advanced and talented students through our advanced learner program. Advanced learners are able to participate in a wide variety of enrichment seminars, clubs, and mentoring opportunities. Advanced students are connected to each other across state boundaries through learning circles, book clubs, and other special-interest activities. In addition, for students needing English language learning assistance ("ELL Students"), we work with the schools and parents to advise on these programs, including with translation services in our enrollment centers.

*Supporting Academically At-Risk Learners.* Our objective is to narrow the achievement gap for those students who enter our virtual or blended public schools behind their same-age peers. To that end, we conduct both formative and summative assessments during the course of the school year in order to identify those students needing specific remedial support as well as measure the effectiveness of the support. We also offer the Passport school program, which is designed for academically at-risk students, particularly those who have previously dropped out of high school, and which includes more counseling and support services.

*Student Support Services.* We provide students attending virtual or blended public schools that we manage and their families with a variety of support services to ensure that we effectively meet their educational needs and goals. We offer support to address any questions or concerns that students and their parents have during the course of their education. We plan and coordinate social events to offer students opportunities to meet and socialize with their school peers. Finally, in connection with our high school offering, each student is assigned a homeroom teacher, and/or an advisor and a guidance counselor who assists them with academic issues, college and career planning and other support as needed.

*Management and Technology Services*

*Turn-key Services.* For most of our managed statewide virtual and blended public schools, we provide turn-key management services. In these circumstances, we take responsibility for all aspects of the management of the schools, including monitoring academic achievement, teacher hiring recommendations and training, compensation of school personnel, financial management, enrollment processing and provision of curriculum, equipment and required services.

*Accreditation.* In 2013, AdvancED renewed our accreditation for another five years. AdvancED serves more than 30,000 public and private schools and districts across the United States and is the parent company of North Central Accreditation Association Commission on Accreditation and School Improvement, Northwest Accreditation Commission and the Southern Association of Colleges and Schools Commission on Accreditation and School Improvement. The schools we manage also maintain regional accreditations with other accrediting associations.

*Compliance and Tracking Services.* Operating a virtual or blended public school entails many of the compliance and regulatory requirements of a traditional public school, as well as an applicable charter school or other requirements specifically adopted for online public schools. We have developed management systems and processes designed to track compliance with those requirements, including tracking appropriate student information and meeting various state and federal reporting, record keeping and privacy requirements for the schools we serve. For example, we collect enrollment related information, monitor attendance and administer proctored state tests. Further, as we have expanded into new states, our processes have grown increasingly robust. In fiscal year 2014, we hired a Chief School Compliance Officer ("CSCO") to supplement and oversee school compliance. Among other responsibilities, our CSCO complements our corporate compliance and ethics function and reviews and advises our managed public schools on applicable regulatory policies, practices and procedures. The CSCO reports semi-annually to the Audit Committee and annually to the Board of Directors.

*Financial Management Services.* For the schools we manage, we oversee the preparation of the annual budget and coordinate with the school's governing body to determine its annual objectives. In

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addition, we implement an internal control framework, develop policies and procedures, provide accounting services and payroll administration, oversee all federal entitlement programs, arrange for external audits and ensure all state and local financial compliance reporting is met.

*Facility, Operations and Technology Support Services.* We generally operate administrative offices and all other facilities on behalf of the schools we manage. We provide these schools with a complete technology infrastructure. In addition, we provide a comprehensive help desk solution for students and school staff to address their computer or other technical issues.

*Human Resources Support Services.* We are actively involved in recruiting virtual and blended public school administrators, teachers and staff, through a thorough interview and orientation process. To better facilitate the hiring process, we review and analyze the profiles of teachers that have been highly effective in our managed public and blended schools learning systems to identify the attributes desired in future new hires. While many schools employ teachers directly, we also help negotiate and secure employment benefits and payroll services for school staff on behalf of the schools and administer employee benefit plans for school employees. Additionally, we assist the schools we serve in drafting and implementing administrative policies and procedures.

**Competition**

As a general matter, we face varying degrees of competition from a variety of education companies because the scope of our offerings and the customers we serve encompass many separate and distinct segments of the education business. We compete primarily with companies that provide online curriculum and school support services to K-12 virtual and blended public schools, and school districts. These companies include Pearson PLC (Connections Academy and Advanced Academics), White Hat Management, LLC, and National Network of Digital Schools Management Foundation Inc., among others. We also face competition from online and print curriculum developers. The online curriculum providers include Apex Learning Inc., Compass Learning Inc., Edgenuity Inc., Glynlyon, Inc., Edmentum Inc., Renaissance Learning, Inc., Rosetta Stone Inc. and traditional textbook publishers including Houghton Mifflin Harcourt, McGraw-Hill Companies and Pearson PLC. We also compete with institutions such as The Laurel Springs School (Nobel Learning Communities, Inc.) and Penn Foster Inc. for online private school students. Additionally, we compete with state-administered online programs such as Florida Virtual School.

We believe that the primary factors on which we compete are:

extensive experience in, and understanding of, K-12 virtual schooling;

track record of student academic gains and customer satisfaction;

quality of curriculum and online delivery platform;

qualifications, experience and training teachers for online instruction;

comprehensiveness of school management and student support services;

platform designed to allow school district partners to centrally manage multiple online solutions;

integrated K12 solutions, with components designed and built to work together;

ability to scale across our lines of business;

sophisticated government affairs knowledge and experience in virtual school regulatory environments; and

competitive pricing.



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Broadly speaking, we participate in the market for K-12 education. In states where we enter into long-term service agreements to manage virtual and blended public schools, we believe that we generally serve less than 1% of the public school students in that state. The customers for Institutional Sales are schools and school districts seeking individual courses to supplement their course catalogs or school districts seeking to offer an online education program to serve the needs of a small subset of their overall student population. Defining a more precise relevant market upon which to base a share estimate would not be meaningful due to significant limitations on the comparability of data among jurisdictions. For example, some providers to K-12 virtual public schools serve only high school students; others serve the elementary and middle school students, and a few serve both. There are also providers of online virtual K-12 education that operate solely within individual states or geographic regions rather than globally as we do. Furthermore, some school districts offer their own virtual programs with which we compete. Parents in search of an alternative to their local public school have a number of alternatives beyond virtual and blended public schools, including private schools, public charter schools and home schooling. In our International and Private Pay schools, we compete for students seeking an English-based K-12 education worldwide, and we currently draw students from more than 100 countries. In addition, our integrated learning systems consist of components that face competition from many different types of education companies, such as traditional textbook publishers, test and assessment firms and private education management companies. Finally, our learning systems are designed to operate domestically and internationally over the Internet, and thus the geographic market for many of our products and services is global and indeterminate in size.

**Key Functional Areas**

*Public Affairs, School Development, Student Recruitment and Marketing*

We seek to increase public awareness of the educational and fiscal benefits of individualized online learning options through full-time virtual and blended instructional models as well as supplementary course options. We receive numerous inquiries from school districts, legislators, public charter school boards, community leaders, state departments of education, educators and parents who express the desire to have a choice in public school options. Our public affairs and school development teams work together with these interested parties to identify and pursue opportunities to expand the use of our products and services in new and existing jurisdictions.

Our student recruitment and marketing team is responsible for generating interest in new student enrollments, managing the consumer sales business, conducting market and customer research, defining, packaging and pricing our product offerings to customers, and enhancing the experience of students enrolled in the schools we serve through the development and operation of student clubs and parent support opportunities. This team employs a variety of strategies designed to better understand and address the requirements of our target markets.

*Operations*

The physical learning kits that accompany our online lessons are an essential component of many of our courses. A student enrolling in one of our courses may receive multiple textbooks, art supplies, laboratory supplies (e.g. microscopes and scales) and other reference materials designed to enhance the learning experience. We package these books and materials into course-specific learning kits. Because each student's curriculum is customized, the combination of kits for each student must also be customized. In fiscal year 2015, we assembled approximately 7.1 million items into more than 806,000 kits.

Over our fifteen years of operation, we believe that we have gained significant experience in the sourcing, assembly and delivery of school supplies and materials. We have developed strong relationships with partners allowing us to source goods at favorable price, quality and service levels. Our fulfillment partner stores our inventory, assembles our learning kits and ships the kits to students. We have invested in



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systems, including our Order Management System, to automatically translate the curriculum selected by each enrolled student into an order to build the corresponding individualized learning kit. As a result, we believe we have an end-to-end warehousing and fulfillment operation that will cost-effectively scale as the business grows in scope and complexity.

For many of our virtual and blended public school customers, we attempt to reclaim any materials that could be cost-effectively re-utilized in the next school year. These items, once returned to our fulfillment centers, are refurbished and included in future learning kits. This reclamation process allows us to maintain lower materials costs. Our fulfillment activities are highly seasonal, and are centered on the start of school in August or September. Accordingly, approximately 65% of our annual materials inventory is received between March and May and approximately 65% of shipments to customers occur between June and September. In order to ensure that students in virtual and blended public schools have access to our OLS, we often provide students with a computer and all necessary support. We source computers and ship them to students when they enroll and reclaim the computers at the end of a school year or upon termination of their enrollment or withdrawal from the school in which they are enrolled.

**Technology**

Our online learning systems, along with our back office support systems, are built on our proprietary Service Oriented Architecture ("SOA") to ensure high availability and redundancy. The flexibility and security enabled by our SOA are the core principles of our systems' foundation.

*Service Oriented Architecture.* All of our systems leverage our SOA that is built on top of Enterprise Java. The SOA allows us to develop iterative solutions expeditiously to meet both present and future market needs. Our high availability and scalability are also facilitated by this architecture. The SOA also enables seamless integration with third-party solutions in our platform with ease and efficiency.

*Availability and Redundancy.* Our SOA allows for primary and secondary equipment to be utilized at all network and application tiers. Each application layer is load balanced across multiple servers, which, along with our sophisticated network management capabilities, allows for additional hardware to be inserted into our network providing us with optimal scalability and availability as evidenced by our typically greater than 99% uptime over a growing user base. We regularly backup critical data and store this backup data at an offsite location.

*Security.* Our security measures and policies include dividing application layers into multiple zones controlled by firewall technology. Sensitive communications are encrypted between client and server and our server-to-server accessibility is strictly controlled and monitored. We also have engaged an outside firm to manage unwanted traffic that may target our services and systems.

*Physical Infrastructure.* We utilize leading vendors to provide a foundation for our SOA. Our systems are housed offsite in data centers that provide a robust, redundant network backbone, power and geographically separated disaster recovery. Our second data center, geographically separated from our primary center, operates as a ready business continuity site with secured, near-real time data replication from our primary data center. We vigilantly monitor our physical infrastructure for security, availability and performance.

**Other Information**

***Intellectual Property***

We continue to invest in our intellectual property as we develop more courses for new grades and expand into adjacent education markets, both in the United States and overseas. Through acquisitions, we have also acquired curriculum, patents and trademarks that expand our portfolio of educational products and services. We continue to add features and tools to our proprietary learning platform and support systems to assist teachers and students and improve educational outcomes, such as adaptive learning

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technologies. These intellectual property assets are critical to our success and we avail ourselves of the full protections provided under the patent, copyright, trademark and trade secrets laws. We also routinely utilize confidentiality and licensing agreements with our employees, the virtual and blended public schools, traditional schools, school districts and private schools that we serve, individual consumers, contractors and other businesses and persons with which we have commercial relationships.

Our patent portfolio includes issued patents and pending applications directed towards various aspects of our educational products and offerings. In particular, the first family of patent applications we filed in the U.S. and in foreign countries was directed towards the first generation of our system and method of virtual schooling and includes two issued patents. Further, two U.S. patents were issued for our systems and methods of online foreign language instruction. We have submitted patent applications in the United States and in foreign countries for aspects of the second generation of our virtual school application, and two U.S. patents and one foreign patent have been issued.

We own and register the copyrights to the lessons contained in the courses that comprise our proprietary curriculum. We also have obtained federal and state registrations for numerous trademarks that are related to our offerings and we have applied to the U.S. Patent and Trademark Office to register certain new trademarks. As a result of the acquisitions we have made, we also own U.S. and foreign trademarks and a portfolio of domain names.

We grant licenses to individuals to use our software in order to access our online learning systems. Similarly, schools are granted a license to use our online learning systems in order to access TotalView and our other systems. These licenses are intended to protect our ownership and the confidentiality of the embedded information and technology contained in our software and systems. We also own many of the trademarks and service marks that we use as part of the student recruitment and branding services we provide to schools. Those marks are licensed to the schools for use during the term of the products and services agreements.

Our employees, contractors and other parties with access to our confidential information sign agreements that prohibit the unauthorized use or disclosure of our proprietary rights, information and technology.

***Employees***

As of June 30, 2015, we had approximately 4,800 employees, including approximately 2,600 teachers. A majority of these employees are located in the United States. In addition, there are approximately 2,700 teachers who are employed by virtual or blended public schools that we manage under turn-key solution contracts with those schools but are not direct employees of K12. None of our employees are represented by a labor union or covered by a collective bargaining agreement; however, certain managed public schools we serve employ unionized teachers. We believe that our employee relations are good.

***Corporate Information***

Our principal executive office is located at 2300 Corporate Park Drive, Herndon, Virginia 20171 and our telephone number is (703) 483-7000. Our website address is [www.K12.com](http://www.K12.com).

***Available Information***

We make available, free of charge through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), promptly after they are electronically filed with the Securities and Exchange Commission (the "SEC"). Our earnings conference calls are web cast live via our website. In addition to visiting our website, you may read and copy public reports we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington D.C. 20549, or at [www.sec.gov](http://www.sec.gov). You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Information contained on our website is expressly not incorporated by reference into this Annual Report.

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**REGULATION**

We and the virtual and blended public schools that we serve are subject to regulation by each of the states in which we operate. The state laws and regulations that impact our business are primarily those that authorize or restrict our ability to operate these schools, as well as the applicable funding mechanisms. To the extent these schools receive federal funds, such as through a grant program or financial support dedicated for the education of low-income families, these schools also become subject to additional federal regulation.

*State Laws Authorizing or Restricting Virtual and Blended Public Schools.* The authority to operate a virtual or blended public school is dependent on the laws and regulations of each state. Laws and regulations vary significantly from one state to the next and are constantly evolving. In states that have implemented specific legislation to support virtual and blended public schools, the schools are able to operate under these statutes. Other states provide for virtual and blended public schools under existing public charter school legislation or provide that school districts and/or state education agencies may authorize them. Some states do not currently have legislation that provides for virtual and blended public schools or have requirements that effectively prohibit such schools and, as a result, may require new legislation before virtual and blended public schools can open in the state. We currently serve virtual and blended public schools or school district-led programs in 32 states plus the District of Columbia.

Obtaining new legislation in the remaining states can be a protracted and uncertain process. When determining whether to pursue expansion into new states in which the laws are ambiguous, we research the relevant legislation and political climate and then make an assessment of the perceived likelihood of success before deciding to commit resources. Specifically, we take into account numerous factors including, but not limited to, the regulations of the state educational authorities, whether the overall political environment is amenable to school choice, whether current funding levels for virtual school and blended schools enrollments are adequate and accessible, and the presence of non-profit and for-profit competitors in the state.

*State Laws and Regulations Applicable to Virtual and Blended Public Schools.* Virtual and blended public schools that purchase our curriculum and management services are often governed and overseen by a non-profit or a local or state education agency, such as an independent public charter school board, local school district or state education authority. We generally receive funds for products and services rendered to operate virtual public schools or blended schools under detailed service agreements with that governing authority. Virtual and blended public schools are typically funded by state or local governments on a per student basis. A virtual or blended public school that fails to comply with the state laws and regulations applicable to it may be required to repay these funds and could become ineligible for receipt of future state funds.

To be eligible for state funding, some states require that virtual and blended public schools be organized under not-for-profit charters exempt from taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). The schools must then be organized exclusively for charitable educational purposes, and not for the benefit of private, for-profit management companies. The board or governing authority of the not-for-profit virtual or blended public school must retain ultimate accountability and control for the school's operations to retain its tax-exempt status. It may not delegate its responsibility and accountability for the school's operations. Our service agreements with these virtual and blended public schools are therefore structured to ensure the full independence of the not-for-profit board and preserve its arms-length ability to exercise its fiduciary obligations to operate a virtual or blended public school.

Laws and regulations affect many aspects of operating a virtual or blended public school. They can dictate the content and sequence of the curriculum, the methods for counting student enrollments for funding purposes, graduation requirements, use of approved textbooks, the length of the school year and the school day, the accessibility of curriculum and technology to students with disabilities, teacher:student

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ratios, the assessment of student performance and any accountability requirements. In addition, a virtual or blended public school may be obligated to comply with states' requirements to offer programs for specific populations, such as students at risk of dropping out of school, advanced and talented students, non-English speaking students, pre-kindergarten students and students with disabilities. Tutoring services and the use of technology may also be regulated. Other state laws and regulations may affect the school's compulsory attendance requirements, treatment of absences and make-up work, and access by parents to student records and teaching and testing materials.

In addition to federal laws protecting the privacy of student education records, a growing number of states are enacting laws to protect the privacy of student data and to guard against its misuse. As a general matter these laws are designed to prevent third-party vendors to schools from using student data for non-educational purposes and ensuring the security of personally identifiable information. In addition, virtual or blended public schools may have to comply with state requirements that school campuses report various types of data as performance indicators of the success of the program.

States have laws and regulations concerning certification, training, experience and continued professional development of teachers and staff with which a virtual or blended public school may be required to comply. There are also numerous laws pertaining to employee salaries and benefits, statewide teacher retirement systems, workers' compensation, unemployment benefits and matters related to employment agreements and procedures for termination of school employees. A virtual or blended public school must also comply with requirements for performing criminal background checks on school staff, reporting criminal activity by school staff and reporting suspected child abuse.

As with any public school, virtual and blended public schools must comply with state laws and regulations applicable to governmental entities, such as open meetings or sunshine laws, which may require the board of trustees of a virtual or blended public school to provide advance public notice of and hold its meetings open to the public unless an exception in the law allows an executive session. Failure to comply with these requirements may lead to personal civil and/or criminal penalties for board members or officers or the invalidation of actions taken during meetings that were not properly noticed and open to the public. Virtual and blended public schools must also comply with public information or open records laws, which require them to make school records available for public inspection, review and copying unless a specific exemption in the law applies. Additionally laws pertaining to records privacy and retention and to standards for maintenance of records apply to virtual and blended public schools.

Other types of regulation applicable to virtual and blended public schools include restrictions on the use of public funds, the types of investments made with public funds, the collection of and use of student fees and controlling accounting and financial management practices.

There remains uncertainty about the extent to which virtual and blended public schools we serve may be required to comply with state laws and regulations applicable to traditional public schools because the concept of virtual and blended public schools is still evolving, especially as technology advances. Although we receive state funds indirectly, according to the terms of each service agreement with the local public school entity, our receipt of state funds subjects us to extensive state regulation and scrutiny. States routinely conduct audits of these schools, to verify enrollment, attendance, information technology security, fiscal accountability, special education services and other regulatory issues. While we may believe that a virtual public school or blended school we serve is compliant with state law, an agency's different interpretation of law in a particular state, or the application of facts to such law, could result in findings of non-compliance, potentially affecting funding.

*Regulations Restricting Virtual and Blended Public School Growth and Funding.* As a public schooling alternative, some state and regulatory authorities have elected to proceed cautiously with virtual and blended public schools while providing opportunities for taxpayer families seeking this alternative. Regulations that control the growth of virtual and blended public schools range from setting caps on

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statewide student enrollments, to prescribing the number of schools in a state, to limiting the percentage of time students may receive instruction online. Funding regulations can also have this effect.

Regulations that hinder our ability to serve certain jurisdictions include: restrictions on student eligibility, such as mandating attendance at a traditional public school prior to enrolling in a virtual or blended public school; caps on the total number of students in a virtual or blended public school; restrictions on grade levels served; geographic limitations on enrollments; fixing the percentage of per pupil funding that must be paid to teachers; state-specific curriculum requirements; and limits on the number of charters that can be granted in a state.

Funding regulations for virtual public schools and blended schools can take a variety of forms. These regulations include: (i) attendance some state daily attendance rules were designed for traditional classroom procedures and applying them to track daily attendance and truancy in an online setting can cause disputes to arise over interpretation and funding; (ii) enrollment eligibility some states place restrictions on the students seeking to enroll in virtual and blended public schools, resulting in lower aggregate funding levels; and (iii) teacher contact time some states have regulations that specify minimum levels of teacher-student face-to-face time. These regulations can create logistical challenges for statewide virtual and blended public schools, reduce funding and eliminate some of the economic, academic and technological advantages of virtual learning.

*Federal and State Grants.* We have worked with some entities to secure public and grant funding that flows to virtual and blended public schools that we serve. These grants are awarded to the not-for-profit entity that holds the charter of the virtual or blended public school on a competitive basis in some instances and on an entitlement basis in other instances. Grants awarded to public schools and programs whether by a federal or state agency or nongovernmental organization often include reporting requirements, procedures and obligations.

*Foreign Laws and Regulations.* Schools we operate in other countries are subject to local laws and regulations. We oversee and rely on the administrators in each school on a continuous basis and seek the advice of local legal and regulatory experts as-needed.

**Federal Laws Applicable to Virtual Public Schools and Blended Schools**

Five primary federal laws are directly applicable to the day-to-day provision of educational services we provide to virtual and blended public schools:

*No Child Left Behind Act ("NCLB") and NCLB Waivers.* Through the funding of the Title I programs for disadvantaged students under the Elementary and Secondary Education Act ("ESEA"), as amended by NCLB, the federal government requires public schools to develop a state accountability system based on academic standards and assessments developed by the state. Each state must set yearly targets, or annual measurable objectives ("AMOs"), which specify the percentage of students that it expects to score at or above a proficiency level (or "cut" test score) in reading and math, and must determine what constitutes adequate yearly progress ("AYP") toward that goal. NCLB set a deadline to ensure that no later than the 2013-14 school year, 100% of students, including those in all identified subgroups (such as economically disadvantaged, limited English proficient and minority students) are proficient. If a Title I school does not make AYP as defined in the state's plan for two or more consecutive years, the local education agency ("LEA") is required to identify the school as needing school improvement, which triggers a series of mandated consequences, such as allowing students to transfer to another public school served by the LEA (which may include a virtual or blended public school), providing supplemental tutoring services, and ultimately the restructuring of the schools' operations.

Beginning in 2011, it became clear that the NCLB goal of 100% of students reaching proficiency by 2014 was unrealistic, among other learned shortcomings in the law, and the U.S. Department of Education ("DOE") announced a policy that would allow states to apply for waivers of certain NCLB requirements,

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including the key accountability provisions, in exchange for agreeing to new principled-based reforms. To qualify for an NCLB waiver, a state must: (i) adopt college and career-ready standards for reading and math (with assessment standards that measure student achievement growth), (ii) establish annual measurable objectives ("AMOs") that can include different target achievement levels for different districts, schools or student groups, (iii) develop and implement teacher and principal evaluation and support systems, and (iv) evaluate and remove duplicative and burdensome state reporting requirements.

As of July 2014, 42 states plus the District of Columbia have obtained NCLB waivers, as well as eight school districts in California after their state application was denied. Only four states have not applied for waivers and waivers are pending for two states. Of the 33 states and the District of Columbia where we currently serve students in Managed Programs, 28 states and the District of Columbia have received waivers from the DOE. Of the remaining four jurisdictions where we manage schools, Wyoming and Iowa are pursuing waivers. California has chosen not to continue pursuing a waiver, and Washington had its waiver revoked in April 2014.

Another provision of the NCLB requires public school programs to ensure that all teachers are highly qualified in core subjects. A highly qualified teacher means one who has: (i) obtained full state certification or licensure as a teacher and who has not had certification or licensure requirements waived on an emergency, temporary or provisional basis; (ii) obtained a bachelor's degree; and (iii) demonstrated competence in the academic subject the teacher teaches. All teacher aides working in a school supported with Title I funds must be highly qualified which means the person must have a high school diploma or its equivalent and one of the following: completed at least two years of study in an institution of higher education, obtained an associate's or higher degree, or met a rigorous standard of quality demonstrated through a formal state or local assessment. Virtual and blended public schools using our products and services may be required to meet these requirements for any persons who perform instructional services.

Under NCLB, even schools that do not receive Title I funding must provide certain notices to parents. For example, schools may be required to provide a school report card and identify whether any school has been identified as needing improvement and for how long. Parents also must be provided data that will be used to determine adequate yearly progress. Virtual and blended public schools may be contacted by military recruiters who have the right to access the names, addresses and telephone numbers of secondary school students for military recruiting purposes. Additionally, virtual public schools and blended schools may be required to notify parents that they have the option to request that this information not be released to military recruiters or to institutions of higher education.

By its terms, the NCLB expired on September 30, 2007, but remains in effect until Congress either reauthorizes or amends the statute.

*Individuals with Disabilities Education Act ("IDEA").* The IDEA is implemented through regulations governing every aspect of the special education of a child with one or more of the specific disabilities listed in the Act. The IDEA created a responsibility on the part of a school to identify students who may qualify under the IDEA and to perform periodic assessments to determine the students' needs for services. A student who qualifies for services under the IDEA must have in place an individual education plan, which must be updated at least annually, created by a team consisting of school personnel, the student, and the parent. This plan must be implemented in a setting where the child with a disability is educated with non-disabled peers to the maximum extent appropriate. The Act provides the student and parents with numerous due process rights relating to the student's program and education, including the right to seek mediation of disputes and make complaints to the state education agency. The schools we manage are responsible for ensuring the requirements of this Act are met. The virtual public schools and blended schools could be required to comply with requirements in the Act concerning teacher certification and training. We, the virtual public school or the blended school could be required to provide additional staff, related services and supplemental aids and services at our own cost to comply with the requirement to provide a free appropriate public education to each child covered under the IDEA. If we fail to meet this

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requirement, we, the virtual public school or blended school could lose federal funding and could be liable for compensatory educational services, reimbursement to the parent for educational service the parent provided and payment of the parent's attorney's fees.

*Section 504 of the Rehabilitation Act of 1973.* A virtual public school or blended school receiving federal funds is subject to Section 504 of the Rehabilitation Act of 1973 ("Section 504") insofar as the regulations implementing the Act govern the education of students with disabilities as well as personnel and parents. Section 504 prohibits discrimination against a person on the basis of disability in any program receiving federal financial assistance if the person is otherwise qualified to participate in or receive benefit from the program. Students with disabilities not specifically listed in the IDEA may be entitled to specialized instruction or related services pursuant to Section 504 if their disability substantially limits a major life activity. Beginning in 2011, the Office of Civil Rights ("OCR") of the United States Department of Education interpreted both Section 504 and Title II of the Americans with Disabilities Act to apply to elementary and secondary schools and to require that students with disabilities be afforded substantially equivalent ease of use as students without disabilities. As applied to online public schools, such "web accessibility" requires technical capabilities similar to those applied to procurements of information technology by the federal government under Section 508 of the Rehabilitation Act or 1973 or standards adopted by the world-wide web consortium. If a school fails to comply with the requirements and the procedural safeguards of Section 504, it may lose federal funds even though these funds flow indirectly to the school through a local board. In the case of bad faith or intentional wrongdoing, some courts have awarded monetary damages to prevailing parties in Section 504 lawsuits.

*Family Educational Rights and Privacy Act.* Virtual public schools and blended schools are also subject to the Family Educational Rights and Privacy Act ("FERPA") which protects the privacy of a student's educational records and generally prohibits a school from disclosing a student's records to a third party without the parent's prior consent. The law also gives parents certain procedural rights with respect to their minor children's education records. A school's failure to comply with this law may result in termination of its eligibility to receive federal education funds.

*Communications Decency Act.* The Communications Decency Act of 1996 ("CDA") provides protection for online service providers against legal action being taken against them because of certain actions of others. For example, the CDA states that no provider or user of an interactive computer service shall be treated as the publisher or speaker of any data given by another provider of information content. Further, Section 230 of the CDA grants interactive online services of all types, broad immunity from tort liability so long as the information at issue is provided or posted by a third party. As part of our technology services offering, we provide an online school platform on which teachers and students may communicate. We also conduct live classroom sessions using Internet-based collaboration software and we may offer certain online community platforms for students and parents. While the CDA affords us with some protection from liability associated with the interactive online services we offer, there are exceptions to the CDA that could result in successful actions against us that give rise to financial liability.

*Other Federal Laws.* Other federal laws that may apply to virtual managed schools depend on the demographics associated with that school. For example, Title VI of the Civil Rights Act of 1964 has been deemed to apply to ELL Students, as further defined in the joint guidance issued by the U.S. Departments of Justice and Education in January 2015. There are also other federal laws and regulations that affect other aspects of our business such as the identify theft rules adopted by the Federal Trade Commission and for which we have adopted policies to ensure compliance. If we fail to comply with these and other federal laws, we could be determined ineligible to receive funds from federal programs or face penalties.

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**ITEM 1A. RISK FACTORS**

**Risks Related to Government Funding and Regulation of Public Education**

*The majority of our revenues come from Public School Programs and depend on per pupil funding amounts and payment formulas remaining near the levels existing at the time we execute service agreements with the managed public schools we serve. If those funding levels or formulas are materially reduced or modified due to economic conditions or political opposition, new restrictions adopted or payments delayed, our business, financial condition, results of operations and cash flows could be adversely affected.*

The public schools we contract with are financed with government funding from federal, state and local taxpayers. Our business is primarily dependent upon those funds. Budget appropriations for education at all levels of government are determined through the political process, which may also be affected by conditions in the economy at large, such as the recessionary climate in the United States which led to budgetary pressures on state and local governments from 2008-13 and significant declines in public school funding. The political process and general economic conditions create a number of risks that could have an adverse effect on our business including the following:

Legislative proposals can and have resulted in budget or program cuts for public education, including the virtual and blended public schools and school districts we serve, and therefore have reduced and could potentially limit or eliminate the products and services those schools purchase from us, causing our revenues to decline. From time to time, proposals are introduced in state legislatures that single out virtual and blended public schools for disparate treatment.

Economic conditions could reduce state education funding for all public schools, and could be disproportionate for the managed public schools we serve. Our annual revenue growth is impacted by changes in federal, state and district per pupil funding levels. For example, due to the budgetary problems arising from the recession, many states reduced per pupil funding for public education affecting many of the public schools we serve, including even abrupt mid- year cuts in certain states, which in some cases were retroactively applied to the start of the school year as a result of formulaic adjustments. In addition, as we enter into service agreements with multiple managed public schools in a single state, the aggregate impact of funding reductions applicable to those schools could be material. We have service agreements with 16 schools in California, for example, and while each school is independent with its own governing authority and no single school in California accounts for more than ten percent of our revenue, regulatory actions that affect the level or timing of payments for all similarly situated schools in that state could adversely affect our financial condition. At this time, many states still have budget issues. The specific level of federal, state and district funding for the coming years is not yet known and, taken as a whole, it is reasonable to believe that a number of the public schools we serve could experience lower per pupil enrollment funding, while others may increase funding as the economic conditions improve.

As a public company, we are required to file periodic financial and other disclosure reports with the SEC. This information may be referenced in the legislative process, including budgetary considerations, related to the funding of alternative public school options, including virtual public schools and blended schools. The disclosure of this information by a for-profit education company, regardless of parent satisfaction and student performance, may nonetheless be used by opponents of virtual and blended public schools to propose funding reductions or restrictions.

From time to time, government funding to schools is not provided when due, which sometimes causes the affected schools to delay payments to us for our products and services. These payment delays have occurred in the past and can deprive us of significant working capital until the matter is resolved, which could hinder our ability to implement our growth strategies and conduct our business. For example, in fiscal year 2012, due to shortfalls in its general revenue funds, California



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announced that it would be deferring its per- student attendance payments to all public schools until early fiscal year 2013, which significantly increased our accounts receivable balance.

***The poor performance or misconduct by us or operators of other virtual public schools, public school district virtual learning programs or blended schools could tarnish the reputation of all the school operators in our industry, which could have a negative impact on our business.***

As a non-traditional form of public education, online public school operators will be subject to scrutiny, perhaps even greater than that applied to traditional brick and mortar public schools or public charter schools. Not all virtual public school, school district virtual learning program or blended school operators will have successful academic programs or operate efficiently, and new entrants may not perform well either. Such underperformance could create the impression that virtual schooling is not an effective way to educate students, whether or not our learning systems achieve satisfactory performance. Consistently poor academic performance could also lead to termination of an approved provider status in some jurisdictions. Beyond academic performance issues, some virtual school operators have been subject to governmental investigations alleging the misuse of public funds or financial irregularities. These allegations have attracted significant adverse media coverage and have prompted legislative hearings and regulatory responses. Although these investigations have focused on specific companies and individuals, or even entire industries in the case of for-profit higher education companies, they may negatively impact public perceptions of virtual public schools, public school district virtual learning programs or blended school providers generally, including us. The precise impact of these negative public perceptions on our current and future business is difficult to discern, in part because of the number of states in which we operate and the range of particular malfeasance or performance issues involved. We have incurred significant costs in several states advocating against harmful legislation which, in our opinion, was aggravated by negative media coverage about us or other operators. If these few situations, or any additional misconduct, cause all virtual public school, school district virtual learning program and blended school providers to be viewed by the public and/or policymakers unfavorably, we may find it difficult to expand into new states or enter into or renew contracts to operate virtual or blended schools. In addition, this perception could serve as the impetus for more restrictive legislation, which could limit our future business opportunities. In addition, these factors could serve as the impetus for more restrictive legislation which could limit our future business opportunities, such as the restrictions enacted in Tennessee which capped enrollment growth but were repealed in 2015.

***Opponents of virtual and blended public schools have sought to challenge the establishment and expansion of such schools through the judicial process. If these interests prevail, it could damage our ability to sustain or grow our current business or expand in certain jurisdictions.***

We have been, and will likely continue to be, subject to public policy lawsuits filed against virtual and blended schools by those who do not share our belief in the value of this form of public education. Whether or not we are a named party to these lawsuits, legal claims have involved challenges to the constitutionality of authorizing statutes, methods of instructional delivery, funding provisions and the respective roles of parents and teachers. For example, in 2014, the New Jersey Education Association, the state affiliate of a national teachers union, challenged the grant of a charter to the Newark Preparatory Charter School that was contracting with us for educational products and services. In this instance, the court denied the union's challenge and sustained the grant of the charter. *In the Matter of the Grant of a Charter to the Merit Preparatory Charter Sch. and in the Matter of the Grant of a Charter to the Newark Preparatory Charter Sch.*, 435 N.J. Super. 273 (App Div. 2014)

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***Should we fail to comply with the laws and regulations applicable to the Public School Programs and the Institutional Sales districts we serve, such failures could result in a loss of public funding and an obligation to repay funds previously received, which could adversely affect our business, financial condition and results of operations.***

Once authorized by law, virtual and blended public schools are generally subject to extensive regulation, as are the school districts served by our Institutional Sales business. These regulations cover specific program standards and financial requirements including, but not limited to: (i) student eligibility standards; (ii) numeric and geographic limitations on enrollments; (iii) state-specific curriculum requirements; (iv) restrictions on open-enrollment policies by and among districts; (v) prescribed teacher: student ratios and teacher funding allocations from per pupil funding; and (vi) teacher certification and reporting requirements. State and federal funding authorities conduct regular program and financial audits of the public schools we serve to ensure compliance with applicable regulations. If a final determination of non-compliance is made, additional funds may be withheld which could impair that school's ability to pay us for services in a timely manner, or the school could be required to repay funds received during the period of non-compliance. Additionally, the indemnity provisions in our standard service agreements with virtual and blended public schools and school districts may require us to return any contested funds on behalf of the school.

***Virtual and blended public schools are relatively new, and enabling legislation therefore is often ambiguous and subject to discrepancies in interpretation by regulatory authorities, which may lead to disputes over our ability to invoice and receive payments for services rendered.***

Statutory language providing for virtual and blended public schools is sometimes interpreted by regulatory authorities in ways that may vary from year to year making compliance subject to uncertainty. More issues normally arise during our first few school years of doing business in a state because the enabling legislation often does not address specific issues, such as what constitutes proper documentation for enrollment eligibility in a virtual or blended school. From time to time there are changes to the regulators' approach to determining the eligibility of virtual or blended school students for funding purposes. Another issue may be differing interpretations on what constitutes a student's substantial completion of a semester in a public school. These regulatory uncertainties may lead to disputes over our ability to invoice and receive payments for services rendered, which could adversely affect our business, financial condition and results of operations.

***The operation of virtual and blended public charter schools depends on the maintenance of the authorizing charter and compliance with applicable laws. If these charters are not renewed, our contracts with these schools would be terminated.***

In many cases, virtual and blended public schools operate under a charter that is granted by a state or local authorizer to the charter holder, such as a community group or an established not-for-profit corporation, which typically is required by state law to qualify for student funding. In fiscal year 2015, approximately 90% of our revenue was derived from Public School Programs, the majority of which were virtual and blended public schools operating under a charter. The service agreement for these schools is with the charter holder or the charter board. Non-profit public charter schools qualifying for exemption from federal taxation under Code Section 501(c)(3) as charitable organizations must also operate on an arms-length basis in accordance with Internal Revenue Service rules and policies to maintain that status and their funding eligibility. In addition, all state public charter school statutes require periodic reauthorization. If a virtual or blended public school we manage fails to maintain its tax-exempt status and funding eligibility, fails to renew its charter, or if its charter is revoked for non-performance or other reasons that may be due to actions of the independent charter board completely outside of our control, our contract with that school would be terminated. For example, in January 2015, the State of Delaware revoked the charter for the Maurice J. Moyer Academy Charter School due to non-performance of charter requirements.

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***Actual or alleged misconduct by our senior management and directors or officials could make it more difficult for us to enter into new contracts or renew existing contracts.***

If we or any of our current or former directors, officers, key employees or officials are accused or found to be guilty of serious crimes or civil violations, including the mismanagement or improper accounting of public funds, or violations of the federal securities laws, the schools we serve could be barred or discouraged from entering into or renewing service agreements with us. As a result, our business and revenues would be adversely affected.

***New laws or regulations not currently applicable to for-profit education companies in the K-12 sector could be enacted and negatively impact our operations and financial results.***

As the provision of online K-12 public education matures, novel issues may arise that could lead to the enactment of new laws or regulations similar to, or in addition to, laws or regulations applicable to other areas of education and education at different levels. For example, for-profit education companies that own and operate post-secondary colleges depend in significant respect on student loans provided by the federal government to cover tuition expenses, and federal laws prohibit incentive compensation for success in securing enrollments or financial aid to any person engaged in student recruiting or admission activities. In contrast, while students in virtual or blended public K-12 schools are entitled to a free public education with no federal or state loans necessary for tuition, laws could be enacted that make for-profit management companies serving such schools subject to similar or other restrictions.

**Risks Related to Our Business and Our Industry**

***The schools we contract with and serve are governed by independent governing bodies that may shift their priorities or change objectives in ways adverse to us, or react negatively to acquisitions or other transactions.***

We contract with and provide a majority of our products and services to virtual and blended public schools governed by independent boards or similar governing bodies. While we typically share a common objective at the outset of our business relationship, over time our interests could diverge resulting in changes adverse to our business. For example, in fiscal year 2013, in connection with a one-year charter renewal of the Colorado Virtual Academy ("COVA") by its school district authorizer, our interests diverged significantly with the COVA governing authority, which expressed its intention to assume management of the school after the 2013-14 school year while continuing to purchase curriculum and other services from us. If these independent boards of the schools or school districts we serve subsequently shift their priorities or change objectives, and as a result reduce the scope of services and products we provide, or terminate their relationship with us, our ability to generate revenues would be adversely affected.

***Our contracts with the managed public schools we serve are subject to periodic renewal, and each year several of these agreements are set to expire. If we are unable to renew several such contracts or if a single significant contract expires during a given year, our business, financial condition, results of operations and cash flow could be adversely affected.***

In fiscal year 2015 we had contracts with 75 Managed Programs to provide our full range of products and services in 32 states and the District of Columbia. Some of these contracts are scheduled to expire in any given year and may not be renewed or may be renewed on terms much less favorable to us. Due to significant advance notice provisions or on the request of a school's charter authority, we usually begin to engage in renewal negotiations before and during the final year of these contracts and any renewed contract could involve a restructuring of our services and management arrangements that could lower our revenue or even change how revenue and expenses are recognized. For example, in fiscal year 2015, the Agora Cyber Charter School ("Agora") renegotiated its service agreement and entered into a three-year contract with us to purchase our curriculum and certain technology services, while the school board assumed the daily operational responsibilities, including its charter renewal process and marketing and

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enrollment activities. If we are unable to renew contracts or if contract renewals have significantly less favorable terms or unbundle previously provided services, our business, financial condition, results of operations and cash flow could be adversely affected.

***If the schools we serve fail to enroll or reenroll a sufficient number of students, our business, financial condition and results of operations will be adversely affected.***

Our revenues are a direct function of how many students are enrolled in our Public School Programs, the number of school districts and students who subscribe to the programs offered in our Institutional Sales business, and the enrollments in our three international and private pay schools.

Because families have alternative choices both within and outside the public school system for educating their children, it is typical during each school year that some students withdraw from schools using our online education services and switch to their traditional local public schools, other charter school alternatives or private schools. While our Public School Programs also accept new student enrollment throughout the year where permitted, generally our average student enrollment declines as the school year progresses such that we serve on average fewer students at the end of any given school year than at the beginning of the year. If our Public School Programs experience higher withdrawal rates during the year and/or enroll fewer new students as the year progresses than we have experienced in the past, our revenues, result of operations and financial conditions would be adversely affected.

Similarly, at the start of each new school year students who had remained enrolled through the end of the previous year may have graduated from eighth or twelfth grade or have left our Public School Programs for any number of reasons. To the extent our Public School Programs do not retain previously enrolled students from the prior year, they must attract new students at the start of the year to sustain their average student enrollment year over year, as well as to grow their enrollment each year, based upon enrollment objectives determined by the governing authority of those schools. If the schools we serve in the aggregate are able only to sustain prior year enrollment levels, our revenues may not grow from the prior year, absent improved revenue capture or the addition of new schools. More fundamentally, if average student enrollment at the schools we serve declines from one year to the next, our revenues, results of operations and financial condition will be adversely affected.

We also contract with virtual public schools and schools districts to provide marketing and enrollment services, and we provide similar services directly to our international and private pay schools. However, many of our customers with Non-managed Programs are responsible for their own marketing and enrollment activities. Efforts on our part to sustain or increase enrollments in the face of higher student withdrawals or fewer returning students at the start of a school year may lead to higher costs for us, and may adversely affect our operating margin. If we or our Non-managed Program partners are unsuccessful in marketing plans or enrollment processes for the schools, the average student enrollment at the schools may not grow or could even decline, and adversely affect our revenues, results of operations and financial condition.

***As we continue to refine and focus our marketing efforts, and support the enrollment activities for our Managed Programs, changes in our marketing efforts and enrollment activities could lead to decline in overall enrollment at the schools we serve.***

As parents evaluate public school choices for their children, we are focusing our marketing efforts to better attract students who we believe are most likely to benefit from and succeed in virtual education programs and who are likely to remain enrolled with a virtual school over several years, while the schools continue to accept any student who seeks to enroll. Our focused efforts may not be wholly successful, and could lead to an overall decline in enrollment for our Managed Programs, thus adversely affecting our revenue and results from operations.

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***The student demographics at the schools we serve have been changing, which can lead to higher costs and affect our ability to sustain or grow our operating income.***

The schools we serve are publicly funded and are generally obligated to accept all students meeting state or district criteria for enrollment. Because an online education environment may offer a better educational opportunity for students falling behind grade level, our Public School Programs have experienced in recent years a higher at-risk student population, requiring supplemental services and closer one-on-one involvement by teachers and school personnel, leading to higher costs to us in providing full management and curriculum services to the schools. The schools we serve also enroll a significant percentage of special needs students with learning and/or physical disabilities, which also add to our total costs.

Education of high school students is generally more costly than K-8 as more teachers with subject matter expertise (e.g. chemistry, calculus) must be hired to support an expansive curriculum, electives, and counseling services. As the relative percentage of high school students increases as part of the total average enrollment in our Public School Programs, our costs are likely to increase.

As our costs structure evolves due to the demographics, educational profile and mix of the students enrolled in our Public School Programs, our profit margins may decline, and we may have increasing difficulty in sustaining or growing our operating income commensurate with our revenues.

***If student performance falls, state accountability standards are not achieved, teachers or administrators tamper with state test scoring, or parent and student satisfaction declines, a significant number of students may not remain enrolled in a virtual or blended public school that we serve, or charters may not be renewed or enrollment caps could be put in place, or enrollment practices could be limited and our business, financial condition and results of operations will be adversely affected.***

The success of our business depends in part on the choice of a family to have their child begin or continue his or her education in a virtual or blended public school that we serve. This decision is based on many factors, including student performance and parent and student satisfaction. Students may perform significantly below state averages or the virtual or blended public school may fail to meet state accountability standards or the standards of the "NCLB" where still applicable, or the conditions of waivers to NCLB requirements granted to states by the U.S. Department of Education. Like many traditional brick and mortar public schools, not all of the managed public schools we serve meet the requirements of NCLB or state accountability frameworks, as large numbers of new enrollments from students underperforming in traditional schools can decrease overall results or the underperformance of any one subgroup can lead to the entire school failing to meet accountability expectations and potentially lead to the school's closure. For example, in Tennessee, the Commissioner of Education has statutory authority to close a virtual school if an accountability trigger is met. In addition, although serving academically at-risk students is an important aspect of our mission to educate any child regardless of circumstance, the performance of these students can adversely affect a school's standing under federal and state accountability systems. We expect that, as our enrollments increase and the portion of students that have not used our learning systems for multiple years increases, the average performance of all students using our learning systems may decrease, even if the individual performance of other students improves over time. This effect may also be exacerbated if students enrolled in schools that we provide services to or acquire are predominately below state proficiency standards. Moreover, Congress may amend the NCLB statute or state authorities may change their testing benchmarks in ways that negatively impact the schools we serve.

Students in the managed public schools we serve are required to periodically complete standardized state testing and the results of this testing may have an impact on school funding. Furthermore, in states granted NCLB waivers to adopt innovative accountability systems that consider student growth and school progress, if a school experiences repeated poor test results, those waivers allow such schools to create their

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own turnaround plans and interventions to address the largest achievement gaps, which in turn could impact our instructional costs. Further, to avoid the consequences of failing to meet applicable required proficiency or accountability standards, teachers or school administrators may engage in improperly altering student test scores, especially if teacher performance and compensation is evaluated on these results. Finally, parent and student satisfaction may decline as not all parents and students are able to devote the substantial time and effort necessary to complete our curriculum. A student's satisfaction may also suffer if his or her relationship with the virtual or blended public school teacher does not meet expectations. If student performance or satisfaction declines, students may decide not to remain enrolled in a virtual or blended public school that we serve and our business, financial condition and results of operations could be adversely affected.

***The transition to Common Core State Standards and Common Core Assessments could result in a decline in state test scores that might adversely affect our enrollment and financial conditions.***

Many states have adopted the CCSS, also known as the College and Career Readiness Standards, but are not choosing to use the assessments developed by two national testing consortia that align with the CCSS curriculum. Instead, these states are electing to use existing or state-developed assessments to evaluate student performance. As a result, it has been reported in many states that students learning under the CCSS but continuing to be tested under the existing state proficiency tests have experienced sharp declines in test results. As the managed public schools we serve undertake this transition, and given the growing number of at-risk students enrolling in these schools, perceived academic performance could temporarily or permanently suffer such that these schools may become a less attractive alternative, enrollments could decline, and our financial condition and results of operations could be negatively impacted.

***Mergers, acquisitions and joint ventures present many risks, and we may not realize the financial and strategic goals that formed the basis for the transaction.***

When strategic opportunities arise to expand our business, we may acquire or invest in other companies using cash, stock, debt, asset contributions or any combination thereof. We may face risks in connection with these or other future transactions, including the possibility that we may not realize the anticipated cost and revenue synergies or further the strategic purpose of any acquisition if our forecasts do not materialize. The pursuit of acquisitions may divert the resources that could otherwise be used to support and grow our existing lines of business. Acquisitions may also create multiple and overlapping product lines that are offered, priced and supported differently, which could cause customer confusion and delays in service. Customers may decline to renew their contracts or the contracts of acquired businesses might not allow us to recognize revenues on the same basis. These transactions may also divert our management's attention and our ongoing business may be disrupted by acquisition, transition or integration activities. In addition, we may have difficulty separating, transitioning and integrating an acquired company's systems and the associated costs in doing so may be higher than we anticipate.

There may also be other adverse effects on our business, operating results or financial condition associated with the expansion of our business through acquisitions. We may fail to identify or assess the magnitude of certain liabilities, shortcomings or other circumstances prior to acquiring a company or technology, which could result in unexpected accounting treatment, unexpected increases in taxes due or a loss of anticipated tax benefits. Our use of cash to pay for acquisitions may limit other potential uses of our cash, including investment in other areas of our business, stock repurchases, dividend payments and retirement of outstanding indebtedness. If we issue a significant amount of equity for future acquisitions, existing stockholders may be diluted and earnings per share may decrease. We may pay more than the acquired company or assets are ultimately worth and we may have underestimated our costs in continuing the support and development of an acquired company's products. Our operating results may be adversely

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impacted by liabilities resulting from a stock or asset acquisition, which may be costly, disruptive to our business, or lead to litigation.

We may be unable to obtain required approvals from governmental authorities on a timely basis, if at all, which could, among other things, delay or prevent us from completing a transaction, otherwise restrict our ability to realize the expected financial or strategic goals of an acquisition or have other adverse effects on our current business and operations. We may face contingencies related to intellectual property, financial disclosures, and accounting practices or internal controls. Finally, we may not be able to retain key executives of an acquired company.

The occurrence of any of these risks could have a material adverse effect on our business, results of operations, financial condition or cash flows, particularly in the case of a larger acquisition or several concurrent acquisitions.

***If market demand for online options in public schooling does not increase or continue or if additional states do not authorize or adequately fund virtual or blended public schools, our business, financial condition and results of operations could be adversely affected.***

Over the previous five fiscal years, we entered into service agreements for managed virtual public schools and blended schools in many new states bringing our total to 32 states and the District of Columbia for the 2014-15 school year. Without adding additional states, our Public School Program revenues may become increasingly dependent on serving more virtual schools in existing states. We also may not be able to fill available enrollment slots as forecasted. If the market demand for virtual and blended public schools does not increase or declines, if the remaining states are hesitant to authorize virtual or blended public schools, if enrollment caps are not removed or raised, or if the funding of such schools is inadequate, our opportunities for growth and our ability to sustain our revenues, results from operations and financial conditions would be adversely affected.

***Increasing competition in the education industry sectors that we serve could lead to pricing pressures, reduced operating margins, loss of market share, departure of key employees and increased capital expenditures.***

As a general matter, we face varying degrees of competition from a variety of education providers because our learning systems integrate all the elements of the education development and delivery process, including curriculum development, textbook publishing, teacher training and support, lesson planning, testing and assessment and school performance and compliance management. In both our Public School Programs and Institutional Sales businesses, we compete with companies that provide online curriculum and support services. We also compete with public school districts that offer K-12 online programs of their own or in partnership with other online curriculum vendors. We anticipate intensifying competition from such competitors and by new entrants. Our competitors may adopt similar curriculum delivery, school support and marketing approaches, with different pricing and service packages that may have greater appeal than our offerings. For example, price competition in the Institutional Sales business is vigorous. In addition, some of our Managed Programs could seek to transition to a self-administered school by seeking competitive alternatives to portions of the products and services now provided entirely by us under our integrated fully managed service agreements. If we are unable to successfully compete for new business, win and renew contracts, including fully managed public school contracts, or students fail to realize sufficient gains in academic performance, our revenues, opportunities for growth and operating margins may decline. Price competition from our current and future competitors could also result in reduced revenues, reduced margins or the failure of our product and service offerings to achieve or maintain more widespread market acceptance.

We may also face competition from publishers of traditional educational materials that are substantially larger than we are and have significantly greater financial, technical and marketing resources, and may enter the field through acquisitions and mergers. As a result, they may be able to devote more

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resources and move quickly to develop products and services that are superior to our platform and technologies. We may not have the resources necessary to acquire or compete with technologies being developed by our competitors, which may render our online delivery format less competitive or obsolete. These new and well-funded entrants may also seek to attract our key executives as employees based on their acquired expertise in virtual education where such specialized skills are not widely available.

Our future success will depend in large part on our ability to maintain a competitive position with our curriculum and our technology, as well as our ability to increase capital expenditures to sustain the competitive position of our product and retain our talent base. We cannot assure that we will have the financial resources, technical expertise, marketing, distribution or support capabilities to compete effectively.

***Regulatory frameworks on the accessibility of technology and curriculum are continually evolving due to legislative and administrative developments and the rapid evolution of technology, which could result in increased product development costs and compliance risks.***

Our online curriculum is made available to students through computers and other display devices connected to the Internet. This curriculum includes a combination of software applications that include graphics, pictures, videos, animations, sounds and interactive content that present challenges to people with disabilities. A number of states and federal authorities have considered or are considering how electronic and information technology procured with state funds should be made accessible to persons with such disabilities. To the extent they enact or interpret laws and regulations to require greater accessibility, we will have to modify our curriculum offerings to satisfy those requirements. For example, in March 2014, the OCR entered into an agreement with the South Carolina Charter School District ("District") to ensure that the seven internet-based public charter schools in the state provide students with disabilities an equal opportunity to access each school's website and online learning environment by December 31, 2015, in compliance with Section 504 and Title II of the Americans with Disabilities Act. In addition, to the extent that we enter into federal government contracts or Section 508 standards are adopted by regulators, similar requirements could be imposed on us under Section 508 of the Rehabilitation Act of 1974. If requirements or technology evolves in such a way as to accelerate or alter the need to make all curriculums accessible, we could incur significant product development costs on an accelerated basis. A failure to meet required accessibility needs could also result in loss or termination of significant contracts or in potential legal liability.

***Our Managed Programs business revenues are based in part on our estimate of the total funds each school will receive in a particular school year and our estimate of the full year expenses to be incurred by each school. As a result, differences between our quarterly estimates and the actual funds received and expenses incurred could have an adverse impact on our results of operations and cash flows.***

We recognize revenues ratably from certain of our fees charged to Managed Programs over the course of our fiscal year. To determine the pro rata amount of revenues to recognize in a fiscal quarter, we estimate the total funds each school will receive in a particular school year. Additionally, we take responsibility for any operating deficits incurred at most of the Managed Programs we serve. Because this may impair our ability to collect the full amount invoiced in a period and therefore collection cannot reasonably be assured, we reduce revenues by the estimated pro rata amount of the school's operating loss. We review our estimates of total funds and operating expenses periodically, and we revise as necessary, amortizing any adjustments over the remaining portion of the fiscal year. Actual school funding received and school operating expenses incurred may vary from our estimates or revisions and could adversely impact our revenues, results from operations and cash flows.



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***Our business is subject to seasonal fluctuations, which may cause our operating results to fluctuate from quarter-to-quarter and adversely impact our working capital and liquidity throughout the year.***

Our revenues and operating results normally fluctuate as a result of seasonal variations in our business, principally due to the number of months in a fiscal quarter that our school customers are fully operational and serving students. In the typical academic year, our first and fourth fiscal quarters have fewer than three full months of operations, whereas our second and third fiscal quarters will have three complete months of operations. We ship learning kits to students in the beginning of the school year, our first fiscal quarter, generally resulting in higher learning kit revenues and margins in the first fiscal quarter relative to the other quarters. In aggregate, the seasonality of our revenues has generally produced higher revenues in the first quarter of our fiscal year.

Our operating expenses are also seasonal. Instructional costs and services increase in the first fiscal quarter primarily due to the costs incurred to ship learning kits at the beginning of the school year. These instructional costs may increase significantly quarter-to-quarter as school operating expenses increase. The majority of our selling and marketing expenses are incurred in the first and fourth fiscal quarters, as our primary enrollment season is July through September.

We expect quarterly fluctuations in our revenues and operating results to continue. These fluctuations could result in volatility and adversely affect our cash flow. As our business grows, these seasonal fluctuations may become more pronounced. As a result, we believe that sequential quarterly comparisons of our financial results may not provide an accurate assessment of our financial position.

**Risks Related to Our Operations**

***We plan to continue to create new products, expand distribution channels and pilot innovative educational programs to enhance academic performance. If we are unable to effectively manage these initiatives or they fail to gain acceptance, our business, financial condition, results of operations and cash flows would be adversely affected.***

As we create and acquire new products, expand our existing customer base and pilot new educational programs, we expect to face challenges distinct from those we currently encounter, including:

our continued development of public blended schools and individualized learning centers (also known as Flex schools) which has produced different operational challenges than those we previously encountered. In addition to the online component, these schools sometimes require us to lease facilities for classrooms, staff classrooms with teachers, provide meals and kitchen facilities, adhere to local safety and fire codes, purchase additional insurance and fulfill many other responsibilities;

the acquisition or opening of additional managed public schools in states where we already have a contract with such schools can potentially create customer dissatisfaction, confuse prospective parents in the school selection process, and present marketing differentiation challenges depending on the facts and circumstances in that state;

our operation of traditional or brick and mortar schools, as well as Flex schools used on a full-time basis by students accessing our curriculum online under the supervision of certified teachers and supporting instructors, has necessitated different management skills and presented additional risks compared to those in our core Managed Programs business;

our efforts to integrate adaptive learning technologies and solutions into our learning management system, which may require significant investment of resources to develop or acquire to continue to improve our educational programs and student outcomes;

operating in international markets may require us to conduct our business differently than we do in the United States or in existing countries. Additionally, we may have difficulty training and retaining qualified teachers or generating sufficient demand for our products and services in

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international markets. International opportunities will also present us with different legal, operational, tax and currency challenges;

the use of our curriculum in classrooms will produce challenges with respect to adapting our curriculum for effective use in a traditional classroom setting;

our online private school business is dependent on a tuition-based financial model and may not be able to enroll a sufficient number of students over time to achieve long-run profitability or deliver a high level of customer satisfaction;

our participation in summer foreign language instruction camps through MIL could generate new legal liabilities and financial consequences associated with our responsibility for students housed on leased college campuses on a 24-hour basis over the duration of the camp; and

our continual efforts to innovate and pilot new programs to enhance student learning may not always succeed or may encounter unanticipated opposition.

Our failure to manage these business expansion programs, or any new business expansion program or new distribution channel we pursue, may have an adverse effect on our business, financial condition, results of operations and cash flows.

***High quality teachers are critical to the success of our learning systems. If we are not able to continue to recruit, train and retain quality certified teachers, our curriculum might not be effectively delivered to students, compromising their academic performance and our reputation. As a result, our brand, business and operating results may be adversely affected.***

High quality teachers are critical to maintaining the value of our learning systems and assisting students with their daily lessons. In addition, teachers in the public schools we manage or who provide instruction in connection with the online programs we offer to school districts, must be state certified (with limited exceptions or temporary waiver provisions in various states), and we must implement effective internal controls in each jurisdiction to ensure valid teacher certifications, as well as the proper matching of certifications with student grade levels and subjects to be taught. Teachers must also possess strong interpersonal communications skills to be able to effectively instruct students in a virtual school setting, and the technical skills to use our technology-based learning systems. There is a limited pool of teachers with these specialized attributes and the managed public schools and school districts we serve must provide competitive compensation packages to attract and retain such qualified teachers.

The teachers in most managed public schools we serve are not our employees and the ultimate authority relating to those teachers resides with an independent not-for-profit the governing body, which oversees the schools. However, under many of our service agreements with virtual and blended public schools, we have responsibility to recruit, train and manage these teachers. The teacher recruitment and student assignment procedures and processes for our Public School Programs must also comply with individual state certification and reporting requirements. We must also provide continuous training to virtual and blended public school teachers so they can stay abreast of changes in student demands, academic standards and other key trends necessary to teach online effectively, including measures of effectiveness. We may not be able to recruit, train and retain enough qualified teachers to keep pace with school demand while maintaining consistent teaching quality in the various managed public schools we serve. Shortages of qualified teachers, failures to ensure proper teacher certifications in each state, or decreases in the quality of our instruction, whether actual or perceived, could have an adverse effect on our Public School Programs and Institutional Sales businesses.

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***School teachers are subject to union organizing campaigns, and if the teachers employed by us or at the managed public schools we serve join a union, collective bargaining agreements negotiated with union representatives could result in higher operating expenses and the loss of management flexibility and innovation for which charter schools were created.***

If the teachers at any one of our managed public schools were to join a union, the school authority or we would be obliged to negotiate a collective bargaining agreement with union representatives. Such an agreement could impact teacher salaries, benefits, work rules, restrictions on the teaching work-day and the time devoted to online communications with students, teacher tenure, and limitations on our flexibility to reassign or remove teachers for inadequate performance. This could result in higher expenses for school operations and could impede the sustainability of or any growth in enrollment at the school due to the loss of management flexibility and innovation. This could result in higher costs to us in providing management and curriculum services to the school, and adversely affect our operating margins and overall revenues.

***We rely on third-party service providers to host some of our solutions and any interruptions or delays in services from these third parties could impair the delivery of our products and harm our business.***

We currently outsource some of our hosting services to third parties. We do not control the operation of any third party facilities. These facilities are vulnerable to damage or interruption from natural disasters, fires, power loss, telecommunications failures and similar events. They are also subject to break-ins, computer viruses, sabotage, intentional acts of vandalism and other misconduct. The occurrence of any of these disasters or other unanticipated problems could result in lengthy interruptions in our service. Furthermore, the availability of our platform could be interrupted by a number of additional factors, including our customers' inability to access the Internet, the failure of our network or software systems due to human or other error, security breaches or ability of the infrastructure to handle spikes in customer usage. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our renewal rates and our ability to attract new customers. Our business will also be harmed if our customers and potential customers believe our service is unreliable.

***We operate a complex company-wide enterprise resource planning ("ERP") system and if it were to experience significant operating problems, it could adversely affect our business and results of operations.***

We operate a complex company-wide, integrated ERP system to handle various business, operating and financial processes which handles a variety of important functions, such as order entry, invoicing, accounts receivable, accounts payable, financial consolidation and internal and external financial and management reporting matters. If the ERP experiences significant problems it could result in operational issues including delayed billing and accounting errors and other operational issues which could adversely affect our business and results of operations. System delays or malfunctioning could also disrupt our ability to timely and accurately process and report results of our operations, financial position and cash flows, which could impact our ability to timely complete important business processes.

***The continued development of our product and service brands is important to our business. If we are not able to maintain and enhance these brands, our business and operating results may suffer.***

Enhancing brand awareness is critical to attracting and retaining students, and for serving additional virtual and blended public schools, school districts and online private schools and we intend to spend significant resources to accomplish that objective. These efforts include sales and marketing directed to targeted locations as well as the national marketplace, discreet student populations, the educational community at large, key political groups, image-makers and the media. As we continue to seek to increase enrollments and extend our geographic reach and product and service offerings, maintaining quality and consistency across all of our services and products may become more difficult to achieve, and any significant and well-publicized failure to maintain this quality and consistency will have a detrimental effect

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on our brands. We cannot provide assurances that our new sales and marketing efforts will be successful in further promoting our brands in a competitive and cost-effective manner. For example, in FY2014 we discontinued the use of our Aventa Learning and A+ brands and introduced a new brand for marketing all of the curriculum and programs we offer to school districts under the FuelEd brand. If we are unable to further enhance our brand recognition and increase awareness of our products and services, or if we incur excessive sales and marketing expenses, our business and results of operations could be adversely affected.

***Our intellectual property rights are valuable, and any inability to protect them could reduce the value of our products, services and brand.***

Our patent, trademarks, trade secrets, copyrights, domain names and other intellectual property rights are important assets. For example, we have been granted three patents relating to the hardware and network infrastructure of our OLS, including the system components for creating and administering assessment tests and our lesson progress tracker and two patents related to foreign language instruction. Additionally, we are the copyright owner of the courses comprising our proprietary curriculum.

Various events outside of our control pose a threat to our intellectual property rights. For instance, effective intellectual property protection may not be available in every country in which our products and services are distributed or made available through the Internet. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant impairment of our intellectual property rights could harm our business or our ability to compete. Also, protecting our intellectual property rights is costly and time consuming. Any unauthorized use of our intellectual property could make it more expensive to do business and harm our operating results.

It is possible that we may not be able to sufficiently protect our innovations. In addition, given the costs of obtaining patent protection, we may choose not to protect certain innovations that later turn out to be important. Further, there is always the possibility that the scope of the protection gained will be insufficient or that an issued patent be deemed invalid or unenforceable.

We also seek to maintain certain intellectual property as trade secrets. This secrecy could be compromised by outside parties, whether through breach of our network security or otherwise, or by our employees or former employees, intentionally or accidentally, which would cause us to lose the competitive advantage resulting from these trade secrets. Third parties may acquire domain names that are substantially similar to our domain names leading to a decrease in the value of our domain names and trademarks and other proprietary rights.

***Lawsuits against us alleging infringement of the intellectual property rights of others and such actions would be costly to defend, could require us to pay damages or royalty payments and could limit our ability or increase our costs to use certain technologies in the future.***

Companies in the Internet, software, technology, education, curriculum and media industries own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. Regardless of the merits, intellectual property claims are time-consuming and expensive to litigate or settle. In addition, to the extent claims against us are successful, we may have to pay substantial monetary damages or discontinue certain products, services or practices that are found to be in violation of another party's rights. We also may have to seek a license and make royalty payments to continue offering our products and services or following such practices, which may significantly increase our operating expenses.

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***We may be subject to legal liability resulting from the actions of third parties, including independent contractors, business partners, or teachers, which could cause us to incur substantial costs and damage our reputation.***

We may be subject, directly or indirectly, to legal claims associated with the actions of or filed by our independent contractors, business partners, or teachers. In the event of accidents or injuries or other harm to students, we could face claims alleging that we were negligent, provided inadequate supervision or were otherwise liable for their injuries and our insurance may not cover the expenses of litigation or settlement amounts. Additionally, we could face claims alleging that our independent curriculum contractors or teachers infringed the intellectual property rights of third parties. A liability claim against us or any of our independent contractors, business partners, or teachers could adversely affect our reputation, enrollment and revenues. Even if unsuccessful, such a claim could create unfavorable publicity, cause us to incur substantial expenses and divert the time and attention of management.

***Unauthorized disclosure or manipulation of student, teacher and other sensitive data, whether through breach of our network security or otherwise, could expose us to costly litigation, jeopardize our contracts with virtual public schools or blended schools, and damage our reputation.***

Maintaining our network security and internal controls over access rights is of critical importance because our systems store proprietary and confidential student, parent and teacher information, such as names, addresses, and other personal information. Although we have developed systems and processes that are designed to protect this information and prevent data loss and other security breaches, including systems and processes designed to reduce the impact of a security breach at a third party vendor, such measures cannot provide absolute security. Individuals and groups may develop and deploy viruses, worms and other malicious software programs that attack or attempt to infiltrate our systems. The techniques used to obtain unauthorized access or breach security systems change frequently and may be difficult to detect. Therefore we may be unable to anticipate these techniques or implement adequate preventative measures. Failure to prevent or mitigate data loss or other security breaches, including breaches of our vendors' technology and systems, could expose us or our students, parents or teachers to a risk of loss or misuse of such information, adversely affect our operating results, result in litigation or potential liability for us, and otherwise harm our business.

If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, third parties may receive or be able to access student records and we could be subject to liability or our business could be interrupted. Penetration of our network security could have a negative impact on our reputation and could lead virtual public schools, blended schools and parents to choose competitive offerings. As a result, we may be required to expend significant resources to provide additional protection from the threat of these security breaches or to alleviate problems caused by these breaches. Additionally, we run the risk that employees or vendors could illegally disclose confidential educational information.

***We rely on the Internet to enroll students and to deliver our products and services to children, which exposes us to a growing number of legal risks and increasing regulation.***

We collect information regarding students during the online enrollment process and a significant amount of our curriculum content is delivered over the Internet. As a result, specific federal and state laws that could have an impact on our business include the following:

the Children's Online Privacy Protection Act, as implemented by regulations of the Federal Trade Commission (revised July 2013), imposes restrictions on the ability of online companies to collect and use personal information from children under the age of 13;

the Family Educational Rights and Privacy Act, which imposes parental or student consent requirements for specified disclosures of student information to third parties, and emerging state student data privacy laws;

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the Communications Decency Act, which provides website operators immunity from most claims arising from the publication of third-party content;

numerous state cyberbullying laws which require schools to adopt policies on harassment through the Internet or other electronic communications;

emerging state student data privacy laws which require schools to adopt privacy policies applicable to virtual schools; and

federal laws that govern schools' obligations to ELL Students.

In addition, the laws applicable to the Internet are still developing. These laws impact pricing, advertising, taxation, consumer protection, quality of products and services, and are in a state of change. New or amended laws may also be enacted, which could increase the costs of regulatory compliance for us or force us to change our business practices. As a result, we may be exposed to substantial liability, including significant expenses necessary to comply with such laws and regulations and indemnification of schools we operate for liabilities resulting from a school's failure to comply with such laws and regulations.

***System disruptions and vulnerability from security risks to our online computer networks could impact our ability to generate revenues and damage our reputation, limiting our ability to attract and retain students.***

The performance and reliability of our technology infrastructure is critical to our reputation and ability to attract and retain virtual public schools, blended schools, school district customers, parents and students. Any sustained system error or failure, or a denial of service ("DNS") attack, could limit our users' access to our online learning systems, and therefore, damage our ability to generate revenues or provide sufficient documentation to comply with state laws requiring proof that students completed the required number of hours of instruction. Our technology infrastructure could be vulnerable to interruption or malfunction due to events beyond our control, including natural disasters, terrorist activities and telecommunications failures.

***We utilize a single logistics vendor at two locations for the management, receiving, assembly and shipping of all of our learning kits and printed educational materials. In addition, we utilize the same vendor at a third location for the reclamation and redeployment of our student computers. This partnership depends upon execution on the part of us and the vendor. Any material failure to execute properly for any reason, including damage or disruption to any of the vendor's facilities would have an adverse effect on our business, financial condition and results of operations.***

Substantially all of the inventory for our learning kits and printed materials is located in two warehouse facilities, both of which are operated by a third-party logistics vendor which handles receipt, assembly and shipping of all physical learning materials. If this logistics vendor were to fail to meet its obligations to deliver learning materials to students in a timely manner, or if a material number of such shipments are incomplete or contain assembly errors, our business and results of operations could be adversely affected. In addition, we provide computers for a substantial number of our students. Execution or merger integration failures which interfere with the reclamation or redeployment of computers may result in additional costs. Furthermore, a natural disaster, fire, power interruption, work stoppage or other unanticipated catastrophic event, especially during the period from April through June when we are awaiting receipt of most of the curriculum materials for the school year and have not yet shipped such materials to students, could significantly disrupt our ability to deliver our products and operate our business. If any of our material inventory items were to experience any significant damage, we would be unable to meet our contractual obligations and our business would suffer.

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***Any significant interruption in the operation of our data centers could cause a loss of data and disrupt our ability to manage our network hardware and software and technological infrastructure.***

We host our products and serve all of our students from third-party data center facilities. As part of our risk mitigation plan, we opened a second data center in a different geographic location. Even with such redundancy, we may not be able to prevent a significant interruption in the operation of these facilities or the loss of school and operational data due to a natural disaster, fire, power interruption, act of terrorism or other unanticipated catastrophic event. Any significant interruption in the operation of these facilities, including an interruption caused by our failure to successfully expand or upgrade our systems or manage our transition to utilizing the expansions or upgrades, could reduce our ability to manage our network and technological infrastructure, which could result in lost sales, enrollment terminations and impact our brand reputation.

Additionally, we do not control the operation of these facilities and must rely on another party to provide the physical security, facilities management and communications infrastructure services related to our data centers. Although we believe we would be able to enter into a similar relationship with another party should this relationship fail or terminate for any reason, our reliance on a single vendor exposes us to risks outside of our control. If this vendor encounters financial difficulty such as bankruptcy or other events beyond our control that causes it to fail to secure adequately and maintain its hosting facilities or provide the required data communications capacity, students of the schools we serve may experience interruptions in our service or the loss or theft of important customer data.

***Any significant interruption in the operation of our enrollment centers could disrupt our ability to recommend educational options to parents, respond to service requests and process enrollments.***

Our primary enrollment center operations are housed in our corporate headquarters and in a facility located in Knoxville, Tennessee. We are able to reroute calls to the other facility if one facility is unable to temporarily service calls. Rerouting of calls may not be able to prevent a significant interruption in the operation of any of the facilities due to natural disasters, accidents, failures of our fulfillment provider. Any significant interruption in the operation of any primary facility, including an interruption caused by our failure to successfully expand or upgrade our systems or to manage these expansions or upgrades, could reduce our ability to respond to service requests, receive and process orders and provide products and services, which could result in lost and cancelled sales, and damage to our brand reputation.

***Capacity limits on some of our technology, transaction processing systems and network hardware and software may be difficult to project and we may not be able to expand and upgrade our systems in a timely manner to meet significant unexpected increased demand.***

As the number of schools we serve increases and our student base grows, the traffic on our transaction processing systems and network hardware and software will rise. We may be unable to accurately project the rate of increase in the use of our transaction processing systems and network hardware and software. In addition, we may not be able to expand and upgrade our systems and network hardware and software capabilities to accommodate significant unexpected increased or peak use. If we are unable to appropriately upgrade our systems and network hardware and software in a timely manner, our operations and processes may be temporarily disrupted.

***Our efforts to expand capacity may not produce the operational and financial results for which those investments were intended.***

As we have grown to serve more schools, students and families in an increasing number of states and countries, we have invested in infrastructure systems and technology to keep pace such as new telephony systems, enterprise hardware and software systems, and enrollment centers. In the absence of compatible

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business processes, adequate employee training, integration with other dependent systems, and sufficient staffing, this expanded capacity alone may not result in improved performance or outcomes.

***We may be unable to keep pace with changes in our industry and advancements in technology as our business and market strategy evolves.***

As changes in our industry occur or macroeconomic conditions fluctuate we may need to adjust our business strategies or find it necessary to restructure our operations or businesses, which could lead to changes in our cost structure, the need to write down the value of assets, or impact our profitability. We also make investments in existing or new businesses, including investments in technology and expansion of our business lines. These investments may have short-term returns that are negative or less than expected and the ultimate business prospects of the business may be uncertain.

As our business and market strategy evolves, we also will need to respond to technological advances and emerging industry standards in a cost-effective and timely manner in order to remain competitive, such as the advent of tablets for public school applications, adaptive learning technologies, and web accessibility standards. The need to respond to technological changes may require us to make substantial, unanticipated expenditures. There can be no assurance that we will be able to respond successfully to technological change.

***Middlebury College exercised its right under our joint venture agreement to require us to purchase its ownership interest in our joint venture, which could adversely affect our financial condition or cause dilution to stockholders.***

As a result of the May 4, 2015 put notice from Middlebury College, we are obligated to purchase Middlebury's interest in the joint venture at a mutually agreed upon fair market value, or for a value determined by an independent valuation. We have the right to pay the redemption cost in cash, stock or a combination thereof, at our option, which form of consideration has not yet been determined. In accordance with the terms of the joint venture agreement, we are in the process of determining the redemption cost value. It is uncertain what the value will be and therefore, we cannot at this time determine the form of the redemption payment and the exact impact to our financial condition or dilution to stockholders.

***We may be unable to attract and retain skilled employees.***

Our success depends in large part on continued employment of senior management and key personnel who can effectively operate our business, which is necessary in the highly regulated public education sector involving a publicly-traded for-profit company. This complexity requires us to attract and retain management and employees with specialized skills and knowledge across many disciplines. If any of these employees leave we and we fail to effectively manage a transition to new personnel, or if we fail to attract and retain qualified and experienced professionals on acceptable terms, our business, financial conditions and results of operations could be adversely affected.

Our success also depends on our having highly trained financial, technical, recruiting, sales and marketing personnel. We will need to continue to hire additional personnel as our business grows. A shortage in the number of people with these skills or our failure to attract them to our Company could impede our ability to increase revenues from our existing products and services, ensure full compliance with federal and state regulations, launch new product offerings, and would have an adverse effect on our business and financial results.

In addition, we are subject to the Fair Labor Standards Act, which governs such matters as minimum wage, overtime and other working conditions, and which can increase our labor costs or subject us to liabilities to our employees. Regulatory changes that increase the number of workers eligible for overtime based on salary levels and other labor costs may increase in the future which could have a material adverse effect on our business, financial condition and results of operations.



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***Healthcare reform legislation could have a negative impact on our business, financial condition and results of operations.***

The Patient Protection and Affordable Care Act, which was adopted in 2010 and is being phased in over several years, may significantly affect the provision of both healthcare services and benefits in the U.S. As these phases become effective, we evaluate the impact on our business and the steps necessary to mitigate such impact, including potential further modifications to our current benefit plans and operational changes to minimize the effect of the legislation on our cost structure. If we cannot effectively modify our programs and operations in response to these mandates, our business, financial condition and results of operations may be adversely impacted.

***We may need additional capital in the future, but there is no assurance that funds will be available on acceptable terms.***

We may need to raise additional funds in order to achieve growth or fund other business initiatives. This financing may not be available in sufficient amounts or on terms acceptable to us and may be dilutive to existing stockholders. Additionally, any securities issued to raise funds may have rights, preferences or privileges senior to those of existing stockholders. If adequate funds are not available or are not available on acceptable terms, our ability to expand, develop or enhance services or products, or respond to competitive pressures will be limited.

***Our curriculum and approach to instruction may not achieve widespread acceptance, which would limit our growth and profitability.***

The curriculum offerings and approach to individualized learning are based on the structured delivery, clarification, verification and practice of lesson subject matter. While we believe our curriculum is aligned with state standards in the jurisdictions where we manage virtual and blended public schools and these schools offer accredited diplomas, this approach is not accepted by all academics and educators, who may favor less formalistic methods and have the ability to negatively influence the market for our products and services. In addition, the acceptance and adoption of the CCSS grade level requirements and proposed common assessments of those standards is uncertain and continues to change at the state and district level. As a result, the standards for measuring student achievement could vary from state to state, and even from district to district, and therefore, we cannot anticipate at this time the impact these varying standards may have in terms of requiring additional investment on our part, or on our ability to sustain or expand our operating margins.

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**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our headquarters are located in approximately 176,000 square feet of office space in Herndon, Virginia. The facilities are under leases that expire between August 2019 and May 2022. In addition, we lease approximately 171,000 square feet in multiple locations throughout the United States under individual leases that expire between November 2015 and July 2021.

**ITEM 3. LEGAL PROCEEDINGS**

In the ordinary conduct of our business, we are subject to lawsuits, arbitrations and administrative proceedings from time to time. We vigorously defend these claims; however, no assurances can be given as to the outcome of any pending legal proceedings. We believe, based on currently available information, that the outcome of any existing or known threatened proceedings, even if determined adversely, should not have a material adverse effect on our business, financial condition, liquidity or results of operations.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock, par value \$0.0001 per share, is traded on the New York Stock Exchange (the "NYSE") under the symbol "LRN." Set forth below are the high and low sales prices for our common stock, as reported on the NYSE. As of August 4, 2015, there were 39 registered holders of our common stock.

	High		Low
<b>Quarter ended:</b>			
June 30, 2015	\$ 17.63	\$	12.53
March 31, 2015	17.71		10.07
December 31, 2014	16.59		11.08
September 30, 2014	24.51		15.96
June 30, 2014	\$ 26.20	\$	21.14
March 31, 2014	23.55		19.66
December 31, 2013	31.66		17.15
September 30, 2013	38.14		25.95

**Stock Performance Graph**

The graph below matches the cumulative return of holders of K12 Inc.'s common stock with the cumulative returns of the S&P 500 index, the NASDAQ Composite Index, the Russell 2000 Index and our Peer Group Index, which is composed of American Public Education Inc., Apollo Group Inc., Bridgepoint Education Inc., Capella Education Company, Devry Inc., Grand Canyon Education Inc., ITT Educational Services, Inc., Pearson PLC, Rosetta Stone Inc., Scholastic Corporation, Strayer Education Inc. and Universal Technical Institute. The graph assumes that the value of the investment in our common stock, in each index (including reinvestment of dividends) was \$100 on June 30, 2010 and tracks it through June 30, 2015. All prices reflect closing prices on the last day of trading at the end of each calendar quarter.

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**COMPARISON OF TWENTY QUARTER CUMULATIVE TOTAL RETURN(1)(2)  
Among K12 Inc., S&P 500 Index, NASDAQ Composite Index, Russell 2000 Index and Peer Group Index**

	30-Jun-10	30-Jun-11	30-Jun-12	30-Jun-13	30-Jun-14	30-Jun-15
<b>LRN</b>	100	146	123	138	136	90
<b>Peer Group Index</b>	100	97	91	82	100	85
<b>S&amp;P 500</b>	100	126	131	149	169	174
<b>Russell 2000</b>	100	133	134	155	175	181
<b>Nasdaq Composite</b>	100	129	137	153	180	192

- (1) The information presented above in the stock performance graph shall not be deemed "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C, except to the extent that we subsequently specifically request that such information be treated as soliciting material or specifically incorporate it by reference into a filing under the Securities Act of 1933, as amended (the "Securities Act"), or a filing under the Exchange Act.
- (2) The stock price performance shown on the graph is not necessarily indicative of future price performance. Information used in the graph was obtained from a source we believe to be reliable, but we do not assume responsibility for any errors or omissions in such information.

**Dividend Policy**

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We have never declared or paid any cash dividends on our common stock and we currently do not anticipate paying any cash dividends for the foreseeable future. Instead, we anticipate that all of our earnings on our common stock will be used to provide working capital, to support our operations, and to finance the growth and development of our business, including potentially the acquisition of, or investment in, businesses, technologies or products that complement our existing business. Any future determination

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relating to dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including, but not limited to, our future earnings, capital requirements, financial condition, future prospects, applicable Delaware law, which provides that dividends are only payable out of surplus or current net profits and other factors our Board of Directors might deem relevant.

**Stock-based Incentive Plan Information**

The following table provides certain information as of June 30, 2015, with respect to our equity compensation plans under which common stock is authorized for issuance:

**Equity Compensation Plan Information  
as of June 30, 2015**

	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted-Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in First Column)
Equity compensation plans approved by security holders(1)	2,914,593	\$ 20.33	3,295,463

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Includes shares under the 2007 Equity Incentive Award Plan.

- (1) The 2007 Equity Incentive Award Plan (the "EIP") adopted in October 2007, as amended in 2010 and approved by the stockholders, contains an "evergreen provision" that allows for an annual increase in the number of shares available for issuance under the EIP on July 1 of each year during the ten-year term of the EIP ending October 30, 2017. The annual increase in the number of shares shall be equal to the least of:

4% of our outstanding common stock on the applicable July 1;

2,745,098 shares; or

a lesser number of shares as determined by our Board of Directors.

**Issuer Purchases of Equity Securities**

On November 4, 2013, the Board of Directors authorized the repurchase of up to \$75.0 million of our outstanding common stock over a two year period. Any purchases under the buyback are dependent upon business and market conditions and other factors. The stock purchases are made from time to time and may be made through a variety of methods including open market purchases and trading plans that may be adopted in accordance with the Rule 10b5-1 of the Exchange Act. For the twelve months ended June 30, 2015, we paid approximately \$26.5 million in cash to redeem 1,307,402 shares of common stock at an average price of \$20.23 per share. As of June 30, 2015 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. There were no repurchases of shares made during the quarter ending June 30, 2015.

**ITEM 6. SELECTED FINANCIAL DATA**

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The following table sets forth our selected consolidated statement of operations, balance sheet and other data as of the dates and for the periods indicated. You should read this data together with "Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes, included elsewhere in this Annual Report. The selected consolidated statements of operations data for each of the years in the three-year period ended

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June 30, 2015, and the selected consolidated balance sheet data as of June 30, 2015 and 2014, have been derived from our audited consolidated financial statements, which are included elsewhere in this Annual Report. The selected consolidated statements of operations data for the years ended June 30, 2012 and 2011 and selected consolidated balance sheet data as of June 30, 2013, 2012 and 2011, have been derived from our audited consolidated financial statements not included in this Annual Report. Our historical results are not necessarily indicative of future operating results.

	<b>Year Ended June 30,</b>				
	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
	<b>(In thousands)</b>				
<b>Consolidated Statement of Operations Data:</b>					
Revenues	\$ 948,294	\$ 919,553	\$ 848,220	\$ 708,407	\$ 522,434
<b>Cost and expenses</b>					
Instructional costs and services	607,756	569,219	498,398	408,560	307,111
Selling, administrative and other operating expenses	307,730	313,258	283,032	245,274	174,762
Product development expenses	14,381	14,220	21,084	25,593	16,347
<b>Total costs and expenses</b>	<b>929,867</b>	<b>896,697</b>	<b>802,514</b>	<b>679,427</b>	<b>498,220</b>
Income from operations	18,427	22,856	45,706	28,980	24,214
Realized gain on sale of assets		6,404			
Interest (expense), net and other	(3,291)	(69)	851	(989)	(1,207)
Income before income tax expense and noncontrolling interest	15,136	29,191	46,557	27,991	23,007
Income tax expense	(5,810)	(11,075)	(20,023)	(11,882)	(11,342)
Net income	9,326	18,116	26,534	16,109	11,665
Add net loss attributable to noncontrolling interest	1,662	1,484	1,577	1,434	1,127
Net income attributable to common stockholders, including Series A stockholders(1)	\$ 10,988	\$ 19,600	\$ 28,111	\$ 17,543	\$ 12,792



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	Year Ended June 30,				
	2015	2014	2013	2012	2011
(In thousands except share and per share data)					
Net income attributable to common stockholders per share:					
Basic	\$ 0.29	\$ 0.50	\$ 0.72	\$ 0.46	\$ 0.37
Diluted(1)	\$ 0.29	\$ 0.50	\$ 0.72	\$ 0.45	\$ 0.37
Weighted average shares used in computing per share amounts:					
Basic	37,330,569	38,987,470	36,267,345	35,802,678	31,577,758
Diluted(1)	37,625,425	39,230,516	39,017,345	38,740,863	34,635,594
<b>Other Data:</b>					
Net cash provided by operating activities	\$ 120,085	\$ 122,873	\$ 94,387	\$ 32,991	\$ 67,213
Depreciation and amortization	\$ 83,801	\$ 86,267	\$ 65,737	\$ 58,033	\$ 42,934
Stock-based compensation expense	\$ 21,299	\$ 22,828	\$ 14,374	\$ 10,067	\$ 9,466
EBITDA(2)	\$ 102,228	\$ 115,527	\$ 111,443	\$ 87,013	\$ 67,148
<b>Capital Expenditures:</b>					
Capitalized curriculum development costs	\$ 18,057	\$ 15,411	\$ 18,560	\$ 16,123	\$ 18,086
Purchases of property, equipment and capitalized software development costs	\$ 43,683	\$ 33,958	\$ 31,785	\$ 32,477	\$ 29,563
New capital lease obligations(3)	\$ 14,654	\$ 24,132	\$ 24,703	\$ 27,209	\$ 15,645
Total capital expenditures	\$ 76,394	\$ 73,501	\$ 75,048	\$ 75,809	\$ 63,294

	As of June 30,				
	2015	2014	2013	2012	2011
(In thousands)					
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 195,852	\$ 196,109	\$ 181,480	\$ 144,652	\$ 193,099
Total assets	\$ 708,599	\$ 711,667	\$ 718,896	\$ 648,835	\$ 582,095
Total short-term debt	\$ 16,635	\$ 20,492	\$ 19,785	\$ 17,095	\$ 13,357
Total long-term obligations	\$ 13,022	\$ 16,447	\$ 16,107	\$ 15,901	\$ 10,851
Total K12 Inc. stockholders' equity	\$ 536,938	\$ 528,930	\$ 530,162	\$ 473,494	\$ 448,621
Working capital	\$ 348,306	\$ 351,441	\$ 348,762	\$ 289,226	\$ 264,447

(1) For the years ended, June 30, 2013, 2012 and 2011, diluted net income per common share reflects pro rata net income allocated to the 2,750,000 non-voting shares of the Series A Special Stock issued in the acquisition of KCDL in July 2010. These shares were converted into common stock on September 3, 2013 and no Series A Special stock remains outstanding as of June 30, 2015 and 2014.

(2) EBITDA consists of net income, plus interest expense, net and other, income tax expense, depreciation and amortization minus noncontrolling interest charges. Interest expense, net primarily consists of interest expense for capital leases, long-term and short-term borrowings, as well as interest income/expense related to our Web investment. We use EBITDA in addition to income from operations and net income as a measure of operating performance. However, EBITDA is not a recognized measurement under U.S. generally accepted accounting principles, or GAAP, and when analyzing our operating performance, investors should use EBITDA in addition to, and not as an alternative for, net income as determined in accordance with GAAP. Because not all companies use identical calculations, our presentation of EBITDA may not be comparable to similarly titled



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measures of other companies. Furthermore, EBITDA is not intended to be a measure of free cash flow for our management's discretionary use, as it does not consider certain cash requirements such as capital expenditures, tax payments, interest payments, or other working capital.

We believe EBITDA is useful to an investor in evaluating our operating performance because it is widely used to measure a company's operating performance without regard to items such as depreciation and amortization, which can vary depending upon accounting methods and the book value of assets, and to present a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired. Our management uses EBITDA:

as an additional measurement of operating performance because it assists us in comparing our performance on a consistent basis;

in presentations to the members of our Board of Directors to enable our Board to have the same measurement basis of operating performance as is used by management to compare our current operating results with corresponding prior periods and with the results of other companies in our industry; and

on an adjusted basis in determining compliance with the terms of our credit agreement.

(3)

New capital lease obligations are primarily for student computers and related equipment.

The following table provides a reconciliation of net income to EBITDA:

	Year Ended June 30,				
	2015	2014	2013	2012	2011
	(In thousands)				
Net Income attributable to common stockholders, including Series A stockholders	\$ 10,988	\$ 19,600	\$ 28,111	\$ 17,543	\$ 12,792
Interest expense, net and other	3,291	69	(851)	989	1,207
Income tax expense	5,810	11,075	20,023	11,882	11,342
Depreciation and amortization(4)(5)	83,801	86,267	65,737	58,033	42,934
Noncontrolling interest	(1,662)	(1,484)	(1,577)	(1,434)	(1,127)
EBITDA	\$ 102,228	\$ 115,527	\$ 111,443	\$ 87,013	\$ 67,148

(4)

For fiscal year 2015, depreciation and amortization includes \$13.9 million of non-cash expense related to accelerated depreciation and amortization for certain curriculum, learning systems and other fixed assets that will no longer be used or developed, computer peripherals that will not be reclaimed, and the write-off of capitalized software that will be abandoned.

(5)

For fiscal year 2014, depreciation and amortization includes approximately \$18.6 million for certain curriculum, learning systems and other fixed assets that will no longer be used or developed, computers that we estimate will not be returned and additional provisions for the decision to discontinue certain products and for excess inventory relative to anticipated demand.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. 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 this 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 consolidated financial statements and related notes included elsewhere in this 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 fiscal year ended June 30, 2015.

*Key Aspects and Trends of Our Operations* a discussion of items and trends that may impact our business in the upcoming year.

*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 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, the impact of inflation, 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 public school districts, public schools, virtual charter schools, private schools and families as we strive to transform the educational experience into one that delivers individualized education on a highly scalable basis.

We achieved revenue growth during fiscal year 2015, primarily in our public school programs. We increased revenues to \$948.3 million from \$919.6 million, a growth rate of 3.1% from fiscal year 2014. In fiscal year 2015, operating income decreased to \$18.4 million, from \$22.9 million in fiscal year 2014, a decrease of 19.7%; net income attributable to common stockholders decreased to \$11.0 million from \$19.6 million, a decrease of 43.9% and EBITDA, a non-GAAP measure (see reconciliation of net income to EBITDA in "Item 6 Selected Financial Data"), decreased to \$102.2 million from \$115.5 million, a

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decrease of 11.5%. The operating income for fiscal year 2015 included \$25.2 million of total expense from bad debt expense, the write-off of capitalized software and curriculum that will no longer be used or developed, certain computer peripherals and other fixed assets that will not be reclaimed, severance and related stock-based compensation, and additional provisions for inventory that we previously anticipated using. The operating income for fiscal year 2014 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.

We believe that the acceptance of online education in grades K-12 continues to grow, and anticipate that increased overall demand for virtual options in education will translate into increased demand for both our Non-managed Programs and our Institutional Sales business (sold under the brand names Fuel Education or FuelEd). At the same time, the Managed Programs business, which serves primarily virtual charter schools, is maturing. Regulatory requirements related to academic performance and accountability are expanding and the independent governing authorities of the virtual charter schools that contract with us are taking different approaches 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, during recent contract renewal negotiations for fiscal year 2016 and beyond, some of our managed public school customers decided to transition to a self-managed model. While these schools continued to purchase our curriculum and some of our management and technology services, they assumed more of the daily operational responsibilities for themselves. Conversely, as new states offer an online public school option, we believe that contracting with us for a fully integrated, virtual school turn-key operation that we manage remains attractive. For the 2015-16 school year, customers in states that recently authorized virtual public schools and then opted for a Managed Program include the North Carolina Virtual Academy and Maine Virtual Academy.

In fiscal year 2015, we revised the description of the line of business previously known as Managed Public Schools and now describe it as Public School Programs which includes both virtual and blended public schools where a district or independent charter board has contracted with us to provide a full-time program of educational products and services. The Public School Programs are classified as Managed Programs and Non-managed Programs. Managed Programs are 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 are where K12 provides curriculum and technology, and the school has an option to contract for instruction or other services. Non-managed Programs do not offer primary administrative oversight. Our Public School Programs line of business accounted for approximately 90% of our revenue in fiscal year 2015. For the 2015-16 school year, we expect to manage 75 contracts in 32 states and the District of Columbia.

Through our Institutional Sales business, we work closely as partners with a growing number of school districts and individual schools, enabling them to offer their students an array of online education solutions, including full-time virtual and blended programs, semester courses and supplemental solutions. In addition to curriculum, systems and programs, we also provide teacher training, teaching services and other support services. 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 as well as full-time virtual and blended programs.

Our International and Private Pay Schools include three online private schools that we operate in which parents can enroll students on a tuition basis for a full-time online education or individual courses to

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supplement their children's traditional instruction. These schools are: (1) K<sup>12</sup> 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 fiscal year 2014, 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.

**Financial Statement Overview**

In recent years, we've experienced growth from existing schools, as well as the new state schools added (identified above) and the continued ramp-up in student enrollments and associated variable operating costs from schools opening over the last five years.

Student enrollment in our Public School Programs experienced a shift in the mix of students with an increased level of high school students. The continued expansion of our Institutional Sales and our International and Private Pay Schools also shifts the mix of our revenue and associated costs of providing services, including additional sales personnel, third-party distributor costs and third-party royalty costs for our Institutional Sales. We may continue to experience changes in our enrollment, revenue and cost mix as we continue to expand into markets different than our traditional Public School Programs.

Our headcount growth from approximately 3,300 employees at the beginning of 2013 to approximately 4,800 at the end of our 2015 fiscal year, including teachers associated with our enrollment growth, the growth of the Institutional Sales, including the expansion of a sales force, and the decision to have more K12-employed teachers in our managed schools have also directly impacted our operating expenses during the last three years. We believe that all the above factors reduce the comparability of our operating results between periods.

**Key Aspects and Trends of Our Operations**

***Revenues Overview***

We generate a significant portion of our revenues from the sale of curriculum, management and technology services to managed virtual and blended public schools, where we provide turn-key management services. Approximately 86% of our revenues were derived from this source in fiscal year 2015. We anticipate that these revenues will continue to represent the majority of our total revenues over the next several years. However we also expect revenues in other aspects of our business to increase as we execute on our growth strategy. Our growth strategy includes increasing revenues in other distribution channels, adding enrollments in our private schools and expanding our Institutional Sales business, and pursuing international opportunities to offer our learning systems. Combined revenues from these other sectors were significantly smaller than that from the Managed Programs in fiscal year 2015. Our success in executing our strategies will impact future growth. We provide products and services primarily to three lines of business: Public School Programs (which includes Managed and Non-managed Programs), Institutional Sales and International and Private Pay Schools.

Factors affecting our revenues include:

- (i) the number of enrollments;
- (ii) the mix of enrollments across grades and states;
- (iii) management services provided to the schools and school districts;

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- (iv) state or district per student funding levels and attendance requirements;
- (v) prices for our products and services;
- (vi) growth in our other customer types; and
- (vii) revenues from new initiatives, mergers and acquisitions.

**Public School Programs**

We define an enrollment as any student enrolled in a virtual or blended public school which qualifies as a Public School Program. Generally, students will take four to six courses, except for some kindergarten students who may participate in half-day programs. We count each half-day kindergarten student as an enrollment. School sessions generally begin in August or September and end in May or June. To ensure that all schools are reflected in our measure of enrollments, we consider the number of students on the first Wednesday of October to be our opening enrollment level, and the number of students enrolled on the last day of May to be our ending enrollment level. For each period, average enrollments represent the average of the month-end enrollment levels for each school month in the period. We continually evaluate our enrollment levels by state, by school and by grade. We track new student enrollments and withdrawals throughout the year.

We believe that our revenue growth from enrollments depends upon the following:

- the number of states and school districts in which we operate;
- the mix of students served;
- the restrictive terms of local laws or regulations, including enrollment caps;
- the appeal of our curriculum and instructional model to students and families;
- the specific school or school district requirements including credit recovery or special needs;
- the effectiveness of our program in delivering favorable academic outcomes;
- the quality of the teachers working in the schools we serve;
- the effectiveness of our marketing and recruiting programs to attract new enrollments; and
- retention of students through successive grade levels.

In fiscal year 2015, total average student enrollments in Managed Programs decreased by 4,618 or 3.9%, to 114,579 as compared to total average student enrollments of 119,197 in fiscal year 2014. Note that in fiscal year 2015 we changed our presentation of Managed Public Schools enrollments to Public School Programs (which includes Managed and Non-managed Programs). For a complete analysis of the three year historical enrollments, please refer to the Enrollment Data tables found below under Results of Operations. We continually evaluate our trends in revenues by monitoring the number of student enrollments in total, by state, by school and by grade, assessing the impact of changes in school funding levels and the pricing of our curriculum and educational services. In fiscal years 2015 and 2014, the growth rate of our revenue

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exceeded the growth in our managed school average student enrollments primarily due to increases in the per-pupil rate of achieved state funding in certain states, school mix (distribution of enrollments by school) and other factors, including changes in state funding rates and higher utilization in federal and state restricted funding per managed student.

Enrollments in Public School Programs on average generate substantially more revenues than enrollments served through our Institutional Sales where we provide limited or no management services. Similarly, revenues earned per pupil across our private school programs vary. As we continue to build our Institutional Sales and increase enrollment in International and Private Pay Schools, enrollment mix is expected to shift and may impact growth in revenues relative to the growth in enrollments.



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During the fiscal years ended June 30, 2015 and 2014, we had a contract with Agora Cyber Charter School ("Agora") that represented approximately \$129.8 million and \$122.1 million of revenue, respectively. Approximately 9% of accounts receivable was attributable to a contract with Agora as of both June 30, 2015 and 2014.

In fiscal year 2015, Agora renegotiated its service agreement and entered into a three-year contract with us to purchase our curriculum and certain technology services, while the school board assumed daily operational responsibilities, including its charter renewal process and marketing and enrollment activities. The negative impact of this event on revenues attributable to the loss of the management component of the Agora contract, while significant, will be dependent upon the number of enrollments Agora can generate independently and the funding rates approved by the Pennsylvania legislature for cyber-charter schools in fiscal year 2016.

**Institutional Sales**

While Public School Programs constitute the majority of our revenue, there is increasing demand by public school districts, public schools and other educational institutions for more limited components of our online services and products than are used in Public School Programs. Sales to those entities are conducted through our Institutional Sales organization. While we expect long-term growth opportunities in our Institutional Sales business, the sector is currently experiencing significant competitive pricing pressures.

The Institutional Sales portfolio contains an array of curriculum and technology solutions packaged in a portfolio of flexible learning and delivery models mapped to specific student, school and district needs. This portfolio provides a continuum of delivery models, from full and part-time virtual to blended learning and other options that can be used in traditional classrooms to differentiate instruction. The Institutional Sales course catalog is comprehensive and enables districts to offer their students educational opportunities that otherwise might not be financially justifiable, such as Advanced Placement ("AP"), honors, world languages, remediation, credit recovery, alternative education, career and technology electives and college readiness. In connection with these solutions, we also offer highly qualified state-certified teachers, professional development and other support services as needed by our customers.

Given the variables discussed in further detail below, we believe that the best performance metric for the Institutional Sales is revenues. The customers served by the Institutional Sales organizations purchase curriculum in a variety of ways, making consistent comparisons on the basis of enrollments less relevant. For example, we serve not only full-time students, but also students taking semester-long courses, students who recover credits through concentrated four to eighteen-week programs, students who are using our curricula as a supplemental enhancement to their traditional textbook, and teachers who may present our lessons on an interactive whiteboard as either the core of their instruction or as an engaging supplement to their lecture. Given all these variables, it is therefore difficult to identify a single metric (such as a full time equivalent or "FTE"), or combination of metrics (such as course enrollments or programs sold), that can accurately capture the Institutional Sales business. Therefore, our efforts to do so led us to the conclusion that at this time, revenue is the best performance metric for the Institutional Sales business.

Sales opportunities in the Institutional Sales are driven by a number of factors in a diverse customer population, which determine the deliverable and price. These factors include:

*Type of Customer* A customer can be a U.S.-based public, private or public charter school, a district, regional education agency, or a commercial company that provides services to students.

*Curriculum Needs* We sell our curriculum solutions based on the scope of the customer need, and a solution is generally purchased as end-user access to a complete catalog, individual course or supplemental content title.

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*License Options* Depending on the scope of the solution, a license can be purchased for individual course enrollments, annual seat, school or district-wide site licenses or a perpetual license (a prepaid lifetime license). We charge incrementally if we are hosting the solution.

*Hosting* Customers may host curricula themselves or license our hosted solution. We are able to track all students for customers who use our hosted solution. However, more often in large-scale, district-wide implementations, a customer may choose to host the curriculum, and in that case we have no visibility of individual student usage for counting enrollments.

*Services Menu* Instructional services may be provided and priced per-enrollment or bundled in the overall price of the solution. Additional services, including professional development, title maintenance and support may also be provided and are priced based on the scope of services.

**International and Private Pay Schools**

Private schools are managed schools where tuition is paid directly by the family of the student. We receive no public funds for students in our private schools. We operate three private online schools at differing price points and service levels. Our revenue is derived from tuition receipts that are a function of course enrollments and program price. In some circumstances, a third-party school may elect to enroll one of its students in a K<sup>12</sup> private school course as a supplement to the student's regular on-campus instruction. In such cases, the third-party school may pay the K<sup>12</sup> private school tuition.

Our private schools business has evolved the past three years as we have acquired and developed new private school offerings with different structures and price points. This has made the use of full-time equivalent metrics no longer as meaningful. As a result, we report financial performance in the private pay schools on the basis of the student counts and semester-course enrollments which more accurately reflects the way revenues and expenses occur in the business.

Student counts tell us how many individual students have been served at any point in time. As a result of the variation in the number of courses taken by students, we measure the total size of our schools by "semester-course enrollments" ("SCEs"). A semester long course is counted as a single SCE and a year-long course is counted as two SCEs. Private school students take courses ranging from a single, semester long K-8 course to a twelve high school course annual load. For example, a student who takes six courses per semester for two semester accounts for twelve SCEs.

Some of our private school operations, notably Keystone and the K<sup>12</sup> International Academy, start classes on a monthly or rolling basis. As a result, there are students in our system of education at any point in time who have just started a course, just finished a course or have partially completed a course.

We believe our revenue growth depends primarily on the recruitment of students into our programs through effective marketing and word-of-mouth referral based on the quality of our service. In addition, through high service quality, we seek to retain existing students and increase the total number of courses each student takes with us. In some cases, students return each summer and take only one course. In other cases, students choose a K<sup>12</sup> private school as their principal form of education and may stay for many years. The flexibility of our programs, the quality of our curriculum and teaching, and the student community features lead to customer satisfaction and therefore, retention.

We have entered into agreements which enable us to distribute our products and services to our international school partners throughout the world who use our courses as a supplement to their on-campus academic programs. These courses provide students with additional electives, AP courses, and sometimes include dual-degree programs that the school cannot offer on its own. Student enrollments derived from partner school programs are included in the count of SCEs for these private schools.

We sometimes offer additional teacher assistance, counseling, clubs and other additive services to our basic course offerings. These additive services may carry additional fees that appear in our revenue. During

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the majority of fiscal year 2014, we also operated IS Berne, a traditional private school in Switzerland. Through the sale date on June 11, 2014, enrollments and revenue from IS Berne are included in our private school totals along with the numbers from our online school operations. We do not include students in our consumer sales business as we are not involved in the progress of these students in the same way as we do in our other programs.

***Instructional Costs and Services Expenses***

Instructional costs and services expenses include expenses directly attributable to the educational products and services we provide. The public schools we manage are the primary drivers of these costs, including teacher and administrator salaries and benefits and expenses of related support services. We also employ teachers and administrators for instruction and oversight in our Institutional Sales and International and Private Schools business. Instructional costs also include fulfillment costs of student textbooks and materials, depreciation and reclamation costs of computers provided for student use, the cost of any third-party online courses and the amortization of capitalized curriculum and related systems. Our instructional costs are variable and are based directly on our number of schools and enrollments.

Our high school offering requires increased instructional costs as a percentage of revenue compared to our kindergarten to 8th grade offering. This is due to the following: (i) generally lower student-to-teacher ratios; (ii) higher compensation costs for some teaching positions requiring subject-matter expertise; (iii) ancillary costs for required student support services, including college placement, SAT preparation and guidance counseling; (iv) use of third-party courses to augment our proprietary curriculum; and (v) use of a third-party learning management system to service high school students. Over time, we may partially offset these factors by obtaining productivity gains in our high school instructional model, replacing third-party high school courses with proprietary content, replacing our third-party learning management system with another third-party system, leveraging our school infrastructure and obtaining purchasing economies of scale.

We have deployed and are continuing to develop new delivery models, including blended schools, where students receive limited face-to-face instruction in a learning center to complement their online instruction, and other programs that utilize brick and mortar facilities. The maintenance, management and operations of these facilities necessitate additional costs, which are generally not required to operate typical virtual public schools. We are pursuing expansion into new states for both virtual public and other specialized charter schools. If we are successful, we will incur start-up costs and other expenses associated with the initial launch of a school, including the funding of building leases and leasehold improvements.

***Selling, Administrative and Other Operating Expenses***

Selling, administrative and other operating expenses include the salaries and benefits of employees engaged in business development, public affairs, sales and marketing, and administrative functions and transaction and due diligence expenses related to mergers and acquisitions.

***Product Development Expenses***

Product development expenses include research and development costs and overhead costs associated with the management of both our curriculum development and internal systems development teams. In addition, product development expenses include the amortization of internal systems. We measure and track our product development expenditures on a per course or project basis to measure and assess our development efficiency. In addition, we monitor employee utilization rates to evaluate our workforce efficiency. We plan to continue to invest in additional curriculum development and related software in the future, primarily to produce additional high school courses, world language courses and new releases of existing courses and to continue to upgrade our content management system and online schools. We capitalize selected costs incurred to develop our curriculum, beginning with application development,

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through production and testing into capitalized curriculum development costs. We capitalize certain costs incurred to develop internal systems into capitalized software development costs.

***Expense Management***

We are constantly searching for ways to deliver more value at a lower cost for our customers and we take pride in our ability to deliver highly-individualized, effective education solutions at significant savings to taxpayers. We have sought to increase efficiencies whenever possible without affecting educational quality. We believe our scale and infrastructure investment positions us for greater efficiency in future periods while allowing us to deliver more value for students.

**Critical Accounting Policies and Estimates**

The discussion of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. In the preparation of our consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, as well as the related disclosures of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. The results of our analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and the impact of such differences may be material to our consolidated financial statements. Our critical accounting policies have been discussed with the Audit Committee of our Board of Directors. We believe that the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our consolidated financial statements:

***Revenue Recognition***

In accordance with Accounting Standards Codification ("ASC") 605, *Revenue Recognition*, we recognize revenue when the following conditions are met: (1) persuasive evidence of an arrangement exists; (2) delivery of physical goods or rendering of services is complete; (3) the seller's price to the buyer is fixed or determinable; and (4) collection is reasonably assured.

We have determined that the separate elements of our multiple element contracts with managed schools do not have standalone value. Accordingly, we account for revenues received under multiple element arrangements with managed schools as a single unit of accounting and recognize the entire arrangement over the term of the contractual service period. While we have concluded that the elements of our contracts do not have standalone value, we invoice schools in accordance with the established contractual terms and rates. Generally, this means that for each enrolled student, we invoice their school on a per student basis for the following items: (1) access to our online school and online curriculum; (2) learning kits; and (3) student computers. We also invoice for management and technology services. We apply ASC 605 to each of these items as follows:

*Access to the Online School and Online Curriculum.* Our proprietary learning management system ("OLS") revenues are generally earned on a per course basis from schools and school districts. Students enrolled through a school are provided access to the OLS and online curriculum. Revenues are earned ratably over the school year, typically 10 months, or over the semester depending on the length of the course.

*Learning Kits.* The lessons in our online school are often accompanied with selected printed materials, workbooks, laboratory materials and other manipulative items which we provide to students. We generally ship all learning kits to a student when their enrollment is approved. Once materials have been shipped, our efforts are substantially complete. Therefore, we recognize revenues upon shipment. Shipments to schools that occur in the fourth fiscal quarter that are for the following school year are recorded in deferred revenues. We also earn reclamation fee income when we reclaim materials for schools at the end of the school year or when a student withdraws from the school.

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*Student Computers.* We provide many enrolled students with the use of a personal computer and complete technical support through our call center. Revenues are generally earned ratably over the school year and we also earn revenues for reclamation services when a student withdraws from a school and returns the computer which may occur in a subsequent school year.

*Management, Technology and Educational Services.* Under most of our statewide virtual public and blended school contracts, we provide the boards of managed schools with turn-key management and technology services. We recognize these revenues ratably over our fiscal year as administrative offices of the school remain open for the entire year. Our management and technology service fees are generally a contracted percentage of yearly school funding. To determine the pro rata amount of revenues to recognize in a fiscal quarter, we estimate 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.

To determine the pro rata amount of revenues to recognize in a fiscal quarter, we estimate 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. We review our estimates of 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 have a material impact on our results of operations. Since the end of the school year coincides with the end of our fiscal year, annual revenues are generally based on actual school funding and actual costs incurred (including costs for our services to the schools plus other costs the schools may incur) in the calculation of school operating losses. Our 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 our monthly funding estimates and for the reported fiscal years ended June 30, 2014, 2013 and 2012, our aggregate funding estimates differed from actual reimbursements impacting total reported revenue by approximately (0.1%), 0.2%, and (0.1%), respectively.

Under the contracts where we provide turnkey management services to schools, we have 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 our charges to the schools. To the extent a school does not receive funding for each student enrolled in the school, the school would incur an operating loss for 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 we collect from the school. A school net operating loss in one year does not necessarily mean we anticipate losing money on the entire contract with the school. However, a school operating loss may reduce our ability to collect its management fees in full and recognized revenues are reduced accordingly to reflect the expected cash collections from such schools. We amortize 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 our ability to collect our management fees in full though as noted it does not necessarily mean that we incur a loss during the period with respect to our services to that school. We recognize revenue, net of our estimated portion of school operating losses, to reflect the expected cash collections from such schools. Revenue is recognized based on our performance of services under the contract, which we believe is proportionate to our incurrence of costs. We incur 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.

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Each state or school district has variations in the school funding formulas and methodologies that we use to estimate funding for revenue recognition at our respective schools. As we build the funding estimates for each school, we are mindful of the state definition for count dates on which reported enrollment numbers will be used for per pupil funding. The parameters we consider in estimating funding for revenue recognition purposes include school district count definitions (which may vary by district and by state), withdrawal rates, average daily attendance, special needs enrollment, student demographics, progress trajectory and historical completion, student location, funding caps and other state specified categorical program funding. We consider the latest information available to us and other material relevant information at the time of the estimates we make each period on a school-by-school basis.

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 our fiscal year, annual revenues are generally based on actual school funding and actual costs incurred (including costs for our services to the schools plus other costs the schools may incur) in the calculation of school operating losses. For the years ended June 30, 2015, 2014 and 2013, our revenue included a reduction for these school operating losses of \$65.2 million, \$49.8 million and \$64.5 million, respectively.

A school operating loss may result from a combination of cost increases or funding reductions attributable to the following:

costs associated with opening new schools including the initial hiring of teachers, administrators and the establishment of school infrastructure;

school requirements to establish contingency reserves;

one-time costs, such as legal claims;

funding reductions due to the inability to qualify specific students for funding;

regulatory or academic performance thresholds that may restrict the ability of a school to fund all expenses;

inadequate school funding in particular states;

providing services without receiving state funding when enrollments occur after enrollment count dates; and

burdensome regulations creating excessive costs.

We generate a small percentage of our revenues from the sale of perpetual licenses of curriculum and ongoing support to schools. Under ASC 605, we account for the license and support of separate units of accounting and recognize revenues associated with the license up front and ongoing maintenance and support over the performance period. We also generate a small percentage of our revenues through the sale of our online courses and learning kits directly to consumers, as well as providing hosting services to certain customers. We record revenue for consumer services over the term of the course subscription.

For the year ended June 30, 2015, special education students comprise approximately 13% of our student population and approximately 21.8% of estimated funding for revenue recognition purposes at our schools. We compute revenue at the school level not based on the type of student served; therefore, we are unable to determine the revenue and profitability by student type. For each student enrolled, we receive basic per pupil funds determined by state funding and count definitions, and policies which vary from state-to-state. Additionally, based on the needs of the student population, we may receive supplemental special education state funding grants and federal funding under the Individuals with Disabilities Act. While we do not track profitability at the student level, these supplemental funding programs are intended

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to offset part of the costs of the education needs of children with learning disabilities through reimbursement of qualifying costs under the programs.

***Capitalized Curriculum Development Costs***

Our curriculum is primarily developed by our employees and, to a lesser extent, by independent contractors. Generally, our courses cover traditional subjects and utilize examples and references designed to remain relevant for long periods of time. The online nature of our curriculum allows us to incorporate user feedback rapidly and make ongoing corrections and improvements. For these reasons, we believe that our courses, once developed, have an extended useful life, similar to computer software. We also publish textbooks and other offline materials. Our curriculum is integral to our learning systems. Our customers generally do not acquire our curriculum or future rights to it.

Due to the similarity in development stages and long economic life of curriculum to computer software, we capitalize curriculum development costs incurred during the application development stage in accordance with ASC 350, *Intangibles Goodwill and Other*. ASC 350 provides guidance for the treatment of costs associated with computer software development and defines those costs to be capitalized and those to be expensed. Costs that qualify for capitalization are external direct costs, payroll and payroll-related costs. Costs related to general and administrative functions are not capitalizable and are expensed as incurred. We capitalize curriculum development costs during the design, development and deployment phases of the project. Many of our new courses leverage off of proven delivery platforms and are primarily content, which has no technological hurdles. As a result, a significant portion of our courseware development costs qualify for capitalization due to the concentration of our development efforts on the content of the courseware. Capitalization ends when a course is available for general release to our customers, at which time amortization of the capitalized costs begins. Capitalized costs are recorded in capitalized curriculum development costs. The period of time over which these development costs will be amortized is generally five years. This is consistent with the capitalization period used by others in our industry and corresponds with our product development lifecycle. We wrote down approximately \$2.6 million and \$2.2 million of capitalized curriculum development costs due to its decision to discontinue certain curriculum during the fiscal years ended June 30, 2015 and 2014, respectively. There were no material write-downs of capitalized curriculum development costs for the fiscal year ended June 30, 2013.

***Software Developed or Obtained for Internal Use***

We develop our own proprietary computer software programs to provide specific functionality to support both our unique education offerings and the student and school management services. These programs enable us to develop courses, process student enrollments, meet state documentation requirements, track student academic progress, deliver online courses to students, coordinate and track the delivery of course-specific materials to students and provide teacher support and training. These applications are integral to our learning systems and we continue to enhance existing applications and create new applications. Our customers do not acquire our software or future rights to it.

We capitalize software development costs incurred during development in accordance with ASC 350. These capitalized development costs are included in capitalized software development costs and are generally amortized over three years. During the fiscal years ended June 30, 2015 and 2014, we wrote down approximately zero and \$3.8 million, respectively, of capitalized software projects after determining the assets either have no future use or are being sunset. There were no material write-downs of capitalized software projects for the fiscal year ended June 30, 2013.

***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*, we review our

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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. We determine the extent to which an asset may be impaired based upon our 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. 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. We wrote down approximately \$2.6 million and \$2.2 million of capitalized curriculum development costs due to its decision to discontinue certain curriculum during the fiscal years ended June 30, 2015 and 2014, respectively. During the fiscal years ended June 30, 2015 and 2014, we wrote down approximately \$4.8 million and \$3.8 million, respectively, of capitalized software projects after determining the assets either have no future use or are being sunset. During the fiscal year ended June 30, 2015, we wrote down approximately \$6.5 million primarily related to computer peripherals shipped to students and for which no reclamation will be processed. There was no such write-down during fiscal year ended June 30, 2014. There were no material impairment charges for the fiscal year ended June 30, 2013.

***Income Taxes***

We account for income taxes in accordance with ASC 740, *Income Taxes*. ASC 740 prescribes the use of the asset and liability method to compute the differences between the tax bases of assets and liabilities and the related financial amounts, using currently enacted tax laws. If necessary, a valuation allowance is established, based on the weight of available evidence, to reduce deferred tax assets to the amount that is more likely than not to be realized. Realization of the deferred tax assets, net of deferred tax liabilities, is principally dependent upon achievement of sufficient future taxable income. We exercise significant judgment in determining our provisions for income taxes, our deferred tax assets and liabilities and our future taxable income for purposes of assessing our ability to utilize any future tax benefit from our deferred tax assets.

Although we believe that our tax estimates are reasonable, the ultimate tax determination involves significant judgments that could become subject to examination by tax authorities in the ordinary course of business. We periodically assess the likelihood of adverse outcomes resulting from these examinations to determine the impact on our deferred taxes and income tax liabilities and the adequacy of our provision for income taxes. Changes in income tax legislation, statutory income tax rates or future taxable income levels, among other things, could materially impact our valuation of income tax assets and liabilities and could cause our income tax provision to vary significantly among financial reporting periods.

We have a valuation allowance on net deferred tax assets of \$2.8 million and \$2.0 million as of June 30, 2015 and 2014, respectively, for the amount that more likely than not will not be realized.

***Stock-based Compensation***

We recognize stock-based compensation expense under the provisions of ASC 718, *Compensation - Stock Compensation*. We use the Black-Scholes option pricing model to calculate the fair value of stock options at their respective grant date. The use of option valuation models requires the input of highly subjective assumptions, including the expected stock price volatility and the expected term of the option. The fair value of restricted stock awards is the fair market value on the date of grant. We recognize these compensation costs on a straight-line basis over the requisite service period, which is generally the vesting period of the award. During 2013 to 2015, we granted more restricted stock awards than stock options, resulting in increased stock-based compensation that will be recognized over the required service periods. In addition, the vesting period is generally three years for restricted stock compared to four years for stock options. The increase in restricted stock awards and the shorter vesting period has increased our stock-based compensation costs, and this increased cost is expected to continue in future periods.



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***Goodwill and Other Intangible Assets***

We record 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 the trade names, customer contracts and curriculum and such intangible assets are amortized on a straight-line basis over their estimated useful lives. We periodically evaluate the remaining useful lives of intangible assets and adjust our amortization period if it is determined that such intangible assets have a shorter useful life. We evaluate the recoverability of our recorded goodwill and other intangible assets annually, or whenever a triggering event of impairment may occur. During fiscal year 2015, we used a qualitative approach to evaluate goodwill for impairment. During the fiscal year ended June 30, 2014, we determined that based on rebranding of the Institutional Sales business, we fully amortized certain trade names that are no longer going to be used and recorded a \$5.2 million impairment charge for the fiscal year ended June 30, 2014. During the fiscal year ended June 30, 2014, we also sold certain business assets and wrote off approximately \$3.4 million of goodwill and \$0.4 million of net intangible assets related to the assets of the business that were sold. There were no such impairment charges for the years ended June 30, 2015 and 2013.

***Consolidation of Noncontrolling Interest***

Our consolidated financial statements reflect the results of operations of our Middle East, Middlebury Interactive Languages and LearnBop joint ventures. Earnings or losses attributable to our partners are classified as "net loss attributable to noncontrolling interest" in the accompanying consolidated statements of operations. Net income or net loss attributable to noncontrolling interest adjusts our consolidated net results of operations to reflect only our share of the after-tax earnings or losses of an affiliated company. In June 2014, we completed a sale of select businesses to Safanad Education Ventures Limited, including our interest in our Middle East joint venture which we had operated with a Safanad Limited affiliate.

***Redeemable Noncontrolling Interest***

In the formation of our joint venture with Middlebury College, at any time after April 12, 2015, the fifth anniversary of the agreement, Middlebury may give written notice of its irrevocable election to sell all of its Membership Interest to us (put right). The purchase price for Middlebury's Membership Interest shall be its fair market value and we may, in our sole discretion, pay the purchase price in cash or shares of the our common stock. In addition, 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 or be released from other contractual rights.

Given the provision of the put right, the redeemable noncontrolling interest is redeemable outside of our control and it is recorded outside of permanent equity at its redemption value, which approximates fair value, in accordance with ASC 480, *Distinguishing Liabilities from Equity*. We adjust the redeemable noncontrolling interest to redemption value on each balance sheet date with changes in redemption value recognized as an adjustment to retained earnings, or in the absence of retained earnings, by adjustment to additional paid-in-capital. The redeemable value as of the end of each fiscal year is based on a third-party valuation, while the redeemable value during interim periods is based on management updates from the date of the most recent independent valuation. As of June 30, 2015 and 2014, the estimated redeemable noncontrolling interest was \$6.8 million and \$16.8 million, respectively.

On May 4, 2015, Middlebury College, under the joint venture agreement, exercised its right to require us to purchase all of its ownership interest in our joint venture. We have the right to pay the redemption cost in cash, stock or a combination thereof, at our option, which form of consideration has not yet been determined.

On July 31, 2014, we acquired a 51% interest in LearnBop Inc. The purpose of the acquisition was to complement our K-12 math curriculum as LearnBop has developed an adaptive math curriculum learning

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software. As part of this transaction, the non-controlling shareholders have a non-transferable put option to sell the remaining minority interest to us, which is exercisable between July 31, 2018 and December 31, 2018. 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 us and LearnBop. Additionally, we have a non-transferable call option to purchase the remaining minority interest at a price of \$3.0 million, which becomes exercisable January 1, 2019 or thereafter. The redeemable value as of the end of each fiscal year is based on an internal valuation, while the redeemable value during interim periods is based on management updates from the date of the most recent internal valuation. As of June 30, 2015, the estimated redeemable noncontrolling interest was \$2.8 million.

**Segment Reporting**

We operate in one operating and reportable business segment: 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 12<sup>th</sup> grade, or K-12. We have the following three lines of business: Public School Programs, Institutional Sales and International and Private Pay Schools. Our Chief Executive Officer is the Chief Operating Decision Maker (the "CODM"). Our CODM manages our business primarily by function and reviews financial information on a consolidated basis, accompanied by disaggregated information on revenues by line of business as well as certain operational data, for purposes of allocating resources and evaluating financial performance. The CODM only evaluates profitability based on consolidated results.

**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).

<b>Public School Programs (Managed and Non-managed)</b>	<b>Institutional Sales</b>	<b>International and Private Pay Schools</b>
Virtual public schools	K <sup>12</sup> curriculum	Managed private schools K <sup>2</sup> International Academy
Blended public schools Hybrid schools	FuelEd Online Courses	George Washington University Online HS
Flex schools	FuelEd Anywhere Learning System	The Keystone School
Passport schools	Middlebury Interactive Languages	
	Pre-kindergarten	Independent course sales (Consumer)

**Enrollment Data**

The following table sets forth total average enrollment data for students in Public School Programs. Public School Programs include both virtual and blended public 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

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instruction or other educational services. Non-managed Programs, however, do not offer primary administrative oversight services.

	Year ended		Growth	
	2015	2014	Change	Change %
<b>Public School Programs</b>				
Managed Programs(1)(3)	114,579	119,197	(4,618)	3.9%
Non-managed Programs(1)	20,053	14,482	5,571	38.5%
<b>Total Public School Programs(2)</b>	<b>134,632</b>	<b>133,679</b>	<b>953</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) Managed Program enrollments are lower than those reported in our historical average student enrollments for Managed Public Schools (see table below) due to reclassifying certain schools that meet the current definition of a Non-managed Program.

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

	Year ended			Growth		Growth	
	2015	2014	2013	Change	Change %	Change	Change %
<b>Managed Public Schools</b>							
Average Student Enrollments(1)	120,257	123,259	117,563	(3,002)	2.4%	5,696	4.8%
<b>International and Private Pay Schools</b>							
Total Student Enrollments	33,680	32,625	31,619	1,055	3.2%	1,006	3.2%
Total Semester Course Enrollments	86,034	89,630	84,642	(3,596)	4.0%	4,988	5.9%

- (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 turnkey 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. We are expanding our disclosure on revenue for fiscal year 2015. The following table provides detail on student

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enrollments revenue in Public School Programs. The following represents our revenue for these lines of business for the fiscal year ended June 30, 2015 and 2014.

(\$ in thousands)	Year ended June 30,		Growth 2015 / 2014	
	2015	2014	Change	Change %
<b>Public School Programs</b>				
Managed Programs	\$ 813,677	\$ 793,854	\$ 19,823	2.5%
Non-managed Programs	39,321	28,836	10,485	36.4
<b>Public School Programs</b>	852,998	822,690	30,308	3.7
<b>Institutional Sales</b>	48,770	48,545	225	0.5
<b>International and Private Pay Schools</b>	46,526	48,318	(1,792)	(3.7)
<b>Total</b>	\$ 948,294	\$ 919,553	\$ 28,741	3.1%

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

(\$ in thousands)	Year ended June 30,			Change 2015 / 2014		Change 2014 / 2013	
	2015	2014	2013	Change	Change %	Change	Change %
<b>Managed Public Schools</b>	\$ 828,286	\$ 804,470	\$ 730,800	\$ 23,816	3.0%	\$ 73,670	10.1%
<b>Institutional Sales</b>	73,482	66,765	73,269	6,717	10.1	(6,504)	(8.9)
<b>International and Private Pay Schools</b>	46,526	48,318	44,151	(1,792)	(3.7)	4,167	9.4
<b>Total</b>	\$ 948,294	\$ 919,553	\$ 848,220	\$ 28,741	3.1%	\$ 71,333	8.4%

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

	Year Ended June 30,					
	2015		2014		2013	
	(Dollars in thousands)					
Revenues	\$ 948,294	100.0%	\$ 919,553	100.0%	\$ 848,220	100.0%
Cost and expenses						
Instructional costs and services	607,756	64.1%	569,219	61.9%	498,398	58.7%
Selling, administrative and other operating expenses	307,730	32.5%	313,258	34.1%	283,032	33.4%
Product development expenses	14,381	1.5%	14,220	1.5%	21,084	2.5%
Total costs and expenses	929,867	98.1%	896,697	97.5%	802,514	94.6%
Income from operations	18,427	1.9%	22,856	2.5%	45,706	5.4%
Realized gain on sale of assets		0.0%	6,404	0.7%		0.0%
Interest (expense), net and other	(3,291)	0.3%	(69)	0.0%	851	0.1%
Income before income tax expense and noncontrolling interest	15,136	1.6%	29,191	3.2%	46,557	5.5%
Income tax expense	(5,810)	0.6%	(11,075)	1.2%	(20,023)	2.4%
Net income	9,326	1.0%	18,116	2.0%	26,534	3.1%
Add net loss attributable to noncontrolling interest	1,662	0.2%	1,484	0.1%	1,577	0.2%
Net income attributable to common stockholders, including Series A stockholders	\$ 10,988	1.2%	\$ 19,600	2.1%	\$ 28,111	3.3%

### **Comparison of Years Ended June 30, 2015 and 2014**

*Revenues.* Our revenues for the year ended June 30, 2015 were \$948.3 million, representing an increase of \$28.7 million, or 3.1%, from \$919.6 million for the year ended June 30, 2014. Public School Program revenue increased \$30.3 million, or 3.7%, year over year. The growth in Public School Program revenue was primarily attributable to increases in achieved funding in certain states, among other factors, while overall enrollments slightly increased by 0.7%. Managed Program enrollments declined 3.9%, while corresponding revenue increased 2.5% for the year ended June 30, 2015 compared to 2014 due primarily to increases in the per-pupil rate of achieved state funding in certain states, school mix (distribution of enrollments by school), and other factors. We attribute the decline in our Managed Programs enrollments to a number of events unrelated to market demand, such as the imposition in Tennessee of an enrollment cap midway through the enrollment season, and a delay in the grant of a charter impacting our attendant service contract and start of enrollments for a school in Colorado. In addition, we provide the schools and school boards we serve with academic programs sufficiently rigorous to yield strong academic results. These challenging performance expectations for students in a virtual public school can result in parents opting to withdraw their students from a managed public school and enroll in other school options. We have also seen some of our virtual public schools transition from Managed Programs to self-administered schools by seeking competitive alternatives to portions of the products and services now entirely provided by us. While any one of these factors alone is not necessarily indicative of a material trend in the growth rate in enrollments, continuing to experience a combination of these factors could negatively impact enrollment growth, revenues and operating income. There also is increasing competition from several sources including online or blended offerings by traditional public schools that are recognizing the value of online study and curriculum delivery.

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Institutional Sales revenue increased \$0.2 million, or 0.5% from the prior year. Excluding the effect from the sale of certain businesses that were included in the prior period revenue, Institutional Sales increased \$4.3 million, or 9.6%. International and Private Pay Schools revenue decreased \$1.8 million, or 3.7%, from the prior year due to the sale of certain businesses. Excluding the effect from the sale of certain businesses that were included in the prior period revenue, International and Private Pay Schools revenue increased \$11.1 million, or 31.3%.

*Instructional Costs and Services Expenses.* Instructional costs and services expenses for the year ended June 30, 2015 were \$607.8 million, representing an increase of \$38.6 million, or 6.8%, from \$569.2 million for the year ended June 30, 2014. During the year ended June 30, 2015, there was \$9.6 million of expense related to accelerated depreciation and amortization for certain curriculum, learning systems and other fixed assets that will no longer be used or developed, computer peripherals that will not be reclaimed, and for excess inventory relative to anticipated demand. During the year ended June 30, 2014, there was \$18.6 million of expense related to accelerated depreciation and amortization for certain curriculum, learning systems and other fixed assets that will 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 the charges noted above, instructional costs and services would have increased \$47.7 million, or 8.7%. The increase in expense was primarily associated with the increased hiring of teachers and instructional support staff, increases in salary and other personnel benefits 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 64.1% of revenue during the year ended June 30, 2015, an increase from 61.9% for the year ended June 30, 2014. Excluding the impact of the charges noted above, instructional costs and services were 63.1% and 59.9% of revenue for the years ended June 30, 2015 and 2014.

*Selling, Administrative, and Other Operating Expenses.* Selling, administrative, and other operating expenses for the year ended June 30, 2015 were \$307.7 million, representing a decrease of \$5.6 million, or 1.8%, from \$313.3 million for the year ended June 30, 2014. During the year ended June 30, 2015, there was \$7.5 million of expense related to uncollectible receivables, as well as \$4.8 million for the write-off of capitalized software that will no longer be developed. Also included in expense during the year ended June 30, 2015 was \$3.4 million related to severance and accelerated stock compensation costs for executives and other employees. Included in expense during the year ended June 30, 2014 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 the charges noted above, selling, administrative, and other operating expenses decreased \$8.7 million, or 2.9% for the year ended June 30, 2015 as compared to the year ended June 30, 2014. Selling, administrative, and other operating expenses were 32.5% of revenue during the year ended June 30, 2015, a decrease from 34.1% for the year ended June 30, 2014. Excluding the impact of the charges noted above, selling, administrative, and other operating expenses were 30.8% and 32.7% of revenue for the years ended June 30, 2015 and 2014. The reduction as a percentage of revenue primarily reflects our overall cost savings initiatives.

*Product Development Expenses.* Product development expenses for the year ended June 30, 2015 were \$14.4 million, representing an increase of \$0.2 million, or 1.4% from \$14.2 million for the year ended June 30, 2014. As a percentage of revenues, product development expenses remained flat at 1.5% for the year ended June 30, 2015, as compared to the same period in the prior year.

*Interest Expense, net and Other.* Net interest expense for the year ended June 30, 2015 was \$3.3 million as compared to net interest expense of \$0.1 million in the same period in the prior year. Net interest expense was primarily associated with the write-off of approximately \$3.2 million in previously recorded interest income related to our investment in Web International Education Group, Ltd., as well as interest expense on our student computer capital leases.

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*Income Tax Expense.* We had an income tax expense of \$5.8 million for the year ended June 30, 2015, or 38.4% of income before taxes, as compared to income tax expense of \$11.1 million, or 37.9% of our income before taxes for the year ended June 30, 2014.

*Net Income.* Net income was \$9.3 million for the year ended June 30, 2015, compared to net income of \$18.1 million for the year ended June 30, 2014, a decrease of \$8.8 million. During the fiscal year ended June 30, 2014, we sold certain businesses which were approximately break-even.

*Noncontrolling Interest.* Net loss attributable to noncontrolling interest for the year ended June 30, 2015 was \$1.7 million as compared to net loss attributable to noncontrolling interest of \$1.5 million for the same period in the prior year. Noncontrolling interest reflects the after-tax losses attributable to minority interest owners in our investments.

**Comparison of Years Ended June 30, 2014 and 2013**

*Revenues.* Our revenues for the year ended June 30, 2014 were \$919.6 million, representing an increase of \$71.4 million or 8.4%, as compared to \$848.2 million for the year ended June 30, 2013. Our revenue growth was primarily attributable to an increase of \$73.7 million, or 10.1%, in Managed Public Schools revenue, largely due to overall enrollment growth of 4.8% and increases in the per-pupil rate of achieved state funding in some states, other changes in state funding rates and higher utilization in federal and state restricted funding per managed student, and a \$4.2 million increase in International and Private Pay revenue, partially as a result of strong growth in iCademy course enrollments. We attribute the overall decline in enrollment growth rate between the 2012-2013 school year and the 2013-2014 school year principally due to operational issues in processing increased applications to our enrollment centers and not necessarily an indication of a trend. We received a 25% increase in enrollment applications between July and September for the 2013-2014 school year compared to the prior year but were unable to convert all of them by the October count date, significantly impacting the reported enrollment growth of 4.8%. Institutional business revenue decreased \$6.5 million, or 8.9%, from the prior year due to decreased volume and rates.

*Instructional Costs and Services Expenses.* Instructional costs and services expenses for the year ended June 30, 2014 were \$569.2 million, representing an increase of \$70.8 million or 14.2%, as compared to \$498.4 million for the prior fiscal year. Of the total increase, \$18.6 million relates to accelerated depreciation and amortization during fiscal year 2014 for certain curriculum, learning systems and other fixed assets that will no longer be used or developed, computers that we estimate will not be returned and additional provisions for the decision to discontinue certain products and for excess inventory relative to anticipated demand. The remaining \$52.2 million increase between periods related to increased salary and other personnel benefits to teachers, program and material costs due to enrollment growth. Instructional costs and services expenses were 61.9% of revenue during the year ended June 30, 2014; however excluding the impact of the accelerated depreciation and amortization, instructional costs and services were 59.9%, compared to 58.7% for the prior fiscal year.

*Selling, Administrative and Other Operating Expenses.* Selling, administrative and other operating expenses for the year ended June 30, 2014 were \$313.3 million, representing an increase of \$30.3 million or 10.7%, as compared to \$283.0 million for the prior fiscal year. Of the total increase, \$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 will no longer be used. The remainder of the increase related to increased headcount, professional fees and marketing costs, offset in part by reduced sales commissions. As a percentage of revenues, selling, administrative and other operating expenses were 34.1% for the year ended June 30, 2014; however excluding severance and accelerated amortization described above, selling, administrative and other expenses were 32.7% as a percentage of revenue, less than the 33.4% for prior fiscal year, reflecting our continued costs savings initiatives.

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*Product Development Expenses.* Product development expenses include costs related to new products and associated systems. Product development expenses for the year ended June 30, 2014 were \$14.2 million, representing a decrease of \$6.9 million or 32.7%, as compared to \$21.1 million for the prior fiscal year. As a percentage of revenues, product development expenses decreased to 1.5% for the year ended June 30, 2014, as compared to 2.5% for the prior fiscal year due to a decrease in third-party professional fees supporting product development activities and our costs savings initiatives.

*Realized Gain on Sale of Assets.* Realized gain on sale of assets for the year ended June 30, 2014 was \$6.4 million, as compared to zero for the prior fiscal year. In June 2014, we completed a sale of select non-strategic businesses to Safanad Education Ventures Limited, including IS Berne, Capital Education, our post-secondary business, and our interest in our joint venture in the Middle East we operated with a Safanad Limited affiliate.

*Interest Expense, net and Other.* Net interest expense for the year ended June 30, 2014 was \$(0.1) million, as compared to net interest income of \$0.9 million for the prior fiscal year. The change to net interest expense compared to net interest income in the prior fiscal year related primarily to a decrease of approximately \$1.0 million in interest income related to our exercise of the put option on our investment in Web International Education Group, Ltd in fiscal year 2013, partially offset by interest expense related our capital leases and equipment financing arrangements.

*Income Tax Expense.* Income tax expense for the year ended June 30, 2014 was \$11.1 million, or 37.9% of income before taxes, as compared to an income tax expense of \$20.0 million, or 43.0% of income before taxes, for the prior fiscal year. Our overall effective tax rate decreased from the prior year due to prior year favorable return to provision true-ups, providing for additional reserves related to the prior year tax positions and additional tax benefits related to research activities of the Company.

*Net Income.* Net income was \$18.1 million for the year ended June 30, 2014 compared to net income of \$26.5 million for the year ended June 30, 2013, a decrease of \$8.4 million, or 31.7%. Net income as a percentage of revenues decreased to 2.0% for the year ended June 30, 2014 as compared to 3.1% for the prior year, as a result of the factors discussed above.

*Noncontrolling Interest.* Net loss attributable to noncontrolling interest for the years ended June 30, 2014 and 2013 was \$1.5 million and \$1.6 million, respectively. Noncontrolling interest reflects the after-tax losses attributable to shareholders in our joint ventures in the Middle East through the sale date and Middlebury Interactive Languages. Our noncontrolling interest fluctuates in proportion to the operating results of these respective joint ventures.

**Discussion of Seasonality of Financial Condition**

Certain accounts in our balance sheet are subject to seasonal fluctuations. As our enrollments and revenues grow, we expect these seasonal trends to be amplified. The bulk of our materials are shipped to students prior to the beginning of the school year, usually in July or August. In order to prepare for the upcoming school year, we generally build up inventories during the fourth quarter of our fiscal year. Therefore, inventories tend to be at the highest levels at the end of our fiscal year. In the first quarter of our fiscal year, inventories tend to decline significantly as materials are shipped to students. In our fourth quarter, inventory purchases and the extent to which we utilize early payment discounts will impact the level of accounts payable.

Accounts receivable balances tend to be at the highest levels in the first quarter of our fiscal year as we begin billing for all enrolled students and our billing arrangements include upfront fees for many of the elements of our offering. These upfront fees result in seasonal fluctuations to our deferred revenue balances. We routinely monitor state legislative activity and regulatory proceedings that might impact the funding received by the schools we serve and to the extent possible, factor potential outcomes into our business planning decisions.



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Generally, deferred revenue balances related to the schools tend to be highest in the first quarter, when the majority of students enroll. Since the deferred revenue is amortized over the course of the school year, which typically ends in May or June, the balance is normally at its lowest at the end of our fiscal year. Generally, deferred revenues from virtual and blended public schools have not been a source of liquidity as most schools receive their funding over the course of the school year.

The deferred revenue related to our direct-to-consumer business results from advance payments for twelve month subscriptions to our online school. These advance payments are amortized over the life of the subscription and tend to be highest at the end of the fourth quarter and first quarter, when the majority of subscriptions are sold.

**Liquidity and Capital Resources**

As of June 30, 2015, we had net working capital, or current assets minus current liabilities, of \$348.3 million. Our working capital includes cash and cash equivalents of \$195.9 million, including \$5.6 million associated with our two joint ventures, and accounts receivable of \$188.2 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 June 30, 2015.

On January 31, 2014, we executed a \$100.0 million unsecured line of credit to be used for general corporate operating purposes with Bank of America, N.A. ("BOA"). The line has a five-year term, bears interest at the higher of the Bank's prime rate plus 0.25%, or the Federal Funds Rates plus 0.75%, or the LIBOR rate plus 1.25%; and incorporates customary financial and other covenants, including but not limited to a maximum debt leverage and a minimum fixed charge coverage ratio. As of June 30, 2015, we were in compliance with these covenants and we had no borrowings outstanding on the line 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. We had \$35.0 million of availability for new leasing during fiscal year 2015. Interest rates on the new borrowings were 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. This availability originally expired in July 2015, but was extended to July 2016. Interest rates on the new borrowings beginning in August 2015 under the extended agreement are based upon an initial rate of 1.88% 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 April 29, 2015 and the Lease Commencement Date, as defined in the lease line of credit.

As of June 30, 2015, the aggregate outstanding balance under the lease lines of credit was \$29.7 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 \$75.0 million of our outstanding common stock over a two year period. Any purchases under the buyback are dependent upon business and market conditions and other factors. The stock purchases are made from time to time and may be made through a variety of methods including open market purchases and trading plans that may be adopted in accordance with the Rule 10b5-1 of the Exchange Act. For the year ended June 30, 2015, we paid approximately \$26.5 million in cash to redeem 1,307,402 shares of common stock at an average price of \$20.23 per share. As of June 30, 2015 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.

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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.

On May 4, 2015, Middlebury College, under the joint venture agreement, exercised its right to require us to purchase all of its ownership interest in our joint venture. We have the right to pay the redemption cost in cash, stock or a combination thereof, at our option, which form of consideration has not yet been determined.

***Operating Activities***

Net cash provided by operating activities for the years ended June 30, 2015, 2014 and 2013 was \$120.1 million, \$122.9 million and \$94.4 million, respectively.

Net cash provided by operating activities for the year ended June 30, 2015 was \$120.1 million compared to \$122.9 million for the year ended June 30, 2014. The decrease of \$2.8 million in cash provided by operations between periods was primarily attributable to net income including non-cash adjustments which increased approximately \$6.1 million, offset by an overall use of cash flows from changes in working capital of \$8.9 million. These changes in working capital were primarily attributable to the timing of cash payments related to accounts payable and decreased accrued liabilities, offset in part by improved collections of accounts receivable. Cash from operations is impacted by the timing of cash collections from products and services provided and payment of operating costs to fund the continued growth and expansion of our business.

Net cash provided by operating activities for the year ended June 30, 2014 was \$122.9 million compared to \$94.4 million for the year ended June 30, 2013. The \$28.5 million improvement in cash flow from operations between periods was attributable primarily to increased accounts receivable collections and less investment in inventory during the year ended June 30, 2014 than during the prior year. Cash from operations is impacted by the timing of cash collections from products and services provided and payment of operating costs to fund the continued growth and expansion of our business.

Net cash provided by operating activities for the year ended June 30, 2013 was \$94.4 million compared to \$33.0 million for the year ended June 30, 2012. The \$61.4 million improvement in cash flow from operations between periods was attributable to higher net income and depreciation, increased cash collections from accounts receivable and less investment in working capital during the year ended June 30, 2013 than during the prior year. These cash collections relate to accounts receivable that increased during fiscal year 2012 from state funding delays to certain of our managed public schools. Cash from operations is impacted by the timing of cash collections from products and services provided and payment of operating costs to fund the continued growth and expansion of our business.

***Investing Activities***

Net cash used in investing activities for the years ended June 30, 2015, 2014 and 2013 was \$68.3 million, \$45.8 million and \$50.3 million, respectively.

Net cash used in investing activities for the year ended June 30, 2015 increased \$22.5 million from 2014. This increase was due primarily to the \$6.5 million investment in LearnBop and a \$12.4 million increase in capital expenditures for property and equipment, capitalized software and curriculum, \$5.7 million received on the sale of assets in 2014, offset by the investment in a mortgage note to a managed school partner for \$2.1 million that was made in the prior year.

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Net cash used in investing activities for the year ended June 30, 2014 decreased \$4.5 million from 2013. This decrease was a result of cash received of \$5.7 million related to a sale of assets and a net decrease of approximately \$1.0 million in net capital expenditures for other property and equipment, capitalized software and curriculum development, offset in part by a note made to a managed school partner of \$2.1 million.

Net cash used in investing activities for the year ended June 30, 2013 was primarily due to investment of \$31.8 million in property and equipment, including internally developed and purchased software, and investment in capitalized curriculum of \$18.6 million.

***Financing Activities***

Net cash used in financing activities for the years ended June 30, 2015, 2014 and 2013 was \$50.4 million, \$63.4 million and \$7.3 million, respectively.

For the year ended June 30, 2015, 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 year ended June 30, 2015, we purchased treasury stock which totaled approximately \$26.5 million. We made \$48.5 million in treasury stock purchases during the year ended June 30, 2014. At June 30, 2015, the total shares of common stock purchased were 3,502,598, and there were no shares remaining under the plan for repurchase. The year ended June 30, 2015 included approximately \$9.7 million less in proceeds from the exercise of stock options than in the prior fiscal year. The timing of cash from the exercise of options impacts our net cash provided by financing activities.

For the year ended June 30, 2014, our primary uses of cash in financing activities were the purchase of treasury stock and the payment of capital lease obligations incurred for the acquisition of student computers. For the year ended June 30, 2014, we purchased treasury stock which totaled approximately \$48.5 million. We made no treasury stock purchases during the year ended June 30, 2013. Our cash payments for capital leases increased approximately \$2.4 million due to increased purchases of student computers financed under capital leases. In addition, the year ended June 30, 2014 included a reduction of \$8.1 million in the excess tax benefit from stock based compensation. The year ended June 30, 2014 included approximately \$3.0 million more in proceeds from the exercise of stock options than the year ended June 30, 2013, which partially offset the increased uses noted above. The timing of cash from the exercise of options impacts our net cash used in financing activities.

For the year ended June 30, 2013, net cash used in financing activities consisted primarily of payments on capital leases totaling \$21.8 million and the repurchase of restricted stock for income tax withholding of \$2.5 million, partially offset by proceeds from the exercise of stock options of \$7.3 million and excess tax benefit from stock-based compensation expense of \$9.8 million. Our cash payments for capital leases increased \$3.7 million between periods resulting from increased purchases of student computers financed under capital leases. The timing of cash from the exercise of options impacts our net cash used in financing activities.

Table of Contents**Contractual Obligations**

Our contractual obligations consist primarily of leases for office space, capital leases for equipment and other operating leases. The following summarizes our long-term contractual obligations as of June 30, 2015, which decreased from \$93.2 million as of June 30, 2014:

	<b>Contractual Obligations Payments due by period</b>				
	<b>Total</b>	<b>&lt; 1 year</b>	<b>1 - 3 years</b>	<b>3 - 5 years</b>	<b>&gt; 5 years</b>
<b>(In thousands)</b>					
<b>Contractual obligations at June 30, 2015</b>					
Capital leases(1)	\$ 30,469	\$ 17,196	\$ 13,273	\$	\$
Operating leases	50,744	8,274	16,016	14,551	11,903
<b>Total</b>	<b>\$ 81,213</b>	<b>\$ 25,470</b>	<b>\$ 29,289</b>	<b>\$ 14,551</b>	<b>\$ 11,903</b>

(1) Includes interest expense.

For the schools to which we provide turn-key management services, we typically take responsibility for any school operating losses that the school may incur. These individual school operating losses, if they occur, are recorded at the time as a reduction in revenues. Potential school operating losses are not included as a commitment or obligation in the above table as they cannot be determined at this time and many may not even occur.

**Off-Balance Sheet Arrangements**

We have provided guarantees of approximately \$9.2 million related to lease commitments on the buildings for certain of our Flex schools. We contractually guarantee that certain schools under our management will not have annual operating deficits and our management fees from these schools may be reduced accordingly to cover any school operating deficits. 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.

**Impact of Inflation**

We believe that inflation has not had a material impact on our results of operations for any of the years in the three year period ended June 30, 2015. We cannot be sure that future inflation will not have an adverse impact on our operating results and financial condition.

**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). On July 9, 2015, the FASB voted to defer the effective date of the new revenue recognition standard by one year. Based on the Board's decision, public organizations would apply the new revenue standard to annual reporting periods beginning after December 15, 2017. We are currently evaluating the impact of the pending adoption of ASU 2014-09 on our consolidated financial statements and have not yet determined the method by which we will adopt the standard.



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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Interest Rate Risk**

At June 30, 2015 and 2014, we had cash and cash equivalents totaling \$195.9 million and \$196.1 million, respectively. We did not enter into market risk sensitive instruments for trading purposes during fiscal years 2015, 2014 and 2013. 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 June 30, 2015, a 1% gross increase in interest rates earned on cash would result in \$2.0 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 as of June 30, 2015, fluctuations in interest rates would not have any 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 June 30, 2015, a 1% change in exchange rates between the U.S. dollar and British pound would result in an approximate impact of less than \$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.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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<u>Consolidated Balance Sheets as of June 30, 2015 and 2014</u>	<u>88</u>
<u>Consolidated Statements of Operations for the years ended June 30, 2015, 2014 and 2013</u>	<u>89</u>
<u>Consolidated Statements of Comprehensive Income for the years ended June 30, 2015, 2014 and 2013</u>	<u>90</u>
<u>Consolidated Statements of Stockholders' Equity for the years ended June 30, 2015, 2014 and 2013</u>	<u>91</u>
<u>Consolidated Statements of Cash Flows for the years ended June 30, 2015, 2014 and 2013</u>	<u>92</u>
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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders  
K12 Inc.  
Herndon, Virginia

We have audited the accompanying consolidated balance sheets of K12 Inc. and subsidiaries (the Company) as of June 30, 2015 and 2014 and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended June 30, 2015. In connection with our audits of the financial statements, we have also audited the financial statement schedule listed in the accompanying index. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of K12 Inc. and subsidiaries at June 30, 2015 and 2014, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2015, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), K12 Inc. and subsidiaries' internal control over financial reporting as of June 30, 2015, based on criteria established in Internal Control Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated August 4, 2015 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Bethesda, Maryland  
August 4, 2015



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## K12 INC.

## CONSOLIDATED BALANCE SHEETS

	June 30,	
	2015	2014
	(In thousands, except share and per share data)	
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 195,852	\$ 196,109
Accounts receivable, net of allowance of \$9,657 and \$3,460 at June 30, 2015 and June 30, 2014, respectively.	188,246	194,676
Inventories, net	29,571	33,830
Deferred tax asset	8,989	7,732
Prepaid expenses	11,428	7,356
Other current assets	24,877	25,498
<b>Total current assets</b>	<b>458,963</b>	<b>465,201</b>
Property and equipment, net	34,407	48,581
Capitalized software, net	62,683	49,920
Capitalized curriculum development costs, net	58,696	60,782
Intangible assets, net	21,195	23,708
Goodwill	66,160	58,088
Deposits and other assets	6,495	5,387
<b>Total assets</b>	<b>\$ 708,599</b>	<b>\$ 711,667</b>
<b>LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 29,819	\$ 30,976
Accrued liabilities	12,486	20,539
Accrued compensation and benefits	26,790	17,400
Deferred revenue	24,927	24,353
Current portion of capital lease obligations	16,635	20,492
<b>Total current liabilities</b>	<b>110,657</b>	<b>113,760</b>
Deferred rent, net of current portion	7,692	8,488
Capital lease obligations, net of current portion	13,022	16,447
Deferred tax liability	22,456	22,478
Other long term liabilities	8,233	4,763
<b>Total liabilities</b>	<b>162,060</b>	<b>165,936</b>
<b>Commitments and contingencies</b>		
<b>Redeemable noncontrolling interest</b>	<b>9,601</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; 41,837,894 and 41,144,062 shares issued and 38,335,296 and 38,948,866 shares outstanding at June 30, 2015 and June 30, 2014, respectively	4	4
Additional paid-in capital	663,461	639,036
Accumulated other comprehensive loss	(1,065)	(112)

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Accumulated deficit	(50,462)	(61,450)
Treasury stock of 3,502,598 and 2,195,196 shares at cost at June 30, 2015 and June 30, 2014, respectively	(75,000)	(48,548)
<b>Total K12 Inc. stockholders' equity</b>	<b>536,938</b>	<b>528,930</b>
<b>Total liabilities, redeemable noncontrolling interest and equity</b>	<b>\$ 708,599</b>	<b>\$ 711,667</b>

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

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## K12 INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended June 30,		
	2015	2014	2013
	(In thousands, except share and per share data)		
<b>Revenues</b>	\$ 948,294	\$ 919,553	\$ 848,220
<b>Cost and expenses</b>			
Instructional costs and services	607,756	569,219	498,398
Selling, administrative and other operating expenses	307,730	313,258	283,032
Product development expenses	14,381	14,220	21,084
<b>Total costs and expenses</b>	929,867	896,697	802,514
<b>Income from operations</b>	18,427	22,856	45,706
<b>Realized gain on sale of assets</b>		6,404	
<b>Interest (expense), net and other</b>	(3,291)	(69)	851
<b>Income before income tax expense and noncontrolling interest</b>	15,136	29,191	46,557
<b>Income tax expense</b>	(5,810)	(11,075)	(20,023)
<b>Net income</b>	9,326	18,116	26,534
<b>Add net loss attributable to noncontrolling interest</b>	1,662	1,484	1,577
<b>Net income attributable to common stockholders, including Series A stockholders</b>	\$ 10,988	\$ 19,600	\$ 28,111
<b>Net income attributable to common stockholders per share, excluding Series A stockholders:</b>			
Basic	\$ 0.29	\$ 0.50	\$ 0.72
Diluted	\$ 0.29	\$ 0.50	\$ 0.72
<b>Weighted average shares used in computing per share amounts:</b>			
Basic	37,330,569	38,987,470	36,267,345
Diluted	37,625,425	39,230,516	39,017,345

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

Table of Contents**K12 INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Year Ended June 30,		
	2015	2014	2013
	(In thousands)		
Net income	\$ 9,326	\$ 18,116	\$ 26,534
Other comprehensive (loss) income, net of tax			
Foreign currency translation adjustment	(953)	182	(394)
Total other comprehensive income, net of tax	8,373	18,298	26,140
Comprehensive loss attributable to noncontrolling interest	1,662	1,484	1,577
Comprehensive income attributable to common stockholders, including Series A stockholders	\$ 10,035	\$ 19,782	\$ 27,717

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

Table of Contents**K12 INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY****K12 Inc Stockholders**

(In thousands, except share data)	Common Stock		Common Stock A		Accumulated			Treasury Stock		Noncontrolling	
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Other Comprehensive Income	Accumulated Deficit	Shares	Amount	Interest	Total
Balance, June 30, 2012	36,436,933	\$ 4	2,750,000	\$ 63,112	\$ 519,439	\$ 100	\$ (109,161)		\$	\$ 4,154	\$ 477,648
Net income (loss)(1)							28,111			(558)	27,553
Foreign currency translation adjustments							(394)				(394)
Stock-based compensation expense					14,374						14,374
Exercise of stock options	437,054				7,253						7,253
Excess tax benefit (expense) from stock-based compensation					8,889						8,889
Issuance of restricted stock awards	768,951										
Forfeiture of restricted stock awards	(86,142)										
Accretion of redeemable noncontrolling interests to estimated redemption value					981						981
Retirement of restricted stock for tax withholding	(116,134)				(2,546)						(2,546)
Balance, June 30, 2013	37,440,662	\$ 4	2,750,000	\$ 63,112	\$ 548,390	\$ (294)	\$ (81,050)		\$	\$ 3,596	\$ 533,758
Net income (loss)(1)							19,600			(209)	19,391
Foreign currency translation adjustments							182				182
Conversion of Series A to Common Stock	2,750,000		(2,750,000)	(63,112)	63,112						
Purchase of Treasury Stock								(2,195,196)	(48,548)		(48,548)
Stock-based compensation expense					22,828						22,828
Exercise of stock options	531,262				10,294						10,294
Excess tax benefit (expense) from stock-based compensation					1,075						1,075
Issuance of restricted stock awards	704,131										
Forfeiture of restricted stock awards	(93,423)										
Accretion of redeemable noncontrolling interests to estimated redemption value					(1,645)						(1,645)
Retirement of restricted stock for tax withholding	(188,570)				(5,018)						(5,018)
Deconsolidation of certain businesses										(3,387)	(3,387)
Balance, June 30, 2014	41,144,062	\$ 4		\$	\$ 639,036	\$ (112)	\$ (61,450)	(2,195,196)	\$ (48,548)	\$	\$ 528,930
Net income(1)							10,988				10,988
Foreign currency translation adjustments							(953)				(953)
Purchase of Treasury Stock								(1,307,402)	(26,452)		(26,452)
Stock-based compensation expense					21,299						21,299

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Exercise of stock options	99,935			553					553					
Excess tax benefit (expense) from stock-based compensation				(2,793)					(2,793)					
Issuance of restricted stock awards	822,698													
Forfeiture of restricted stock awards	(66,480)													
Accretion of redeemable noncontrolling interests to estimated redemption value				8,038					8,038					
Retirement of restricted stock for tax withholding	(162,321)			(2,672)					(2,672)					
Balance, June 30, 2015	41,837,894	\$	4	\$	663,461	\$	(1,065)	\$	(50,462)	(3,502,598)	\$	(75,000)	\$	536,938

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- (1) Net loss attributable to noncontrolling interest excludes \$1.7 million, \$1.3 million and \$1.0 million for the years ended June 30, 2015, 2014 and 2013, respectively, due to the redeemable noncontrolling interest related to Middlebury Interactive Languages and LearnBop, which is reported outside of permanent equity in the consolidated balance sheet (See Note 10).

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

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## K12 INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended June 30,		
	2015	2014	2013
	(In thousands)		
<b>Cash flows from operating activities</b>			
Net income	\$ 9,326	\$ 18,116	\$ 26,534
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation and amortization expense	83,801	86,267	65,737
Stock-based compensation expense	21,299	22,828	14,374
Excess tax benefit from stock-based compensation	(118)	(1,679)	(9,795)
Deferred income taxes	(3,094)	(5,754)	15,770
Provision for doubtful accounts	9,300	1,439	2,070
Provision for inventory obsolescence	1,406	4,293	387
Provision for student computer shrinkage and obsolescence	(430)	(526)	482
Impairment loss on other assets	3,200		
Realized gain on sale of assets		(6,404)	
<b>Changes in assets and liabilities:</b>			
Accounts receivable	(1,892)	(12,257)	(27,708)
Inventories	2,853	6,272	(6,929)
Prepaid expenses	(4,073)	2,735	843
Other current assets	(2,579)	(1,645)	682
Deposits and other assets	(1,440)	(212)	(466)
Accounts payable	(1,192)	9,778	(2,115)
Accrued liabilities	(7,854)	5,474	3,226
Accrued compensation and benefits	9,389	(4,214)	4,616
Deferred revenue	621	(1,429)	3,119
Restricted cash			1,501
Deferred rent	1,562	(209)	2,059
<b>Net cash provided by operating activities</b>	<b>120,085</b>	<b>122,873</b>	<b>94,387</b>
<b>Cash flows from investing activities</b>			
Purchases of property and equipment	(9,928)	(7,405)	(8,339)
Capitalized software development costs	(33,755)	(26,553)	(23,446)
Capitalized curriculum development costs	(18,057)	(15,411)	(18,560)
Mortgage note to a managed school partner		(2,100)	
Net cash received on sale of assets		5,665	
Acquisition of LearnBop Inc.	(6,512)		
<b>Net cash used in investing activities</b>	<b>(68,252)</b>	<b>(45,804)</b>	<b>(50,345)</b>
<b>Cash flows from financing activities</b>			
Repayments on capital lease obligations	(21,939)	(22,694)	(20,275)
Repayments on notes payable		(390)	(1,533)
Purchase of treasury stock	(26,452)	(48,548)	
Proceeds from exercise of stock options	553	10,294	7,253
Net proceeds from investment in noncontrolling interest		1,275	
Excess tax benefit from stock-based compensation	118	1,679	9,795
Retirement of restricted stock for tax withholding	(2,672)	(5,018)	(2,546)
<b>Net cash used in financing activities</b>	<b>(50,392)</b>	<b>(63,402)</b>	<b>(7,306)</b>



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<b>Effect of foreign exchange rate changes on cash and cash equivalents</b>	(1,698)	962	92
<b>Net change in cash and cash equivalents</b>	(257)	14,629	36,828
<b>Cash and cash equivalents, beginning of year</b>	196,109	181,480	144,652
<b>Cash and cash equivalents, end of year</b>	\$ 195,852	\$ 196,109	\$ 181,480

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

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**K12 Inc.**

**Notes to Consolidated Financial Statements**

**1. Description of the Business**

K12 Inc., together with its subsidiaries ("K<sup>12</sup>" 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 curriculum, instruction and related support services to create an individualized learning approach well-suited for virtual and blended public schools, public school districts, 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). In school year 2014-15, the Company managed public schools in 32 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 works closely as partners with a growing number of public schools, public school districts, public charter schools and private 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 consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and all controlled subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

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**

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("GAAP") requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates and assumptions, including those related to allowance for doubtful accounts, inventory reserves, amortization periods, the allocation of purchase price to the fair value of net assets and liabilities acquired in business combinations, fair values used in asset impairment evaluations, valuation of long-lived assets, fair value of redeemable noncontrolling interest, contingencies, income taxes and stock-based compensation expense. The Company bases its estimates on historical

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**3. Summary of Significant Accounting Policies (Continued)**

experience and various assumptions that it believes are reasonable under the circumstances. The results of the analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

***Revenue Recognition and Concentration of Revenues***

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, virtual charter schools, and private schools. In addition to providing the curriculum, books and materials, under most contracts, the Company provides management services and technology to 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 years ended June 30, 2015, 2014 and 2013 were \$338.2 million, \$265.2 million and \$247.1 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, where required, 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 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

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****3. Summary of Significant Accounting Policies (Continued)**

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, annual revenues are generally based on actual school funding 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. 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 fiscal years ended June 30, 2014, 2013 and 2012, the Company's aggregate funding estimates differed from actual reimbursements impacting total reported revenue by approximately (0.1%), 0.2%, and (0.1%), respectively.

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 takes into account 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

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**3. Summary of Significant Accounting Policies (Continued)**

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 funding 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 years ended June 30, 2015, 2014 and 2013, the Company's revenue included a reduction for these school operating losses of \$65.2 million, \$49.8 million, and \$64.5 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.

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. Revenues from associated offline learning kits are recognized upon shipment.

During the years ended June 30, 2015, 2014 and 2013, approximately 86%, 88% and 86%, respectively, of the Company's revenues were recognized from schools the Company managed. The Company had a contract with one school that represented approximately 14% of revenue during 2015, approximately 13% of revenue in 2014 and about 14% of revenue in 2013. Approximately 9% of accounts receivable was attributable to a contract with one school as of June 30, 2015 and 2014, respectively.

In fiscal year 2015, Agora renegotiated its service agreement and entered into a three-year contract with the Company to purchase the Company's curriculum and certain technology services, while the school board assumed daily operational responsibilities, including its charter renewal process and marketing and enrollment activities. The negative impact of this event on revenues attributable to the loss of the management component of the Agora contract, while significant, will be dependent upon the number of enrollments Agora can generate independently and the funding rates approved by the Pennsylvania legislature for cyber-charter schools in fiscal year 2016.

***Reclassifications***

The Company has reclassified certain prior year income tax classifications to conform to the current year presentation. There was no effect on related income tax assets or liabilities, or the income statement from such reclassification. The reclassification had no effect on net cash flows.

***Shipping and Handling Costs***

Shipping and handling costs are expensed when incurred and are classified as instructional costs and services in the accompanying consolidated statements of operations. Shipping and handling charges invoiced to a customer are included in revenues.

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**3. Summary of Significant Accounting Policies (Continued)**

***Research and Development Costs***

All research and development costs, including patent application costs, are expensed as incurred.

***Cash and Cash Equivalents***

Cash and cash equivalents generally consist of cash on hand and cash held in money market and demand deposit accounts. The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

***Allowance for Doubtful Accounts***

The Company maintains an allowance for uncollectible accounts primarily for estimated losses resulting from the inability or failure of individual customers to make required payments. The Company analyzes accounts receivable, historical percentages of uncollectible accounts and changes in payment history when evaluating the adequacy of the allowance for uncollectible accounts. The Company records an allowance for estimated uncollectible accounts in an amount approximating anticipated losses. Actual write-offs might exceed the recorded allowance.

***Inventories***

Inventories consist primarily of textbooks and curriculum materials, a majority of which are supplied to virtual and blended public schools and utilized directly by students. Inventories represent items that are purchased 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 years ended June 30, 2015 and 2014, the Company increased the provision for excess and obsolete inventory by \$1.4 million and \$4.2 million primarily related to the decision to discontinue certain products and excess inventory relative to anticipated demand. The excess and obsolete inventory reserve at June 30, 2015 and 2014 was \$2.2 million and \$9.1 million, respectively. The reduction in the reserve during the year ended June 30, 2015 is primarily due to the disposal of previously reserved inventory.

***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 and amortization 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

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****3. Summary of Significant Accounting Policies (Continued)**

imposes a penalty on the lessee in an amount such that renewal appears, at the inception of the lease, to be reasonably assured. Property and equipment are depreciated over the following useful lives:

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

During the year ended June 30, 2014, the Company updated the estimate of unreturned student 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, during the year ended 2014 the Company recorded accelerated depreciation of \$6.5 million for computers that the Company estimates will not be returned by students. During the year ended June 30, 2015, the Company continued to perform this analysis and as a result recorded \$5.0 million in accelerated depreciation related to this estimate. The Company recorded no accelerated depreciation related to these estimates for the year ended June 30, 2013.

In addition, during the year ended June 30, 2015, the Company wrote down approximately \$4.8 million of capitalized software projects after determining the assets either have no future use or are being sunset. Further, during the fiscal year ended June 30, 2015, the Company wrote down approximately \$6.5 million primarily related to computer peripherals and other fixed assets shipped to students, and for which no reclamation will be processed. The Company recorded no such write-downs during the year ended June 30, 2013.

***Capitalized Software***

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 \$33.8 million, \$26.6 million and \$23.4 million for the years ended June 30, 2015, 2014 and 2013, respectively. During the year ended June 30, 2014, the Company wrote down approximately \$3.8 million of capitalized software projects after determining the assets either have no future use or are being sunset. There were no material write-downs of capitalized software projects for the year ended June 30, 2013.

Amortization expense for the years ended June 30, 2015, 2014 and 2013 was \$26.8 million, \$20.1 million and \$14.7 million, respectively.

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**3. Summary of Significant Accounting Policies (Continued)**

***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 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 \$18.1 million, \$15.4 million and \$18.6 million for the years ended June 30, 2015, 2014 and 2013, respectively. These amounts are recorded on the accompanying consolidated balance sheets, net of amortization and impairment charges. Amortization charges are recorded in instructional costs and services on the accompanying consolidated statements of operations. Amortization expense for the years ended June 30, 2015, 2014 and 2013 was \$20.1 million, \$19.0 million and \$14.3 million, respectively. The Company wrote down approximately \$2.6 million and \$2.2 million of capitalized curriculum development costs due to an assessment of recoverability of certain curriculum, as well as a decision to discontinue certain curriculum during the years ended June 30, 2015 and 2014. There were no material write-downs of capitalized curriculum development costs for the year ended June 30, 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 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. The Company's consolidated balance sheets reflect noncontrolling interests within the equity section of the consolidated balance sheets, except for redeemable noncontrolling interests. Noncontrolling interest was classified separately in the Company's 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. However, if the redemption amount is other than fair value (e.g. fixed or variable), the redeemable noncontrolling interest is accounted for at the fixed or variable redeemable value. The redeemable noncontrolling interests are adjusted to their redeemable 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.



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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**3. Summary of Significant Accounting Policies (Continued)**

***Goodwill and Intangible Assets***

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. As of June 30, 2015 and 2014, finite-lived intangible assets were recorded at \$37.4 million and \$37.4 million, respectively, and accumulated amortization of \$16.2 million and \$13.7 million, respectively. Amortization expense for the years ended June 30, 2015, 2014 and 2013 was \$2.6 million, \$8.0 million and \$4.6 million, respectively. During the year ended June 30, 2014, the Company determined that based on rebranding of the Institutional Sales business, the Company fully amortized certain trade names that are no longer going to be used and recorded a \$5.2 million impairment charge. There was no material impairment charge for the years ended June 30, 2015 and 2013. Future amortization of intangible assets is \$2.5 million, \$1.9 million, \$1.9 million, \$1.9 million and \$1.9 million in the years ended June 30, 2016 through June 30, 2020, respectively and \$10.7 million thereafter. As of June 30, 2015 and 2014, the goodwill balance was \$66.2 million and \$58.1 million, respectively.

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. The Step 0 analysis focused on a number of events and circumstances that may be considered when making this qualitative assessment. Upon careful consideration of these events and circumstances, the Company recorded no goodwill impairment for the years ended June 30, 2015, 2014 and 2013.

As a result of the sale of the business assets during the fiscal year ended June 30, 2014, the Company wrote off goodwill of \$3.4 million and net intangibles of \$0.4 million associated with these entities.

On July 31, 2014, the Company acquired a 51% majority interest in LearnBop Inc. ("LearnBop"), for \$6.6 million in cash (see Note 10).

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****3. Summary of Significant Accounting Policies (Continued)**

The following table represents goodwill additions/reductions during fiscal years ended June 30, 2015, 2014 and 2013:

(\$ in millions)	Amount
<b>Goodwill</b>	
Balance as of June 30, 2013	\$ 61.4
Sale of business assets	(3.4)
Adjustments due to other foreign exchange translations	0.1
Balance as of June 30, 2014	\$ 58.1
Acquisition of LearnBop	8.1
Balance as of June 30, 2015	\$ 66.2

Intangible Assets:

(\$ in millions)	2015			2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Trade names	\$ 17.5	\$ (5.7)	\$ 11.8	\$ 17.5	\$ (4.6)	\$ 12.9
Customer and distributor relationships	18.2	(9.1)	9.1	18.2	(7.7)	10.5
Developed technology	1.2	(1.2)	0.0	1.2	(1.2)	0.0
Other	0.5	(0.2)	0.3	0.5	(0.2)	0.3
	\$ 37.4	\$ (16.2)	\$ 21.2	\$ 37.4	\$ (13.7)	\$ 23.7

During fiscal year ended 2014, 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. There were no such impairment charges during fiscal years ended June 30, 2015 and 2013.

***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. 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.

***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



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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**3. Summary of Significant Accounting Policies (Continued)**

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.

***Sales Taxes***

Sales tax collected from customers is excluded from revenues. Collected but unremitted sales tax is included as part of accrued liabilities in the accompanying consolidated balance sheets. Revenues do not include sales tax as the Company considers itself a pass-through conduit for collecting and remitting sales tax.

***Stock-Based Compensation***

The Company estimates the fair value of share-based awards on the date of grant. The fair value of stock options is determined using the Black-Scholes option-pricing model and the fair value of restricted stock awards is based on the closing price of the Company's common stock on the date of grant. The determination of the fair value of the Company's stock option awards and restricted stock awards is based on a variety of factors including, but not limited to, the Company's common stock price, expected stock price volatility over the expected life of awards, and actual and projected exercise behavior. Additionally, the Company has estimated forfeitures for share-based awards at the dates of grant based on historical experience, adjusted for future expectation. The forfeiture estimate is revised as necessary if actual forfeitures differ from these estimates.

***Advertising and Marketing Costs***

Advertising and marketing costs consist primarily of internet advertising, online marketing, direct mail, print media and television commercials and are expensed when incurred.

***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 were outstanding as of June 30, 2015 and June 30, 2014.

***Net Income 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

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****3. Summary of Significant Accounting Policies (Continued)**

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 consolidated balance sheets include restricted stock awards outstanding. Securities that may participate in undistributed net income with common stock are considered participating securities. Since the Series A Shares participate in all dividends and distributions declared or paid with respect to common stock of the Company (as if a holder of common stock), the Series A Shares meet the definition of participating security under ASC 260. All securities that meet the definition of a participating security, regardless of whether the securities are convertible, non-convertible or potential common stock securities, are included in the computation of both basic and diluted EPS (as a reduction of the numerator) using the two-class method. Under the two-class method, all undistributed earnings in a period are to be allocated to common stock and participating securities to the extent that each security may share in earnings as if all of the earnings for the period had been distributed.

The following schedule presents the calculation of basic and diluted net income per share:

	Year Ended June 30,		
	2015	2014	2013
(In thousands except shares and per share data)			
<b>Basic earnings per share computation:</b>			
Net income attributable to common stockholders, including Series A stockholders	\$ 10,988	\$ 19,600	\$ 28,111
Amount allocated to participating Series A stockholders	\$	\$	\$ (1,985)
Income available to common stockholders basic	\$ 10,988	\$ 19,600	\$ 26,126
Weighted average common shares basic	37,330,569	38,987,470	36,267,345
Basic net income per share	\$ 0.29	\$ 0.50	\$ 0.72
<b>Dilutive earnings per share computation:</b>			
Income available to common stockholders basic	\$ 10,988	\$ 19,600	\$ 26,126
Amount allocated to participating Series A stockholders	\$	\$	\$ 1,985
Net income attributable to common stockholders, including Series A stockholders	\$ 10,988	\$ 19,600	\$ 28,111
<b>Share computation:</b>			
Weighted average common shares basic	37,330,569	38,987,470	36,267,345
Series A Special Stock			2,750,000
Effect of dilutive stock options and restricted stock awards	294,856	243,046	
Weighted average common shares outstanding diluted	37,625,425	39,230,516	39,017,345

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Diluted net income per share	\$	0.29	\$	0.50	\$	0.72
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At June 30, 2015, the Company had 41,837,894 shares of common stock issued and 38,335,296 shares outstanding, which included the 2,750,000 common shares associated with the Series A special stock conversion which occurred on September 3, 2013.

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****3. Summary of Significant Accounting Policies (Continued)**

As of June 30, 2015, 2014 and 2013, the shares of common stock issuable in connection with stock options of 2,784,593, 558,186 and 1,181,820, respectively, were not included in the diluted income per common share calculation since their effect was antidilutive.

***Fair Value Measurements***

ASC 820, *Fair Value Measurements*, 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 instruments valuation.

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

The redeemable noncontrolling interest includes the Company's joint venture with Middlebury College to form Middlebury Interactive Languages ("MIL"). Under the agreement, Middlebury College has an irrevocable election to sell all of its membership interest to the Company (put right). The fair value of the redeemable noncontrolling interest reflects management's best estimate of the redemption value of the put right.

The following table summarizes certain fair value information at June 30, 2015 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	\$ 6,801	\$	\$	\$ 6,801
Total	\$ 6,801	\$	\$	\$ 6,801

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****3. Summary of Significant Accounting Policies (Continued)**

The following table summarizes certain fair value information at June 30, 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
Total	\$ 16,801	\$	\$	\$ 16,801

The following table presents activity related to the Company's fair value measurements categorized as Level 3 of the valuation hierarchy, valued on a recurring basis, for the fiscal year ended June 30, 2015.

Description	Fair Value June 30, 2014	Fiscal Year Ended June 30, 2015		
		Purchases, Issuances, and Settlements	Unrealized Gains/(Losses)	Fair Value June 30, 2015
		(In thousands)		
Redeemable Noncontrolling Interest in Middlebury Joint Venture	\$ 16,801	\$	\$ (10,000)	\$ 6,801
Total	\$ 16,801	\$	\$ (10,000)	\$ 6,801

The fair value of the redeemable noncontrolling interest in the Middlebury Joint Venture was accounted for 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, 2015. As of June 30, 2015 the fair value of the Middlebury Joint Venture was estimated at \$6.8 million.

Historically, Middlebury projections included a product that will no longer be developed by Middlebury. Further, based on several years of historical performance, growth projections for the Middlebury Joint Venture were reduced. As a result, the fair value of Middlebury significantly decreased as of the June 30, 2015 valuation date, as can be seen from the table above. Based on the results of the third-party valuation, there was no impairment of Middlebury's net assets.

On May 4, 2015, Middlebury College, under the joint venture agreement, exercised its right to require the Company to purchase all of its ownership interest in the joint venture. The Company has the right to pay the redemption cost in cash, stock or a combination thereof, at the Company's option, which form of consideration has not yet been determined.

**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





Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****3. Summary of Significant Accounting Policies (Continued)**

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). On July 9, 2015, the FASB voted to defer the effective date of the new revenue recognition standard by one year. Based on the Board's decision, public organizations would apply the new revenue standard to annual reporting periods beginning after December 15, 2017. 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.

**4. Property and Equipment and Capitalized Software**

Property and equipment consist of the following at:

	June 30,	
	2015	2014
	(In thousands)	
Student computers	\$ 44,823	\$ 61,165
Computer software	26,368	30,788
Computer hardware	17,559	16,377
Leasehold improvements	12,070	11,369
Office equipment	1,515	1,387
Furniture and fixtures	6,002	5,698
Web site development costs	1,115	1,115
State Testing computers	2,654	
	112,106	127,899
Less accumulated depreciation and amortization	(77,699)	(79,318)
	\$ 34,407	\$ 48,581

The Company recorded depreciation expense related to property and equipment reflected in selling, administrative and other operating expenses of \$6.0 million, \$9.4 million and \$9.8 million during the years ended June 30, 2015, 2014 and 2013, respectively. Depreciation expense of \$27.5 million, \$28.1 million and \$21.0 million related to computers leased to students is reflected in instructional costs and services during the years ended June 30, 2015, 2014 and 2013, respectively. During the year ended June 30, 2015, the Company wrote down approximately \$4.8 million of capitalized software projects after determining the assets either have no future use or are being sunset. Amortization expense of \$0.9 million, \$1.7 million and \$1.4 million related to student software costs is reflected in instructional costs and services during the years ended June 30, 2015, 2014 and 2013, respectively.

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****4. Property and Equipment and Capitalized Software (Continued)**

In the course of its normal operations, the Company incurs maintenance and repair expenses. Those are expensed as incurred and amounted to \$11.2 million, \$10.2 million and \$8.1 million for the years ended June 30, 2015, 2014 and 2013, respectively.

Capitalized software consists of the following at:

	<b>June 30,</b>	
	<b>2015</b>	<b>2014</b>
	<b>(In thousands)</b>	
Capitalized software costs	\$ 144,285	\$ 109,590
Less accumulated depreciation and amortization	(81,602)	(59,670)
	<b>\$ 62,683</b>	<b>\$ 49,920</b>

The Company recorded amortization expense of \$19.4 million, \$18.2 million and \$12.2 million related to capitalized software development reflected in instructional costs and services during the years ended June 30, 2015, 2014 and 2013, respectively. Amortization expense of zero, zero and \$0.8 million related to capitalized software development was reflected in product development expenses during the years ended June 30, 2015, 2014 and 2013, respectively. The Company recorded amortization of capitalized software development costs reflected in selling, administrative and other operating expenses of \$7.4 million, \$1.9 million and \$1.7 million during the years ended June 30, 2015, 2014 and 2013, respectively. During the year ended June 30, 2014, the Company wrote down approximately \$3.8 million of capitalized software projects after determining the assets either have no future use or are being sunset. There were no material write-downs of capitalized software costs for the years ended June 30, 2015 and 2013.

**5. Income Taxes**

The provision for income taxes is based on earnings reported in the 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 year.

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****5. Income Taxes (Continued)**

Deferred tax assets and liabilities result primarily from temporary differences in book versus tax basis accounting. Deferred tax assets and liabilities consist of the following:

	June 30,	
	2015	2014
	(In thousands)	
<b>Deferred tax assets (liabilities):</b>		
Net operating loss carryforward	\$ 4,059	\$ 3,066
Reserves	5,042	5,462
Accrued expenses	9,837	6,953
Stock compensation expense	13,113	12,055
Other assets	1,666	2,232
Deferred rent	1,998	2,074
Deferred revenue	396	490
Tax basis intangibles		576
Federal tax credits	20	20
State tax credits	912	975
Total deferred tax assets	37,043	33,903
<b>Deferred tax liabilities</b>		
Capitalized curriculum development	(11,301)	(12,782)
Capitalized software and website development costs	(22,635)	(18,743)
Property and equipment	(1,166)	(2,313)
Investment in Middlebury Interactive Languages	(599)	(1,361)
Returned materials	(5,944)	(5,316)
Purchased intangibles	(6,074)	(6,166)
Total deferred tax liabilities	(47,719)	(46,681)
Net deferred tax liability before valuation allowance	(10,676)	(12,778)
Valuation Allowance	(2,791)	(1,968)
Net deferred tax liability	\$ (13,467)	\$ (14,746)
Reported as:		
Current deferred tax assets	\$ 8,989	\$ 7,732
Long-term deferred tax liabilities	(22,456)	(22,478)
Net deferred tax liability	\$ (13,467)	\$ (14,746)

The Company maintains a valuation allowance on net deferred tax assets of \$2.8 million and \$2.0 million as of June 30, 2015 and 2014, respectively, predominantly related to state and foreign income tax net operating losses ("NOL") as the Company does not believe it is more likely than not that it will utilize these deferred tax assets. The Company adjusted its valuation allowance for the year ended June 30, 2015 due to the reduction of state operating losses, partially offset by the increase of foreign operating losses. The Company has not provided for U.S.

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deferred income taxes on undistributed foreign earnings because such earnings are considered to be permanently reinvested. Undistributed earnings of certain consolidated foreign subsidiaries at June 30, 2015 amounted to \$16.2 million. If such earnings were not

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****5. Income Taxes (Continued)**

permanently reinvested, a U.S. deferred income tax liability of approximately \$6.5 million would have been required.

At June 30, 2015, the Company had available federal NOL carryforwards of \$2.9 million. These NOLs expire in 2021 if unused.

For the years ended June 30, 2015 and 2014, the Company has evaluated whether a change in the Company's ownership of outstanding classes of stock as defined in Internal Revenue Code Section 382 could prohibit or limit the Company's ability to utilize its NOLs. As a result of this study, the Company has concluded it is more likely than not that the Company will be able to fully utilize its NOLs subject to the Section 382 limitation.

The related components of the income tax expense for the years ended June 30, 2015, 2014 and 2013 were as follows:

	Year Ended June 30,		
	2015	2014	2013
	(In thousands)		
<b>Current:</b>			
Federal	\$ 6,490	\$ 14,025	\$ 1,153
State	1,964	2,748	3,134
Foreign	450	56	(34)
<b>Total current</b>	<b>8,904</b>	<b>16,829</b>	<b>4,253</b>
<b>Deferred:</b>			
Federal	(2,291)	(6,185)	16,388
State	(1,635)	(362)	(784)
Foreign	832	793	166
<b>Total deferred</b>	<b>(3,094)</b>	<b>(5,754)</b>	<b>15,770</b>
<b>Total income tax expense</b>	<b>\$ 5,810</b>	<b>\$ 11,075</b>	<b>\$ 20,023</b>

The provision for income taxes can be reconciled to the income tax that would result from applying the statutory rate to the net income before income taxes as follows:

	Year Ended June 30,		
	2015	2014	2013
U.S. federal tax at statutory rates	35.0%	35.0%	35.0%
Permanent items	2.3	1.3	0.4
Lobbying	5.0	(0.2)	1.6
Transaction costs		(0.1)	0.4
State taxes, net of federal benefit	1.8	4.3	3.5
Research and development tax credits	(1.7)	(0.7)	(0.7)
Domestic production activities deduction	(6.5)	(6.4)	
Change in valuation allowance	5.2	2.4	
Effects of foreign operations	(13.6)	(4.0)	2.4
Reserve for unrecognized tax benefits	6.1	3.9	
Noncontrolling Interests	5.5	1.8	0.9
Other	(0.7)	0.6	(0.5)

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Provision for income taxes	38.4%	37.9%	43.0%
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Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****5. Income Taxes (Continued)**

The effective income tax rates during the years ended June 30, 2015, 2014 and 2013 were 38.4%, 37.9%, and 43.0%, respectively. The primary causes of the changes in the effective tax rate were provision true-ups and additional tax benefits related to research activities of the Company, offset by additional reserves related to prior year tax positions.

***Tax Uncertainties***

The Company follows the provisions of ASC 740-10 which applies to all tax positions related to income taxes. ASC 740-10 provides a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. ASC 740-10 clarifies accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. If the probability for sustaining a tax position is greater than 50%, then the tax position is warranted and recognition should be at the highest amount which would be expected to be realized upon ultimate settlement.

The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense. At June 30, 2015, the Company had \$0.2 million in interest and penalties accrued.

	Year Ended June 30,		
	2015	2014	2013
	(In thousands)		
Balance at beginning of the year	\$ 2,555	\$ 1,346	\$ 906
Additions for prior year tax positions	137	702	302
Additions for current year tax positions	989	507	138
Reductions for prior year tax positions	(123)		
Balance at end of the year	\$ 3,558	\$ 2,555	\$ 1,346

The Company or one of its subsidiaries files income tax returns in the U.S. federal, foreign and various state jurisdictions. Given the federal and certain state net operating losses generated in prior years, the statute of limitations for all tax years beginning with the period ended December 31, 2001 are still open. The statute of limitations for certain states for certain subsidiaries that have generated income may only extend back to 2010. The returns of the foreign subsidiaries are open to examination for the periods dating back to 2010.

If recognized, all of the \$3.6 million balance of unrecognized tax benefits would affect the effective tax rate. It is reasonably expected that unrecognized tax benefits related to income tax issues may change by a significant amount over the next twelve months.

**6. Lease Commitments*****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 June 30, 2015 and 2014, respectively. As of June 30, 2015 and 2014, the aggregate outstanding balance under the lease line of credit, including



Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****6. Lease Commitments (Continued)**

balances from prior years, was \$29.7 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 7). The net carrying value of leased student computers as of June 30, 2015 and 2014 was \$12.9 million and \$20.9 million, respectively.

The Company incurs capital lease obligations for student computers under a lease line of credit with PNC Equipment Finance, LLC with annual lease availability limits. The Company had \$35.0 million of availability for new leasing during fiscal year 2015. Interest rates on the new borrowings were 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. This availability originally expired in July 2015, but was extended to July 2016. Interest rates on the new borrowings beginning in August 2015 under the extended agreement are based upon an initial rate of 1.88% 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 April 29, 2015 and the Lease Commencement Date, as defined in the lease line of credit.

The following is a summary as of June 30, 2015 of the present value of the net minimum lease payments on capital leases under the Company's commitments:

<b>As of June 30,</b>	<b>Capital Leases</b> <b>(\$ in thousands)</b>
2016	17,196
2017	9,747
2018	3,526
Total minimum payments	30,469
Less amount representing interest (imputed weighted average capital lease interest rate of 2.63%)	(812)
Net minimum payments	29,657
Less current portion	(16,635)
Present value of minimum payments, less current portion	\$ 13,022

***Operating leases***

The Company has fixed non-cancelable operating leases with terms expiring through 2022 for office space leases. Office leases generally contain renewal options and certain leases provide for scheduled rate increases over the lease terms.

Rent expense was \$8.1 million, \$8.8 million and \$7.7 million for the years ended June 30, 2015, 2014 and 2013, respectively.

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****6. Lease Commitments (Continued)**

Future minimum lease payments under non-cancelable operating leases with initial terms of one year or more are as follows:

(\$ in thousands)	Year Ending June 30,
2016	\$ 8,274
2017	8,096
2018	7,920
2019	7,863
2020	6,688
Thereafter	11,903
<b>Total future minimum lease payments</b>	<b>\$ 50,744</b>

**7. Line of Credit**

On January 31, 2014, the Company executed a \$100.0 million unsecured line of credit to be used for general corporate operating purposes with Bank of America, N.A. ("BOA"). The line has a five-year term, bears interest at the higher of the Bank's prime rate plus 0.25%, or the Federal Funds Rates plus 0.75%, or the LIBOR rate plus 1.25%; and incorporates customary financial and other covenants, including but not limited to a maximum debt leverage and a minimum fixed charge coverage ratio. As of June 30, 2015, the Company was in compliance with these covenants and the Company had no borrowings outstanding on the line of credit.

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 customary financial and other covenants, including but not limited to maximum debt leverage and minimum fixed charge coverage ratios. As of June 30, 2015 and 2014, the Company was in compliance with these covenants.

**8. Equity Transactions**

The Company's Third Amended and Restated Certificate of Incorporation authorizes the Company to issue 100,000,000 shares of Common Stock and 10,000,000 shares of Preferred Stock. No Preferred Stock was issued or outstanding as of June 30, 2015 or 2014.

Series A Special Stock

The Company issued 2,750,000 shares of Series A Special Stock in connection with its acquisition of KC Distance Learning, Inc. 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 for 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 June 30, 2015.

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**8. Equity Transactions (Continued)**

Common Stock Repurchases

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 are dependent upon business and market conditions and other factors. The stock purchases are made from time to time and may be made through a variety of methods including open market purchases and trading plans that may be adopted in accordance with the Rule 10b5-1 of the Exchange Act. For fiscal year ended June 30, 2015, the Company paid approximately \$26.5 million in cash to redeem 1,307,402 shares of common stock at an average price of \$20.23 per share. As of June 30, 2015 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.

**9. Stock Option Plan**

The Company adopted a Stock Option Plan in May 2000 (the "Option Plan") under which, employees, outside directors and independent contractors could participate in the Company's future performance through awards of nonqualified stock options to purchase common stock. In October 2007, the Company's Board adopted the 2007 Equity Incentive Award Plan, as amended (the "2007 Plan") increasing the number of common stock shares reserved for issuance to 4,213,921 shares plus increases in the shares pursuant to an "evergreen provision" that may be issued under the 2007 Plan over the course of its ten-year term. Under the evergreen provision, the 2007 Plan provides that the number of shares available for issuance automatically increases by an amount equal to the least of i) 4% of the Company's outstanding common stock on the applicable July 1, or ii) 2,745,098 shares, or iii) a lesser number of shares as determined by the Company's Board of Directors. In fiscal year 2015, the Company's Board of Directors authorized 1,557,995 additional shares for issuance pursuant to the 2007 Plan's evergreen provision. Through June 30, 2015, the remaining aggregate number of shares of the Company's common stock authorized for future issuance under the Plan was 3,295,463. Through June 30, 2015, there were 4,160,097 shares of the Company's common stock that were issued and remain outstanding as a result of equity awards granted under the Plan.

Each stock option is exercisable pursuant to the vesting schedule set forth in the stock option agreement granting such stock option, generally over four years. No stock option shall be exercisable after the expiration of its option term. The Company has granted stock options under the 2007 Plan and the Company has also granted stock options to executive officers under stand-alone agreements outside the Plan. Options granted under stand-alone agreements totaled 1,441,168 as of June 30, 2015, 2014 and 2013. There have been no grants of stock options to independent contractors.

Compensation expense for all equity-based compensation awards is based on the grant-date fair value estimated in accordance with the provisions of ASC 718. The Company recognizes these compensation costs on a straight-line basis over the requisite service period, which is generally the vesting period of the award.

The Company uses the Black-Scholes option pricing model method to calculate the fair value of stock options. The use of option valuation models requires the input by management of highly subjective assumptions, including the expected stock price volatility, the expected life of the option term and forfeiture rate. These assumptions are utilized by the Company in determining the estimated fair value of stock options.

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****9. Stock Option Plan (Continued)**

The fair value of the Company's service and performance based stock options was estimated as of the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Year Ended June 30,		
	2015	2014	2013
Dividend yield	0.00%	0.00%	0.00%
Expected volatility	48% to 51%	49% to 55%	51% to 58%
Risk-free interest rate	1.27% to 1.71%	1.23% to 1.73%	0.62% to 1.23%
Expected life of the option term (in years)	4.97 to 5.11	4.82 to 5.14	4.82 to 5.14
Forfeiture rate	12% to 28%	12% to 28%	10% to 28%

The fair value of the options granted for the years ended June 30, 2015, 2014 and 2013 was \$4.4 million, \$3.0 million and \$6.9 million, respectively. This amount will be expensed over the required service period.

*Dividend yield* The Company has never declared or paid dividends on its common stock and has no plans to do so in the foreseeable future.

*Expected volatility* Volatility is a measure of the amount by which a financial variable such as a share price has fluctuated (historical volatility) or is expected to fluctuate (expected volatility) during a period. Prior to fiscal year 2014, since the Company did not have sufficient historical data, the basis for the standard option volatility calculation is derived from known publicly traded comparable companies. The annual volatility for these companies is derived from their historical stock price data. Beginning in 2014, the Company used its own volatility rather than utilizing a peer group volatility.

*Risk-free interest rate* The assumed risk free rate used is a zero coupon U.S. Treasury security with a maturity that approximates the expected term of the option.

*Expected life of the option term* The period of time that the options granted are expected to remain unexercised. Options granted during the year have a maximum term of eight years. The Company estimates the expected life of the option term based on an average life between the dates that options become fully vested and the maximum life of options granted.

*Forfeiture rate* The estimated percentage of options granted that are expected to be forfeited or canceled before becoming fully vested. The Company uses a forfeiture rate based on historical forfeitures of different classification levels of employees in the Company.

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****9. Stock Option Plan (Continued)**

Stock option activity including stand-alone agreements during the years ended June 30, 2015, 2014 and 2013 are as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding, June 30, 2012	2,949,940	\$ 20.41	4.21	\$ 36,916
Granted	740,509	21.35		
Exercised	(437,054)	16.59		
Forfeited or canceled	(360,207)	28.93		
Outstanding, June 30, 2013	2,893,188	\$ 20.17	4.98	\$ 50,038
Granted	306,220	26.90		
Exercised	(531,262)	17.49		
Forfeited or canceled	(89,745)	22.63		
Outstanding, June 30, 2014	2,578,401	\$ 21.44	4.57	\$ 42,754
Granted	617,985	16.12		
Exercised	(99,935)	5.68		
Forfeited or canceled	(181,858)	29.85		
Outstanding, June 30, 2015	2,914,593	\$ 20.33	4.05	\$ 88
Stock options exercisable at June 30, 2015	1,941,836	\$ 20.88	2.68	\$

Stock options outstanding at June 30, 2015 included 368,437 options related to performance or market based options. There were no performance based options that vested during the year ended June 30, 2015. Stock options exercisable at June 30, 2015 included 368,437 stock options related to performance based options. Vesting of performance based options is contingent on meeting various company-wide performance goals.

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing stock price on the last day of the year and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2015. The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock.

The total intrinsic value of options exercised for the years ended June 30, 2015, 2014 and 2013 was \$0.3 million, \$7.4 million and \$3.4 million, respectively.

As of June 30, 2015, there was \$5.9 million of total unrecognized compensation expense related to unvested stock options granted under the Stock Option Plans adopted in May 2000 and October 2007. The cost is expected to be recognized over a weighted average period of 2.70 years. During the years ended June 30, 2015, 2014 and 2013, the Company recognized \$5.5 million, \$7.0 million and \$5.0 million, respectively, of stock based compensation expense. Included in expense for the year ended June 30, 2015, the Company recorded stock-based compensation of \$0.4 million associated with accelerated vesting of option awards for executives and other employees. During the year ended June 30, 2014, the Company recorded stock-based compensation of \$1.6 million associated with extending the exercise period of certain



Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****9. Stock Option Plan (Continued)**

option awards to the Company's former Chief Executive Officer upon his resignation from the Board of Directors and \$1.5 million associated with accelerated vesting of option awards to the Company's former Chief Executive Officer and other employees upon termination of employment. There were no similar charges in the year ended June 30, 2013.

***Restricted Stock Awards***

The Company has approved grants of restricted stock awards ("RSA") pursuant to the 2007 Plan. Under the Plan, employees, outside directors and independent contractors are able to participate in the Company's future performance through the awards of restricted stock. Each RSA vests pursuant to the vesting schedule set forth in the restricted stock agreement granting such RSA's, generally over three years. Under the 2007 Plan, there have been no awards of restricted stock to independent contractors.

Restricted stock award activity during the years ended June 30, 2015, 2014 and 2013 was as follows:

	Shares	Weighted-Average Fair Value
Nonvested, June 30, 2012	591,637	\$ 25.12
Granted	768,951	21.78
Vested	(346,309)	24.00
Canceled	(86,142)	23.01
Nonvested, June 30, 2013	928,137	\$ 22.97
Granted	704,131	31.49
Vested	(559,250)	25.11
Canceled	(93,423)	26.24
Nonvested, June 30, 2014	979,595	\$ 22.97
Granted	822,698	17.54
Vested	(490,309)	15.63
Canceled	(66,480)	22.46
Nonvested, June 30, 2015	1,245,504	\$ 22.30

During the year ended June 30, 2015, 117,553 new performance based restricted stock awards were granted and 277,764 were outstanding at June 30, 2015. During the year ended June 30, 2015, 43,604 performance or market based awards vested. Vesting of the performance-based restricted stock awards is contingent on certain financial performance goals.

The fair value of restricted stock awards granted for the year ended June 30, 2015 was \$14.2 million. As of June 30, 2015, there was \$16.1 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 1.7 years. The total fair value of shares vested during the year ended June 30, 2015 was \$8.2 million. During the years ended June 30, 2015, 2014 and 2013, the Company recognized \$15.8 million, \$15.8 million and \$9.4 million, respectively, of stock-based compensation expense related to restricted stock awards. Included in the expense for the year ended June 30, 2015, the Company recorded stock-based compensation of \$2.5 million associated with accelerated vesting of equity awards to executives and other employees. During the year ended June 30, 2014, the Company recorded stock-based compensation

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****9. Stock Option Plan (Continued)**

of \$3.6 million associated with accelerated vesting of equity awards to the Company's former Chief Executive Officer and other employees upon termination of employment. There were no similar charges in the year ended June 30, 2013.

**10. Redeemable Noncontrolling Interest*****Investment in LearnBop Inc.***

On July 31, 2014, the Company acquired a majority interest in LearnBop Inc. ("LearnBop"), for \$6.6 million in cash in return for a 51% interest in LearnBop. The purpose of the acquisition was 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 \$6.6 million was allocated to the underlying assets and liabilities based on their estimated fair value at the date of acquisition. The Company recorded goodwill of \$8.1 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 purchase price allocation for LearnBop (in millions):

As of July 31, 2014	Amount
Current assets	\$ 0.2
Capitalized software	0.9
Goodwill	8.1
Current liabilities	(0.1)
Redeemable noncontrolling interest	(2.5)
Fair value of total consideration transferred	\$ 6.6

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 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 value recognized as an adjustment to retained earnings, or in the absence of retained earnings, by adjustment to additional paid-in-capital.

The noncontrolling interest is redeemable at other than fair value as the redemption value is determined based on a specified formula. The noncontrolling interest becomes redeemable after the passage of time, and therefore the Company records the carrying amount of the noncontrolling interest at the greater of 1) the initial carrying amount, increased or decreased for the noncontrolling interest's share of net income or loss, or 2) the redemption value.



Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****10. Redeemable Noncontrolling Interest (Continued)**

According to ASC 480-10-S99, *Accounting for Redeemable Equity Instruments*, to the extent that the noncontrolling interest holder has the contractual right to receive an amount upon share redemption that is other than fair value of such shares, only the portion of the periodic adjustment to the instrument's carrying amount that reflects redemption in excess of fair value is treated like a dividend for earnings per share computation purposes. No adjustment to the earnings per share computation was necessary as estimated fair value of the noncontrolling interest is greater than the redemption value.

***Middlebury College Joint Venture***

In May 2010, the Company entered into an agreement to establish a joint venture with Middlebury College ("Middlebury") to form Middlebury Interactive Languages LLC ("MIL"). The venture creates and distributes innovative, high-quality online language courses under the trademark Middlebury and other marks. At any time after the fifth (5th) anniversary of forming the joint venture, Middlebury may give written notice of its irrevocable election to sell 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.

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.

On May 4, 2015, Middlebury College, under the joint venture agreement, exercised its right to require the Company to purchase all of its ownership interest in the joint venture at a mutually agreed upon fair market value or for a value to be determined by an independent valuation. The Company has the right to pay the redemption cost in cash, stock or a combination thereof, at the Company's option, which form of consideration has not yet been determined.

The following is a summary of the activity of the redeemable noncontrolling interest at June 30, 2015 and 2014:

<b>(In thousands)</b>	<b>Value</b>
Balance of redeemable noncontrolling interest at June 30, 2013	\$ 15,200
Net loss	(1,319)
Net proceeds from noncontrolling interest contribution	1,275
Adjustment to redemption value	1,645
Balance of redeemable noncontrolling interest at June 30, 2014	\$ 16,801
Net loss	(1,662)
Acquisition of LearnBop	2,500
Adjustment to redemption value	(8,038)
Balance of redeemable noncontrolling interest at June 30, 2015	\$ 9,601

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**11. Commitments and Contingencies**

*Litigation*

In the ordinary conduct of the Company's business, the Company is subject to lawsuits, arbitrations and administrative proceedings from time to time. The Company believes that the outcome of any existing or known threatened proceedings, even if determined adversely, should not have a material adverse effect on the Company's business, financial condition, liquidity or results of operations.

*Employment Agreements*

The Company has entered into employment agreements with certain executive officers that provide for severance payments and, in some cases other benefits, upon certain terminations of employment. Except for the agreements with the Company's CEO that have three year terms, all other agreements provide for employment on an "at-will" basis. If the employee is terminated for "good reason" or without cause, the employee is entitled to salary continuation, and in some cases benefit continuation, for varying periods depending on the agreement.

*Off-Balance Sheet Arrangements*

The Company provided guarantees of approximately \$9.2 million related to lease commitments on the buildings for certain of the Company's Flex schools. The Company contractually guarantees that certain schools under the Company's management will not have annual operating deficits and the Company's management fees from these schools may be reduced accordingly to cover any school operating deficits. Other than these lease and operating deficit guarantees, the Company did not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

**12. Acquisitions and Investments**

*Investment in Web International Education Group Ltd. (Web)*

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 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 the Company accrued interest up through December 31, 2014. However, given the difficulties in expatriating money from China, and the resulting administrative hurdles related to collecting this receivable, starting January 1, 2015, the Company discontinued the accrual of interest. However, during Q4 2015, and upon further negotiation with Web, the Company wrote off the full amount of accrued interest totaling \$3.2 million. This amount was recorded in interest expense, net and other, for the year ended June 30, 2015. Despite this, the Company and Web continue to mutually work toward a mechanism for collection of the principal.

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**12. Acquisitions and Investments (Continued)**

During the years ended June 30, 2015, 2014 and 2013, the Company recorded interest income of zero, \$0.8 million and \$2.0 million, respectively, associated with Web.

***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 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.

During June 2015, the Company engaged a 3rd party valuation firm to conduct an appraisal of the property to assess market value at June 30, 2015. The appraisal concluded a market value in excess of the note carrying value.

***Acquisition of LearnBop Inc.***

On July 31, 2014, the Company acquired a majority interest in LearnBop Inc. ("LearnBop"), for \$6.6 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. For further information, see Note 10.

**13. Sale and Deconsolidation of Assets**

On June 11, 2014, the Company sold an asset group comprised of certain domestic and international business and assets including Capital Education a post-secondary education product, a brick and mortar school named the International School of Berne, and the Company's 60% interest in the Middle East Joint Venture ("Middle East JV") to Safanad Education Ventures Limited ("Safanad"). Safanad is an affiliate of Safanad Limited, the Company's former partner in the Middle East JV. There was no retained interest in the disposed businesses and, as a result of the loss of control in the sale, the Company deconsolidated the assets recording a non-operating gain of approximately \$6.4 million. In aggregate, these businesses were responsible for \$16.9 million in revenue for the year ended June 30, 2014.

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**K12 Inc.**

**Notes to Consolidated Financial Statements (Continued)**

**13. Sale and Deconsolidation of Assets (Continued)**

As part of the transaction, the Company entered into a services agreement to license, host and provide other related services to use its curriculum and technology for education services in limited territories and markets as defined by the agreement. In addition, the Company entered into a Transition Services Agreement (TSA) with Safanad to provide various administrative and support services.

**14. Related Party Transactions**

During the fiscal year ended June 30, 2014, 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 June 30, 2015 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. Also see Note 12.

**15. Employee Benefits**

The Company maintains a 401(k) salary deferral plan (the "401(k) Plan") for its employees. Employees who have been employed for at least 30 days may voluntarily contribute to the Plan on a pretax basis, up to the maximum allowed by the Internal Revenue Service. The 401(k) Plan provides for a matching Company contribution of 25% of the first 4% of each participant's compensation, which begins following six months of service with full vesting after three years of service. The Company expensed \$1.8 million, \$3.7 million and \$2.6 million during each of the years ended June 30, 2015, 2014 and 2013, respectively under the 401(k) Plan.

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****16. Supplemental Disclosure of Cash Flow Information**

(In thousands)	Year Ended June 30,		
	2015	2014	2013
Cash paid for interest	\$ 1,051	\$ 1,054	\$ 1,237
Cash paid for taxes	\$ 19,390	\$ 9,134	\$ 1,517
<b>Supplemental disclosure of non-cash investing and financing activities:</b>			
Property and equipment financed by capital lease obligations	\$ 14,654	\$ 24,132	\$ 24,703
<b>Business Combinations</b>			
Current Assets	\$ 27	\$	\$
Capitalized software development costs	\$ 940	\$	\$
Goodwill	\$ 8,101	\$	\$
Assumed liabilities	\$ (50)	\$	\$
Deferred revenue	\$ (23)	\$	\$

**17. Common Stock Repurchases**

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 are dependent upon business and market conditions and other factors. The stock purchases are made from time to time and may be made through a variety of methods including open market purchases and trading plans that may be adopted in accordance with the Rule 10b5-1 of the Exchange Act. For fiscal year ended June 30, 2015, the Company paid approximately \$26.5 million in cash to redeem 1,307,402 shares of common stock at an average price of \$20.23 per share. As of June 30, 2015 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.

**18. Quarterly Results of Operations (Unaudited)**

The unaudited consolidated interim financial information presented should be read in conjunction with other information included in the Company's consolidated financial statements. The following unaudited consolidated financial information reflects all adjustments necessary for the fair presentation of

Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****18. Quarterly Results of Operations (Unaudited) (Continued)**

the results of interim periods. The following tables set forth selected unaudited quarterly financial information for each of the Company's last eight quarters.

	Jun 30, 2015	Mar 31, 2015	2015 Dec 31, 2014	Sep 30, 2014
	(In thousands)			
<b>Consolidated Quarterly Statements of Operations</b>				
<b>Revenues</b>	\$ 235,655	\$ 244,623	\$ 231,304	\$ 236,712
<b>Cost and expenses</b>				
Instructional costs and services	166,900	148,985	145,029	146,842
Selling, administrative and other operating expenses	80,756	64,871	62,557	99,546
Product development expenses	4,317	3,337	3,245	3,482
<b>Total costs and expenses</b>	251,973	217,193	210,831	249,870
<b>(Loss) income from operations</b>	(16,318)	27,430	20,473	(13,158)
<b>Interest (expense), net and other</b>	(3,158)	(315)	151	31
<b>(Loss) income before income tax expense and noncontrolling interest</b>	(19,476)	27,115	20,624	(13,127)
<b>Income tax income (expense)</b>	6,901	(10,586)	(8,663)	6,538
<b>Net (loss) income</b>	(12,575)	16,529	11,961	(6,589)
<b>Add net loss attributable to noncontrolling interest</b>	995	484	370	(187)
<b>Net (loss) income attributable to common stockholders, including Series A stockholders</b>	\$ (11,580)	\$ 17,013	\$ 12,331	\$ (6,776)
<b>Net (loss) income attributable to common stockholders per share, excluding Series A stockholders:</b>				
Basic	\$ (0.31)	\$ 0.46	\$ 0.33	\$ 0.18
Diluted	\$ (0.31)	\$ 0.45	\$ 0.33	\$ 0.18
<b>Weighted average shares used in computing per share amounts:</b>				
Basic	37,318,085	37,211,634	37,096,480	37,695,681
Diluted	37,318,085	37,408,911	37,160,829	37,695,681





Table of Contents**K12 Inc.****Notes to Consolidated Financial Statements (Continued)****18. Quarterly Results of Operations (Unaudited) (Continued)**

	Jun 30, 2014	Mar 31, 2014	2014 Dec 31, 2013	Sep 30, 2013
	(In thousands)			
<b>Consolidated Quarterly Statements of Operations</b>				
<b>Revenues</b>	\$ 232,046	\$ 235,222	\$ 223,919	\$ 228,366
<b>Cost and expenses</b>				
Instructional costs and services	142,053	140,592	153,672	132,902
Selling, administrative and other operating expenses	74,847	64,414	75,753	98,244
Product development expenses	2,303	2,831	3,402	5,684
<b>Total costs and expenses</b>	219,203	207,837	232,827	236,830
<b>Income (loss) from operations</b>	12,843	27,385	(8,908)	(8,464)
<b>Realized gain on sale of assets</b>	6,404			
<b>Interest (expense), net and other</b>	55	(12)	(28)	(84)
<b>Income before income tax expense and noncontrolling interest</b>	19,302	27,373	(8,936)	(8,548)
<b>Income tax (expense) income, net</b>	(7,349)	(11,861)	4,685	3,450
<b>Net income (loss)</b>	11,953	15,512	(4,251)	(5,098)
<b>Add net loss attributable to noncontrolling interest</b>	403	437	586	58
<b>Net income (loss) attributable to common stockholders, including Series A stockholders</b>	\$ 12,356	\$ 15,949	\$ (3,665)	\$ (5,040)
<b>Net income (loss) attributable to common stockholders per share, excluding Series A stockholders:</b>				
Basic	\$ 0.32	\$ 0.40	\$ (0.09)	\$ (0.13)
Diluted	\$ 0.32	\$ 0.40	\$ (0.09)	\$ (0.13)
<b>Weighted average shares used in computing per share amounts:</b>				
Basic	38,540,464	39,596,798	39,977,228	37,868,928
Diluted	38,742,379	39,596,798	39,977,228	37,868,928

The loss before income tax expense and noncontrolling interest for the fourth quarter of fiscal year 2015 included \$28.4 million of total expense from bad debt expense, the write-off of capitalized software and curriculum that will no longer be used or developed, certain computer peripherals and other fixed assets that will not be reclaimed, severance and related stock-based compensation, the write-off of previously recorded interest income, and additional provisions for inventory that the Company previously anticipated using. The loss before income tax expense and noncontrolling interest for the second quarter of fiscal year 2014 included \$31.2 million of total expense from 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 the Company previously anticipated using.

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## SCHEDULE II

**K12 INC**  
**VALUATION AND QUALIFYING ACCOUNTS**  
**YEARS ENDED June 30, 2015, 2014, and 2013**

**1. ALLOWANCE FOR DOUBTFUL ACCOUNTS**

	Balance at Beginning of Period	Additions Charged to Cost and Expenses	Deductions from Allowance	Balance at End of Period
June 30, 2015	\$ 3,459,928	9,299,766	3,102,602	\$ 9,657,092
June 30, 2014	\$ 2,560,207	1,438,964	539,243	\$ 3,459,928
June 30, 2013	\$ 1,623,974	2,070,033	1,133,800	\$ 2,560,207

**2. INVENTORY RESERVE**

	Balance at Beginning of Period	Charged to Cost and Expenses	Deductions, Shrinkage and Obsolescence	Balance at End of Period
June 30, 2015	\$ 9,056,142	1,405,988	8,269,896	\$ 2,192,234
June 30, 2014	\$ 4,893,783	4,292,974	130,615	\$ 9,056,142
June 30, 2013	\$ 4,506,981	386,802		\$ 4,893,783

**3. COMPUTER RESERVE(1)**

	Balance at Beginning of Period	Additions (Deductions) Charged to Cost and Expenses	Deductions, Shrinkage and Obsolescence	Balance at End of Period
June 30, 2015	\$ 1,462,424	379,030	809,201	\$ 1,032,253
June 30, 2014	\$ 1,988,400	1,862,553	2,388,529	\$ 1,462,424
June 30, 2013	\$ 1,507,299	482,188	1,087	\$ 1,988,400

(1)

A reserve account is maintained against potential obsolescence and unreturned computers provided to the Company's students. The reserve is calculated based upon several factors including historical percentages, the net book value and the remaining useful life. During fiscal years 2015, 2014 and 2013, certain computers were written off against the reserve.

**4. INCOME TAX VALUATION ALLOWANCE**

	Balance at Beginning of Period	Additions to Net Deferred Tax Asset Allowance	Deductions in Net Deferred Tax Asset Allowance	Balance at End of Period
June 30, 2015	\$ 1,968,482	1,352,231	529,680	\$ 2,791,033
June 30, 2014	\$ 1,268,966	699,516		\$ 1,968,482
June 30, 2013	\$ 1,065,829	203,137		\$ 1,268,966

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**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As required by Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act") management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports the Company files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding our required disclosure. In designing and evaluating our 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 applies its judgment in evaluating and implementing possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2015, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.

**Management's Annual Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting.

Internal control over financial reporting refers to a process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our board of directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these

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inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Management evaluated the effectiveness of our internal control over financial reporting as of June 30, 2015 using the framework set forth in the report of the Treadway Commission's Committee of Sponsoring Organizations (COSO), "Internal Control Integrated Framework (2013)." As a result of management's evaluation of our internal control over financial reporting, management concluded that as of June 30, 2015, our internal control over financial reporting was effective. The effectiveness of our internal control over financial reporting as of June 30, 2015 has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in its report which appears on page 128 of this Annual Report on Form 10-K.

*Changes in Internal Control over Financial Reporting:*

In addition, management carried out an evaluation, as required by Rule 13a-15(d) of the Exchange Act, under supervision of the Chief Executive Officer and Chief Financial Officer, of changes in the Company's internal control over financial reporting. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that there were no changes in the Company's internal control over financial reporting that occurred during the last fiscal year that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders  
K12 Inc.  
Herndon, Virginia

We have audited K12 Inc. and subsidiaries' (the Company) internal control over financial reporting as of June 30, 2015, based on criteria established in Internal Control Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). K12 Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying "Item 9A, Management's Annual Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, K12 Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of K12 Inc. and subsidiaries as of June 30, 2015 and 2014 and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended June 30, 2015 and our report dated August 4, 2015 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

Bethesda, Maryland  
August 4, 2015

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**ITEM 9B. OTHER INFORMATION**

On August 3, 2015, Mr. Timothy L. Murray, President and Chief Operating Officer of K12 Inc. (the "Company"), notified the Company of his intent to resign effective September 15, 2015. The Company and Mr. Murray have entered into a Consulting Agreement, effective September 16, 2015, whereby Mr. Murray will provide transition and other consulting services for a term of up to six months and payment of \$43,985.00 per month for services rendered.

**PART III**

We will file a definitive Proxy Statement for our 2015 Annual Meeting of Stockholders (the "2015 Proxy Statement") with the SEC, pursuant to Regulation 14A, not later than 120 days after the end of our fiscal year. Accordingly, certain information required by Part III has been omitted under General Instruction G(3) to Form 10-K. Only those sections of the 2015 Proxy Statement that specifically address the items set forth herein are incorporated by reference.

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by Item 10 is hereby incorporated by reference to our 2015 Proxy Statement under the captions "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance."

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by Item 11 is hereby incorporated by reference to our 2015 Proxy Statement under the captions "Executive Compensation" and "Director Compensation."

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS, MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by Item 12 is hereby incorporated by reference to our 2015 Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management."

**ITEM 13. CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information required by Item 13 is hereby incorporated by reference to our 2015 Proxy Statement under the captions "Certain Transactions" and "Director Independence."

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by Item 14 is hereby incorporated by reference to our 2015 Proxy Statement under the caption "Independent Registered Public Accounting Firm Fees."

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

- (a)
  - (1) *Financial Statements.*

The information required by this item is incorporated herein by reference to the financial statements and notes thereto listed in Item 8 of Part II and included in this Annual Report.

- (a)
  - (2) *Financial Statement Schedules.*

## Edgar Filing: K12 INC - Form 10-K

Except for Schedule II which was presented separately, all financial statement schedules are omitted because the required information is included in the financial statements and notes thereto listed in Item 8 of Part II and included in this Annual Report.

(c)

*Exhibits.*

The following exhibits are incorporated by reference or filed herewith.

See Exhibit Index



Table of Contents**SIGNATURES**

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

**K12 INC.**

By: /s/ NATHANIEL A. DAVIS

Name: Nathaniel A. Davis  
 Title: *Chief Executive Officer*  
 August 4, 2015

**POWER OF ATTORNEY**

Know all persons by these presents, that each person whose signature appears below constitutes and appoints Nathaniel A. Davis, James J. Rhyu and Howard D. Polsky, and each of them severally, his or her true and lawful attorney-in-fact with power of substitution and resubstitution to sign in his or her name, place and stead, in any and all capacities, to do any and all things and execute any and all instruments that such attorney may deem necessary or advisable under the Securities Exchange Act of 1934, as amended, and any rules, regulations and requirements of the U.S. Securities and Exchange Commission in connection with the Annual Report on Form 10-K and any and all amendments hereto, as fully for all intents and purposes as he or she might or could do in person, and hereby ratifies and confirms all said attorneys-in-fact and agents, each acting alone, and his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
<u>/s/ NATHANIEL A. DAVIS</u> Nathaniel A. Davis	Chief Executive Officer (Principal Executive Officer)	August 4, 2015
<u>/s/ JAMES J. RHYU</u> James J. Rhyu	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	August 4, 2015
<u>/s/ CRAIG R. BARRETT</u> Craig R. Barrett	Director	August 4, 2015
<u>/s/ GUILLERMO BRON</u> Guillermo Bron	Director	August 4, 2015

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<b>Signature</b>	<b>Title</b>	<b>Date</b>
<u>/s/ FREDDA J. CASSELL</u>	Director	
Fredda J. Cassell		August 4, 2015
<u>/s/ ADAM L. COHN</u>	Director	
Adam L. Cohn		August 4, 2015
<u>/s/ JOHN M. ENGLER</u>	Director	
John M. Engler		August 4, 2015
<u>/s/ STEVEN B. FINK</u>	Director	
Steven B. Fink		August 4, 2015
<u>/s/ MARY H. FUTRELL</u>	Director	
Mary H. Futrell		August 4, 2015
<u>/s/ JON Q. REYNOLDS</u>	Director	
Jon Q. Reynolds		August 4, 2015
<u>/s/ ANDREW H. TISCH</u>	Director	
Andrew H. Tisch		August 4, 2015

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**Exhibit Index**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
3.1	Third Amended and Restated Certificate of Incorporation of K12 Inc. (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2007, filed with the SEC on February 14, 2008, File No. 001-33883).
3.2	Amended and Restated Bylaws of K12 Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2007, filed with the SEC on February 14, 2008, File No. 001-33883).
3.3	Amendment to the Amended and Restated Bylaws of K12 Inc., dated November 21, 2013 (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on November 27, 2013, File No. 001-33883).
4.1	Form of stock certificate of common stock (incorporated by reference to Exhibit 4.1 to the Registrant's Amendment No. 4 to Registration Statement on Form S-1, filed with the SEC on November 8, 2007, File No. 333-144894).
4.2*	Amended and Restated Stock Option Plan and Amendment thereto (incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-1, filed with the SEC on July 27, 2007, File No. 333-144894).
4.3*	Form of Stock Option Agreement Employee (incorporated by reference to Exhibit 4.3 to the Registrant's Registration Statement on Form S-1, filed with the SEC on July 27, 2007, File No. 333-144894).
4.4	Form of Stock Option Agreement Director (incorporated by reference to Exhibit 4.4 to the Registrant's Registration Statement on Form S-1, filed with the SEC on July 27, 2007, File No. 333-144894).
4.5*	K12 Inc. 2007 Equity Incentive Award Plan, as amended (incorporated by reference to Exhibit 4.6 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2014, filed with the SEC on August 15, 2014, File No. 001-33883).
4.6*	Form of Indemnification Agreement for Non-Management Directors and for Officers of K12 Inc. (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2008, filed with the SEC on November 14, 2008, File No. 001-33883).
4.7	Form of Director's Indemnification Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on October 22, 2008, File No. 001-33883).
4.8	Form of Second Amended and Restated Stockholders Agreement (incorporated by reference to Exhibit 4.5 to the Registrant's Registration Statement on Form S-1, filed with the SEC on July 27, 2007, File No. 333-144894).
10.1*	Amendment to Amended and Restated Stock Option Agreement, dated December 23, 2010 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2010, filed with the SEC on February 9, 2011, File No. 001-33883).
10.2*	Employment Agreement for Nathaniel A. Davis, effective January 7, 2013 (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2012, filed with the SEC on February 5, 2013, File No. 001-33883).

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<b>Exhibit No.</b>	<b>Description of Exhibit</b>
10.3*	First Amendment to Employment Agreement for Nathaniel A. Davis, effective January 7, 2013 (incorporated by reference to Exhibit 10.28 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2013, filed with the SEC on August 29, 2013, File No. 001-33883).
10.4*	Amended and Restated Employment Agreement for Nathaniel A. Davis, effective March 10, 2014 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, filed with the SEC on April 29, 2014, File No. 001-33883).
10.5*	Employment Agreement of Timothy L. Murray, dated March 7, 2012 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2012, filed with the SEC on May 9, 2012, File No. 001-33883).
10.6*	First Amendment to Employment Agreement of Timothy L. Murray, effective December 19, 2013 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2013, filed with the SEC on February 4, 2014, File No. 001-33883).
10.7*	Second Amendment to Employment Agreement of Timothy L. Murray, effective November 24, 2014 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2014, filed with the SEC on January 29, 2015, File No. 001-33883).
10.8*	Employment Agreement of James J. Rhyu, dated May 1, 2013 (incorporated by reference to Exhibit 10.29 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2013, filed with the SEC on August 29, 2013, File No. 001-33883).
10.9*	Employment Agreement of Howard D. Polsky, dated June 1, 2004 (incorporated by reference to Exhibit 10.16 to the Registrant's Amendment No. 1 to Registration Statement on Form S-1, filed with the SEC on September 26, 2007, File No. 333-144894).
10.10*	First Amendment to Employment Agreement of Howard D. Polsky, dated June 1, 2004 (incorporated by reference to Exhibit 10.18 to the Registrant's Amendment No. 4 to Registration Statement on Form S-1, filed with the SEC on November 8, 2007, File No. 333-144894).
10.11	Educational Products and Services Agreement between the Agora Cyber Charter School and K12 Virtual Schools LLC, dated November 13, 2009 (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, filed with the SEC on May 3, 2013, File No. 001-33883).
10.12	First Amendment to the Educational Products and Services Agreement between the Agora Cyber Charter School and K12 Virtual Schools LLC, dated April 8, 2010 (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, filed with the SEC on May 3, 2013, File No. 001-33883).
10.13	Second Amended and Restated Educational Products and, Administrative, and Technology Services Agreement between the Ohio Virtual Academy and K12 Ohio L.L.C., dated April 19, 2007 (incorporated by reference to Exhibit 10.21 to Amendment No. 4 to the Registrant's Registration Statement on Form S-1, filed with the SEC on November 8, 2007, File No. 333-144894).

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<b>Exhibit No.</b>	<b>Description of Exhibit</b>
10.14	Deed of Lease by and between ACP/2300 Corporate Park Drive, LLC and K12 Inc., dated December 7, 2005 (incorporated by reference to Exhibit 10.13 to the Registrant's Amendment No. 1 to Registration Statement on Form S-1, filed with the SEC on September 26, 2007, File No. 333-144894).
10.15	First Amendment to Deed of Lease by and between ACP/2300 Corporate Park Owner, LLC and K12 Inc., dated November 30, 2006 (incorporated by reference to Exhibit 10.21 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2008, filed with the SEC on September 26, 2008, File No. 001-33883).
10.16	Second Amendment to Deed of Lease by and between ACP/2300 Corporate Park Owner, LLC and K12 Inc., dated March 26, 2007 (incorporated by reference to Exhibit 10.22 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2008, filed with the SEC on September 26, 2008, File No. 001-33883).
10.17	Credit Agreement, dated January 31, 2014, by and among K12 Inc., certain of K12's subsidiaries, Bank of America, N.A., and the other lenders party thereto (incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2013, filed with the SEC on February 4, 2014, File No. 001-33883).
10.18*	Form of Stock Option Agreement under the 2007 Equity Incentive Award Plan, as amended, filed herewith.
10.19*	Form of Restricted Stock Award Agreement under the 2007 Equity Incentive Award Plan, as amended, filed herewith.
21.1	Subsidiaries of K12 Inc.
23.1	Consent of BDO USA, LLP.
24.1	Power of Attorney (included in signature pages).
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.INS#	XBRL Instance Document
101.SCH#	XBRL Taxonomy Extension Schema
101.CAL#	XBRL Taxonomy Extension Calculation
101.LAB#	XBRL Taxonomy Extension Labels
101.PRE#	XBRL Taxonomy Extension Presentation
101.DEF#	XBRL Taxonomy Extension Definition

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Denotes management compensation plan or arrangement.

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Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files included in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those Sections.