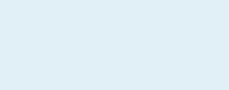
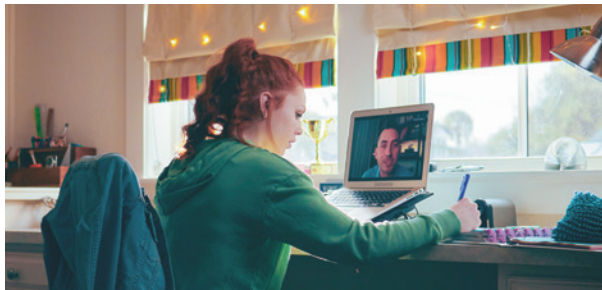
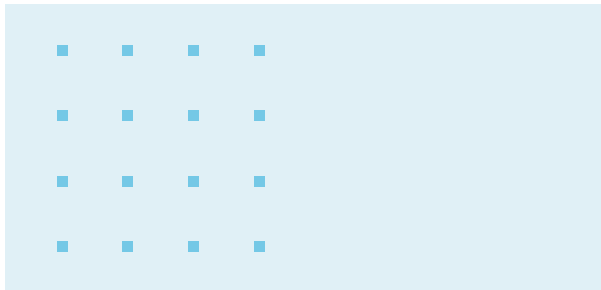
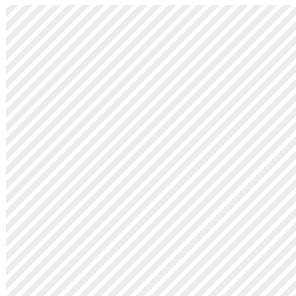
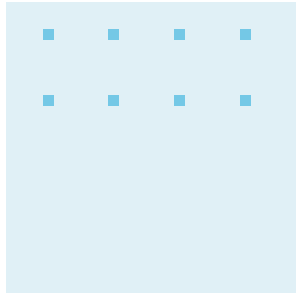
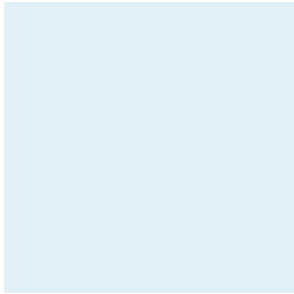




ANNUAL REPORT



2020





NATHANIEL A. DAVIS

Chief Executive Officer
and Chairman



OUR MISSION

WE HELP STUDENTS REACH THEIR FULL
POTENTIAL THROUGH INSPIRED TEACHING
AND PERSONALIZED LEARNING.

TO OUR FELLOW SHAREHOLDERS:

When Dr. Jennalyn Crapuchettes was a child, her younger sister developed a rare genetic disorder and needed a bone marrow transplant. As a result, her family did everything they could to decrease the number of germs in their house. Part of this plan included enrolling Jennalyn in classes at Idaho Virtual Academy.

She didn't know it then, but online school and her sister's illness would change the trajectory of Jennalyn's life. She recently graduated with a doctoral degree in pharmacy from Idaho State University and says online school helped her reach this dream.

"Because of my online education experience in high school, I was an independent learner," Jennalyn says. "And by the time I got to college, I was already well prepared."

I tell you this story because, at K12, we have an opportunity—an obligation, even—to lead more students like Jennalyn on a path to fulfilling their academic, personal, and career dreams too.

DURING THIS TRULY UNPRECEDENTED TIME IN OUR COUNTRY, STUDENTS—OF EVERY AGE, RACE, CREED, GENDER, RELIGION, AND BACKGROUND—NEED TO KNOW AND BELIEVE THAT **ANYTHING STILL IS POSSIBLE.**

That's why, today, our mission at K12 is even more critical: we help students reach their full potential through inspired teaching and personalized learning.

I am proud that this mission has continued to guide us as we help provide a high-quality online education for families across the nation—particularly those whose plans and goals have been upended by the coronavirus.



GABBY

Florida Online School
Student, 2020

“ I THINK GROUP PROJECTS ARE GOOD BECAUSE YOU GET DIFFERENT PERSPECTIVES. YOU LEARN HOW TO COLLABORATE BETTER, YOU LEARN HOW TO DO THINGS, NOT JUST IN YOUR OWN WAY, BUT THE WAY EVERYBODY ELSE WANTS TO. ”

Amid the pandemic this year, we used our twenty years of experience to offer many valuable online learning resources for students, teachers, and school districts in every region of the country. This includes online curriculum, webinars, Facebook and Instagram live sessions, platforms, training, and technical assistance.

TO DATE, MORE THAN 200,000 STUDENTS, FAMILIES, AND TEACHERS HAVE USED THESE ONLINE TOOLS.

It's been truly amazing to see the hard work and dedication of our incredible network of online teachers, administrators, school leaders, and staff members as we continue to move the needle on online education.



TEAM PROJECT FOSTERS NEW DREAM

Gabby, a student at Florida Online School, was selected by her team to be the leader of their “Building Better Bikes” project. The group’s assignment was to perform an operational analysis for a bike shop struggling with inventory management and cash flow.

They visited a local bike shop to better understand the business and then developed real-life strategies to address their shop’s challenges.

The project not only helped Gabby understand how to run a business; it also sparked a new dream. Now she’s thinking about starting a bakery that specializes in Puerto Rican desserts.

The widespread and increasing interest in K12’s academic and career learning programs highlight an important fact—this period in time is a game-changing moment to show our country and the world how strong and effective online programs can be.

To this end, this year’s Annual Report highlights the work we have done—and continue to do—to meet the critical educational and workforce challenges facing our communities today.

Our tireless efforts to strengthen the customer and academic experience for K–12 students, our initiatives that support a diverse range of adult learners, and our devotion to preparing every student for a digital-first workplace is fostering our growth and solidifying our position as a world-class education services company.



PARTNERING WITH INDUSTRIES TO PROVIDE A PATH TO A REWARDING CAREER

Over the past two decades, the number of Americans retiring has nearly doubled. That number will continue to rise through 2030 when baby boomers will be older than 65.¹ It's becoming increasingly clear that we need to do more to prepare students to seize the opportunities retirees leave behind.

At Tyson Foods, one of the world's largest food companies, nearly 60 percent of industrial maintenance and refrigeration employees are 50 years old or older.²

THE COMPANY IS TAKING A CREATIVE APPROACH TO FILLING THESE ESSENTIAL JOBS AFTER THEIR CURRENT WORKERS RETIRE—IT'S PARTNERING WITH SCHOOLS ACROSS THE COUNTRY LIKE **ARKANSAS VIRTUAL ACADEMY**.

Through this unique partnership, high school students are getting exposed to potential career paths they may not even know exist. This is crucial, whether students are planning to pursue a four-year college degree, enter the workforce right after high school, or do both.

There's no single path that guarantees success. If we want our kids to find more than just a job—if we want them to find fulfilling, rewarding, long-lasting opportunities instead—career learning opportunities like this are valuable tools to help them get there.

PREPARING STUDENTS FOR A DIGITAL-FIRST WORKPLACE

At K12—whether we are helping students achieve at least one year of academic growth, refining our special education and honors courses, or creating more opportunities for tutoring support—we want every student to relish their role as a lifelong learner.

As part of this commitment, we encourage middle and high school students to consider their post-graduation plans. However, that doesn't exclusively mean getting a four-year college degree. They want and need the option of entering a career or the military right out of high school. K12's Destinations Career Academies (DCAs) help provide them with a diploma, industry exposure, and skills training to do exactly that.

The ongoing pandemic has made career preparation even more vital. Research shows that "40 percent of U.S. households earning less than \$40,000 a year lost their jobs in March" of this year, and the unemployment rate rose to nearly 15 percent in April, the highest rate since the Great Depression.³

These figures speak to the need to prepare a new generation for jobs that are pandemic and recession-proof. Career learning programs are a way to get there. Over the last three years, we have successfully built a comprehensive and innovative approach to career learning.

TO DATE, THIS SEGMENT OF OUR COMPANY HAS SERVED MORE THAN 13,000 STUDENTS AND POSTED MORE THAN \$100 MILLION IN REVENUES.

With our DCAs, we provide students with both the academic and the professional skills they need to succeed in the digital-first workplace. This year, we expanded our career learning programs into middle school grades in seven schools, allowing students to get a jump start on career exploration. That means, in total, more than 9 million students across the nation now have access to a K12-powered career learning option.

¹ United States Census Bureau, "Older People Projected to Outnumber Children for First Time in U.S. History", March 2018

² Tyson Foods, "Tackling the Skills Gap in Industrial Maintenance", October 2018

³ The Hill, "40 percent of households earning less than \$40K lost jobs in March: Fed chairman", May 2020

MORE THAN JUST CURRICULUM

Many K12-powered programs also offer project-based learning opportunities that mimic the real-world working environment for students. This school year, we rolled out sixteen new project-based learning courses in subjects like entrepreneurship, marketing, healthcare, and computer literacy—just to name a few. This learning approach keeps students more engaged and makes classes more collaborative.

Other career learning programs provide the chance to earn college credits and a high school diploma. Some students can even earn an associate's degree. In addition to acquiring these “dual credits,” students will experience their first taste of attending college while still in high school and may reduce the long-term cost of earning a postsecondary degree.

TO SUPPORT THIS RAPIDLY GROWING PART OF OUR COMPANY, OUR CAREER LEARNING TEAMS ARE HARD AT WORK PREPARING TO OPEN NEW DCAs NEXT YEAR AND STEADILY **EXPANDING OUR CAREER LEARNING PROGRAMS** FOR MIDDLE AND HIGH SCHOOL STUDENTS.

They are also establishing new partnerships with industry leaders and enhancing the DCA curriculum. Additionally, in conjunction with our partners Nepris and Tallo, we expose students to the professional skills and expertise they will need to set themselves apart amid an increasingly competitive workforce.

Importantly, Tallo—the nation’s premier online platform for connecting students with employers, colleges, and universities—reached a significant milestone as they surpassed one million talent users on their platform. That’s almost double the number of users who were on the platform a year ago.

CREATING FUTURE CAREERS FROM THE COMFORT OF HOME

Theo is a science-loving middle school student. His brother, Red, is already working as a professional animator. At Oregon Virtual Academy, both brothers are laser-focused on their passions and even preparing for future careers.

Theo's favorite class activities are labs—like using gummy bears to learn about osmosis. He wants to study zoology to become a veterinarian. Red manages his time so he can attend class, balance school assignments and animation work, and attend studio meetings in different time zones. Plus, his online teachers are available to guide him in achieving his goals.

Red is taking career-focused electives in online school too. In marketing class, he's learning how to appeal to specific audiences using social media, which will come in handy for promoting his future short films.



“ I VIEW ONLINE LEARNING AS A VERY POSITIVE THING ... IT IS A REALLY GOOD OPPORTUNITY TO GET INTO MY OWN INTERESTS. ”

RED

Oregon Virtual Academy
Student, 2020

SUPPORTING ADULT LEARNERS

At K12, we believe students of every age and background deserve an equal shot at a rewarding educational experience and a professional career. This principle drives us to prioritize academic outcomes and work toward building the world's leading career learning program.

To support this effort, we expanded our career learning model this year to serve adult learners and address evolving workforce needs in the high-demand field of information technology.

ACCORDING TO THE U.S. BUREAU OF LABOR STATISTICS, EMPLOYMENT IS EXPECTED TO GROW BY SIX MILLION JOBS OVER THE NEXT NINE YEARS.⁴

At the top of the list for in-demand jobs, now and in the future, are software engineers and data scientists. However, despite the growing demand for these roles, they are some of the most challenging positions to fill.

This year, to better address this skills gap, we acquired Galvanize Inc., one of the nation's leading companies in developing software engineering and data science capabilities for adult learners.



⁴ U.S. Bureau of Labor Statistics, "Employment Projections: 2019-2029 Summary", September 2020



THE WEEK THAT LAUNCHED THOUSANDS OF CAREERS

K12's second annual Job Shadow Week provided an opportunity for more than 3,000 ambitious middle school and high school students nationwide to connect with career professionals and discover opportunities for life after graduation.

During a summer in which internships have been cut in half, experiences like Job Shadow Week prepare students for the future of work, introducing them to career paths and giving them exposure to the professional skills they'll need to succeed.

Originally planned as a collection of in-person events nationwide, Job Shadow Week 2020 was transitioned to a virtual offering due to COVID-19 restrictions. For five days, students participated in live chats with career professionals and accessed 9,000 sessions across multiple industries. Participating organizations included nonprofits, local companies, and large national companies like Google, Salesforce, and YouTube.

more than

3,000

MIDDLE SCHOOL AND HIGH SCHOOL PARTICIPANTS

“ WHETHER STUDENTS ARE LOOKING FOR IDEAS FOR THEIR FUTURE OR ACTIVELY PURSUING JOBS IN FINANCE, MANUFACTURING, HEALTH CARE, OR PUBLIC SERVICE, HAVING A FLUENCY WITH CAREER OPTIONS AND A COMFORT LEVEL WITH PROFESSIONAL INTERACTIONS ONLINE IS GOING TO SET THEM UP FOR SUCCESS IN THE JOB MARKET. ”

JOB SHADOW WEEK

LEILANI M. BROWN

K12's Senior Vice President of Strategic Partnerships and External Engagement, 2020



**HARSH
PATEL**

Galvanize CEO

“ I AM PROUD TO JOIN K12 IN OUR SHARED GOAL TO BRIDGE THE GAP BETWEEN INDUSTRY DEMANDS AND EDUCATION. TOGETHER, WE WILL PREPARE MORE LEARNERS TO THRIVE IN THE MODERN DIGITAL ECONOMY. ”



LEARNING IS A LIFELONG JOURNEY

With a background in K–12 teaching, Galvanize CEO Harsh Patel has devoted his career to highlighting the intersection between education, engineering, and business. This trajectory eventually led him to his current position with Galvanize, one of the country’s top workforce training providers in software engineering and data science.

Like K12, Galvanize provides high-quality, affordable learning programs. Amid the pandemic, its core immersive bootcamp and enterprise businesses are being provided fully online. The Galvanize team is also setting up more virtual programming, including mentor sessions and coffee chats, to help their members continue to grow their businesses.

This year, companies like USAA, T-Mobile, and Ally Financial have hired Galvanize to upskill portions of their IT talent base, which is a cost-efficient way to re-train existing employees. And Galvanize is not limiting its enterprise efforts to the U.S. The team has fielded interest from companies in Germany, Mexico, Saudi Arabia, Pakistan, and India. As the economy begins to recover, K12 anticipates increased interest from enterprises across the globe in the opportunities Galvanize can provide.

This year’s acquisition of Galvanize puts K12 in a unique position to make a difference in the IT space as it builds its rapidly growing career learning business and provides more K12-powered students with digital and IT-related opportunities. During the 2021 spring semester, several K12-powered schools will roll out the company’s first high school course based on Galvanize’s content.



8,000+

Galvanize graduates since 2012⁵

Tony Phillips, the Chief Product Officer at Galvanize, is a proud educator-turned-entrepreneur. After college, he earned a coveted Fulbright scholarship in education. As part of this opportunity, he served as a public middle and high school teacher in South Korea and subsequently led an immersive language school there.

Then, after starting several successful companies, Tony co-created Hack Reactor—a software engineering bootcamp that has become one of the top five bootcamps in the country. Today, Hack Reactor is an integral part of Galvanize’s portfolio, offering both full- and part-time online training opportunities for lucrative careers that don’t require a four-year college degree. Tony also spearheads each of Galvanize’s tech education offerings.

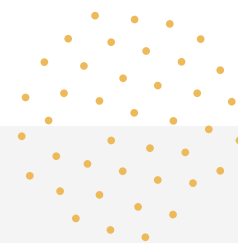
Harsh, Tony, the entire Galvanize management team, their alumni network, and the company’s industry-leading programs are accelerating K12’s entry into the vital and growing market for software engineers and data scientists. The Galvanize acquisition is also a valuable part of K12’s journey toward becoming a world-class leader in career education for learners at various stages of life.

“AS WE EMERGE FROM THE PANDEMIC INTO A REALITY THAT LOOKS A LOT DIFFERENT THAN THE ONE WE LEFT BEHIND, WE NEED TO RECONSIDER WHAT A ‘TYPICAL’ EDUCATION LOOKS LIKE.”

TONY
PHILLIPS
Galvanize Chief
Product Officer



⁵ Galvanize, “G.R.A.D. Reporting Standards for Student Outcomes”



THE NEXT GENERATION OF MEDICAL HEROES

According to some studies, our country may experience a shortage of up to 104,900 physicians by 2030.⁶ To meet this growing demand for healthcare workers, we need to expose high school and middle school students to the benefits a career in the medical profession can provide, says Dr. Sherri Wilson, who joined K12 this year as the Health Careers Program Director.

“High school students can even work toward earning industry certifications that can serve as stepping-stones for advanced careers in medicine, nursing, and many other disciplines within the healthcare industry,” says Dr. Wilson.

Before coming to K12, Dr. Wilson served as a public health nursing administrator with the Fairfax County Health Department in Virginia. She’s also the founder of The Wilson Initiative for Health & Social Equity, Inc.—an organization that focuses on addressing healthcare disparities and workforce diversity through scholarships and mentoring.

“ THE STARTLING PANDEMIC WE’RE LIVING THROUGH HAS UNEARTHED AN ISSUE THAT’S PLAGUED THE HEALTHCARE INDUSTRY FOR DECADES: THE GROWING SKILLS GAP. WE CAN’T AFFORD TO KEEP TALKING ABOUT OUR NATION’S SKILLS GAP WHEN IT COMES TO HEALTH CARE. ”



**DR. SHERRI
WILSON**

K12’s Health Careers Program Director, 2020

STEPPING INTO THE FUTURE WITH GALVANIZE

With Galvanize, students and entrepreneurs gain the most relevant and in-demand skills that the current job market demands. At Galvanize's campuses and online bootcamps, students and entrepreneurs gain unparalleled access to technical experts and instructors and a variety of innovative learning opportunities that advance their tech-related skills. It's important to note that Galvanize offers the software engineering bootcamp under its industry-recognized brand name Hack Reactor. Hack Reactor is rated as one of the top five bootcamps in the country. And Galvanize, which is home to a growing alumni base of more than 8,000 professionals, is well recognized for the quality of its training programs.

Additionally, graduates earn, on average, annual base wages of \$90,000 or more.⁷ Graduates in New York and San Francisco start at even higher salaries. Galvanize grads have been hired by more than 2,000 companies, which includes some of the nation's leading Fortune 500 companies.⁷ For instance, Amazon, Facebook, Google, and Apple have all turned to Galvanize to train their technical teams or help them find skilled workers. With this in mind, we conservatively estimate that the adult learning market we are targeting with the Galvanize acquisition is more than \$50 billion.⁸

It's clear—Galvanize represents an incredible opportunity for DCA students and K12-powered schools. Now we are poised to provide more students with digital and IT-related opportunities beyond high school graduation. For the spring semester of the upcoming school year, we plan to roll out our first high school course based on Galvanize's content. This is a core synergy for the combined companies and a key differentiator for our career learning business. We're planning to create additional courses for the high school market and other white-label adult learning opportunities.

Our work with Galvanize is yet another step in our ongoing effort to build on our career readiness offerings for learners of all ages. Learning is truly a lifelong journey. And no matter where a student is on that journey—whether they're just discovering their passion, trying to switch career fields, honing their job skills, or learning new skills in pursuit of a new opportunity—K12 is helping them along the way.

⁶ Association of American Medical Colleges, "Research Shows Shortage of More than 100,000 Doctors by 2030", March 2017

⁷ Galvanize, "G.R.A.D. Reporting Standards for Student Outcomes"

⁸ EY-Parthenon, "Capital Roundtable When the Music Stops: Perspectives on how sub-sectors fare in an economic downturn", January 2018




STRENGTHENING ACADEMIC PROGRAMS AND THE CUSTOMER EXPERIENCE

Career learning is rapidly becoming a larger part of our business, but make no mistake, our mission remains the same—we help K12-powered students reach their full potential through inspired teaching and personalized learning.

As part of our unwavering dedication to our mission, we made significant investments that strengthen our core general education business of supporting K–12 students. This includes developing more exciting course content, providing more opportunities for personalized support, and offering enhanced wraparound services to better support families' needs outside the classroom.

Our guiding principle for this work is our internal campaign to ensure that every student enrolled in a K12-powered school achieves at least a year's growth, or more, for every year they attend school—whether they start on grade level, above grade level, or below grade level. This year, we helped more students reach this goal in a number of ways.

First, we focused on enhancing student engagement through smaller group sessions and more opportunities for student–teacher interaction. We also designed several initiatives to keep students more actively engaged in their academic success.



THROUGH OUR ENHANCED ADVISOR PROGRAM, 60,000 STUDENTS NOW HAVE A SINGLE POINT OF CONTACT TO HELP GUIDE THEM THROUGH THE EARLY STAGES OF THEIR ACADEMIC EXPERIENCE.

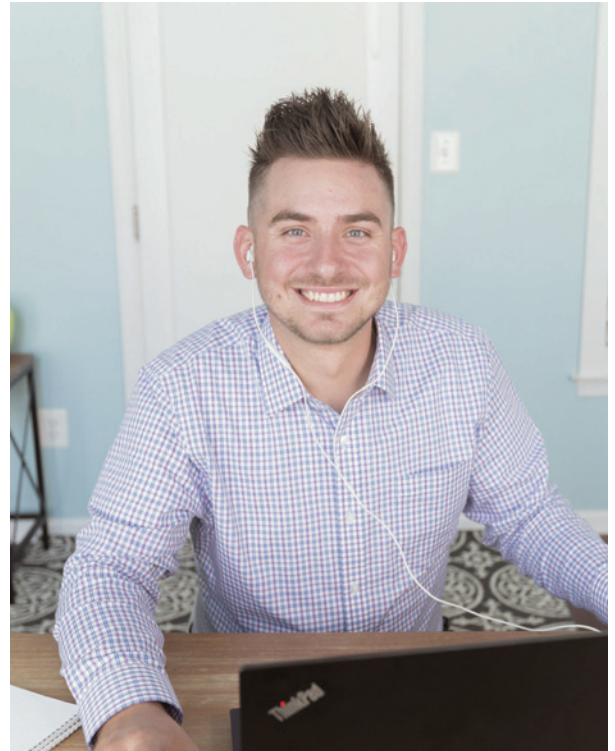
And in future months, our expanded social clubs and learning programs will also foster more authentic and meaningful activities that will help build a sense of belonging and community among students, families, and staff.

TURNING STUDENTS' LOVE OF GAMING INTO CAREERS THEY LOVE

Ben Leskovansky, or “Mr. Lesko” as he is known to his students, teaches Intro to Programming in JavaScript and Game Design at Insight Pennsylvania Cyber Charter School. He sees game design as a way to turn students’ passion for video games into career opportunities.

“The game design portion gets the kids’ interest, and it’s a great and natural way to take kids through the software development process as well as debugging, troubleshooting, and complex problem-solving,” Mr. Leskovansky says.

One of his goals is to help students work toward earning industry certifications in the software applications they use in the classroom. This not only helps their resumes stand out; it can also lead to an informational interview or entry-level programming job.



BEN

LESKOVANSKY

Insight Pennsylvania Cyber
Charter School Teacher, 2020



“ SOMETHING I LIKE TO SHARE WITH MY STUDENTS IS THEY’RE NOT NECESSARILY JUST GOING TO BE GAME DESIGNERS AT THE END OF THIS PATHWAY. THEY’RE GOING TO BE PROGRAMMERS, PROBLEM-SOLVERS, DESIGNERS, COLLABORATORS, AND TEAM PLAYERS. ”



“ I LIKE THE LIVE SESSIONS WITH MY CLASSMATES. BEING ABLE TO WORK IN GROUPS GIVES ME TIME TO GET TO KNOW NEW FRIENDS. ”

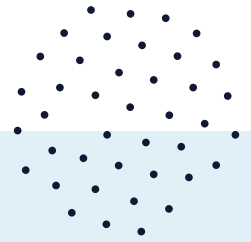


SARAI
Insight Pennsylvania
Cyber Charter School
Student, 2020

Lastly, we supported inspired teaching and cultivated stronger school leaders with more customized instruction tools, more data-driven programs, an improved instructional coaching process, and enhanced regular assessments that better predict student success.

As part of this commitment, we continued to provide teachers with the industry’s most comprehensive professional development programs specifically built for online learning.

THIS INCLUDES MORE THAN **175 HOURS OF INSTRUCTION WHEN THEY BEGIN TEACHING AT K12-POWERED SCHOOLS AND INCREMENTAL DEVELOPMENT OPPORTUNITIES EVERY YEAR.**



LEARNING ANY TIME, ANY PLACE

Siblings Sarai and Micah are interactive and curious learners at Insight Pennsylvania Cyber Charter School. Their parents wanted a more challenging, active approach to learning and the opportunity to build in physical activities during the day to keep them engaged.

With a K12-powered school, the kids have scheduled live classes and can work their other assignments around the day's activities—whether that includes dance and basketball or hikes and trips to the trampoline park. Their parents are both entrepreneurs who also work to be a hands-on learning team for Sarai and Micah.

While these initiatives are significant, we still have a long way to go to ensure we are delivering the best products and services to students, teachers, and schools. This principle is the crux of our newly created Customer Experience organization. Its role is to proactively drive positive experiences for students and their families—from their first interaction with K12 through their entire in-school journey.

This team has developed and executed special research programs to better ensure that K12 remains in tune with customer expectations, challenges, and opportunities. And because of their efforts, teams across the company are now hard at work refining student and family communications, reimagining the online learning experience for late-starting students, developing new opportunities for social engagement, and researching new ways to provide program flexibility for students who need it most.

Now more than ever, we are committed to providing engaging customer experiences and dynamic academic programs that keep students invested in the learning process.



FLEXIBLE AND FUN—GETTING A KICK OUT OF ONLINE SCHOOL

Austin, a student at Ohio Virtual Academy, was once bullied for having one arm. Today, Austin is a martial arts champion who has his eyes set on representing Team USA in the 2024 Paralympic Games.

Austin switched to his K12-powered school after 5th grade and quickly discovered that he loved the benefits of learning online; it allows him to focus on schoolwork and train and travel for taekwondo competitions.

Martial arts routines require discipline, just like online school. And Austin says his online courses help him prepare for his future, and he's even earning college credits. By taking dual enrollment classes, Austin is getting a head start on his college journey and wants to eventually study zoology to become a veterinarian.

“ TAEKWONDO HAS HELPED ME KEEP MENTALLY STRONG. IT HELPED ME GAIN MY CONFIDENCE. ”



AUSTIN

Ohio Virtual Academy
Student, 2020



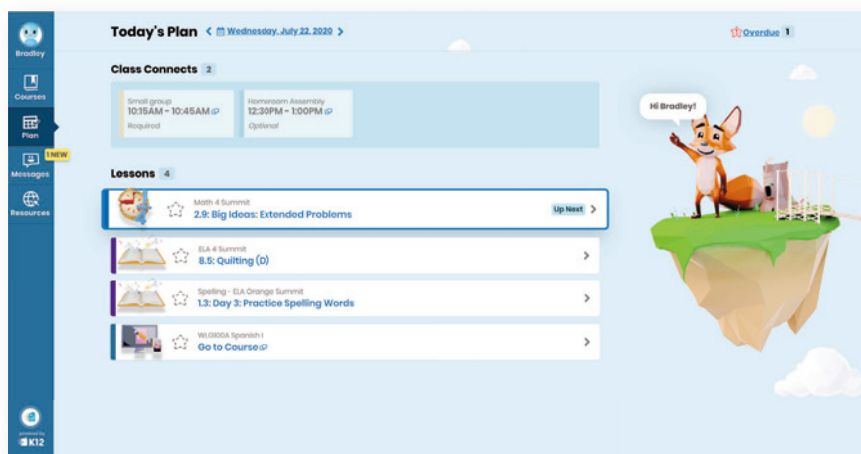
STAYING AHEAD OF THE CURVE

As an educational technology company, we are also committed to staying ahead of the curve regarding digital tools—from our classrooms to our boardrooms. To this end, our Product Development and Information Technology teams have undertaken the meticulous task of transitioning our company’s data centers to a cloud-based data services platform with Amazon Web Services (AWS). AWS will help our corporate teams and K12-powered schools access much-needed data more efficiently. It will also increase the data capacity that schools require to better manage student records. Put simply, this company-wide change supports our broader vision to do things smarter, better, and faster.

Included in K12’s new technology is the integration of a video-based virtual teaching tool that helps enhance English and language arts offerings. Also included is a unique platform that gives students single sign-on access to the entire K12 library of apps, links, and school resources from one location and on any device. These changes support our efforts to further deliver an interactive, standards-aligned curriculum for K–12 students.

The company’s newly redesigned online school (OLS) for kindergartners through fifth graders is another way we are improving the student learning experience. With updated visual designs and improved speed, accessibility, and scalability, the new OLS will provide an even better learning experience for our youngest learners. In addition, a new, fully responsive mobile-friendly platform will allow learners to work from anywhere more independently.

K12’S REDESIGNED ONLINE SCHOOL



FINANCIAL RESULTS

At the end of Fiscal Year 2020, K12 reported a strong financial performance. Revenue for the year was \$1,040.8 million, growing 2.5 percent year-over-year. This was driven by the strength of our managed public school business and the demand for full-time online school options.

We ended the year with 118,600 students in our partner programs, an increase of 2.6 percent year-over-year. This is the fourth year in a row of increasing year-over-year gains in managed public school enrollments. Importantly, enrollment growth was not concentrated in one school or one state—more than 80 percent of the states in which we operate posted gains.

Adjusted operating income for the year was \$56.1 million. Excluding the impact of the Galvanize acquisition, adjusted operating income would have been \$74.1 million, an increase of more than 19.1 percent year-over-year.

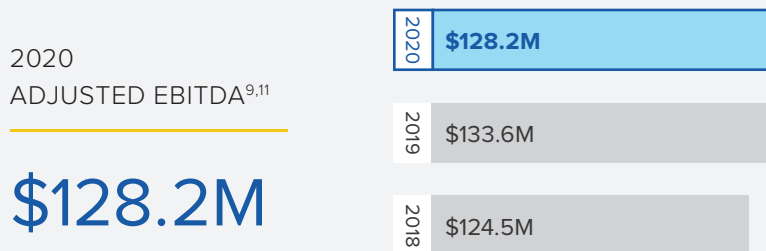
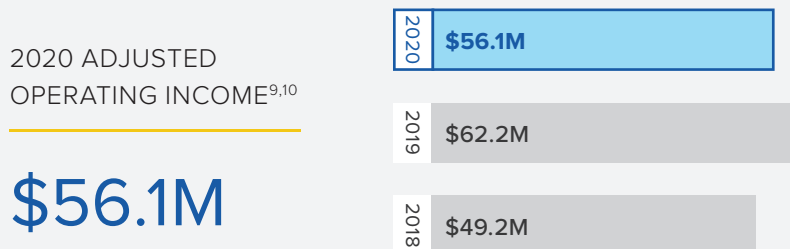
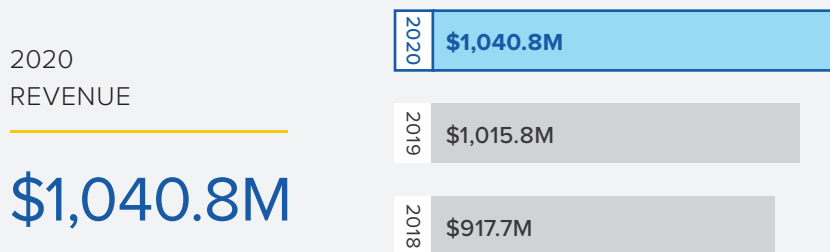
THIS WAS A RESULT OF OUR ONGOING COMMITMENT TO MAKING TARGETED EXPENDITURES TO DRIVE ACADEMIC EXCELLENCE AND OUTCOMES, WHILE SIMULTANEOUSLY FOCUSING ON GROWING PROFITABILITY.

Our cash, cash equivalents, and restricted cash were \$213.3 million at year's end. While this balance includes \$100 million the company borrowed from its revolving credit facility, that balance is after the \$165 million investment we made to acquire Galvanize.

It's clear we are entering Fiscal Year 2021 with a strong financial position and the capacity to support increasing enrollment levels, an expanded career learning business, and funding for our long-term growth initiatives.

2020 Highlights

A reconciliation of Adjusted Operating Income and Adjusted EBITDA metrics to GAAP results can be found on page 129.



⁹In the third quarter of fiscal year 2018, the Company incurred \$4.3 million in charges relating to a CEO transition. Adjusted operating income and Adjusted EBITDA for 2018 are shown excluding these costs, where applicable to the calculation. Included in the \$4.3 million charges is \$1.4 million of stock-based compensation expense.

¹⁰Adjusted Operating Income (Loss) is defined as income (loss) from operations as adjusted for stock-based compensation expense.

¹¹Adjusted EBITDA is defined as income (loss) from operations as adjusted for stock-based compensation expense and depreciation and amortization.

LOOKING AHEAD

Since its inception twenty years ago, K12 has been committed to removing barriers that impact academic equity and providing a high-quality education for anyone—particularly those in underserved communities who need it most. In the weeks, months, and years ahead, we want to continue ensuring every K12-powered school provides a safe space for students to learn and grow. Our new pledge, “We Stand Together,” underscores our continued commitment to a series of initiatives that support equity and inclusion in education.

Part of this commitment includes designing new, interactive courses that highlight community and civic changemakers to inspire the next generation of leaders and allies. It also includes improving recruiting, training, and retention strategies in instructional, teaching, leadership, and administrative roles. If the students we serve don’t see themselves in us, and if they don’t have role models exposing them to diverse experiences, we will not help them realize their learning potential.

As educators and school leaders, we are role models for the future—not only for the students we serve but also for the children in our families and neighborhoods. It’s my hope that our ongoing efforts to bridge the differences that divide our communities will help build a better, stronger, more inclusive nation. As a company, our priorities to deliver on our mission at this critical time are steadfast: keeping our employees and communities safe, continuing to support our school partners, and deploying resources and services for America’s schools and families. We know that the online classroom may not be for everyone, but at K12, we are committed to providing an education for any ONE.

Thank you for your support.



Nate Davis

Chief Executive Officer and Chairman



 **K12 FORM 10-K**

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended June 30, 2020

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)

2300 Corporate Park Drive
Herndon, VA 20171

(Address of Principal Executive Offices)

95-4774688

(I.R.S. Employer
Identification No.)

(703) 483-7000

(Registrant's telephone number, including area code)

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

| <u>Title of each class</u> | <u>Trading Symbol</u> | <u>Name of each exchange on which registered</u> |
|----------------------------------|-----------------------|--|
| Common Stock, \$0.0001 par value | LRN | New York Stock Exchange (NYSE) |

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

None

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

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 No

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

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

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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, 2019 was \$594,180,562. Aggregate market value excludes an aggregate of approximately 11,749,368 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, 2020 was 41,309,402.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the registrant's definitive proxy statement for its 2020 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, 2020, 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,” “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,” “will be,” “expects,” “plans,” “intends,” “should,” “would” 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 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;
- governmental investigations that could result in fines, penalties, settlements, or injunctive relief;
- declines or variations in academic performance outcomes of the students and schools we serve as curriculum standards, testing programs and state accountability metrics 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;
- changes in national and local economic and business conditions and other factors, such as natural disasters, pandemics and outbreaks of contagious diseases and other adverse public health developments, such as coronavirus disease 2019 (“COVID-19”);
- discrepancies in interpretation of legislation by regulatory agencies that may lead to payment or funding disputes;
- termination of our contracts, or a reduction in the scope of services, with schools;
- failure to develop the career readiness education business;
- entry of new competitors with superior technologies and lower prices;
- unsuccessful integration of mergers, acquisitions and joint ventures;
- 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;
- disruptions to our Internet-based learning and delivery systems, including, but not limited to, our data storage systems, resulting from cybersecurity attacks; and
- misuse or unauthorized disclosure of student and personal data.

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 and regulatory 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 uncertainties. Our actual results and financial condition may differ, possibly materially, from the anticipated results and financial condition 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.

PART I

ITEM 1. BUSINESS

Company Overview

We are a technology-based education company and offer proprietary and third-party curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade, or K-12. Our learning systems combine curriculum, instruction and related support services to create an individualized learning approach. Our learning systems are well suited for virtual and blended public schools, school districts, charter schools, and private schools that utilize varying degrees of online and traditional classroom instruction, and other educational applications. We are accredited by Cognia (formerly known as AdvancEd), a non-profit international accreditation agency for schools, districts, education service agencies, post-secondary institutions, and corporations.

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 in effective online instruction, provide administrative support 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 dynamics of virtual and blended learning that can complement and transform traditional schools. These factors enable us to provide products and services to three lines of business that share many common attributes, including curriculum, learning systems, administration, logistical systems and marketing. These lines of business are: (i) Managed Public School Programs, (ii) Institutional, and (iii) Private Pay Schools and Other.

K12’s career readiness education (“CRE”) initiative offers online curriculum and career services to middle and high school students, under the Destinations Career Academy (“DCA”) brand name, which can provide services to all of our lines of business. The initiative is designed to give students a head start on their career goals by providing them with content pathways toward an industry certification, college credits, and work experiences.

| Managed Public School Programs | Institutional | Private Pay Schools and Other |
|--|---|--|
| <ul style="list-style-type: none"> • Virtual public schools | <ul style="list-style-type: none"> • Non-managed public school programs | <ul style="list-style-type: none"> • Private schools —K12 Private Academy (formerly, K12 International Academy) |
| <ul style="list-style-type: none"> • Blended public schools | <ul style="list-style-type: none"> • Institutional software and services | <ul style="list-style-type: none"> —George Washington University Online High School |
| <ul style="list-style-type: none"> • Destinations Career Academies / Career readiness education | <ul style="list-style-type: none"> • Destinations Career Academies / Career readiness course offerings | <ul style="list-style-type: none"> —The Keystone School • Destinations Career Academies (Private) • Galvanize |

We continue to make significant capital investments intended to improve student academic outcomes, including the: (i) ongoing development and enhancement of our current and next generation curriculum and software; (ii) addition of new features to our proprietary learning management platform for K-5 students; (iii) strengthening of our corporate and school infrastructure to increase data security, protect student privacy, and ensure compliance with evolving reporting and regulatory requirements; (iv) procurement and delivery of student computers; and (v) conversion of interactive instructional products to enable delivery through tablets and mobile devices.

Managed Public School Programs

Our Managed Public School Programs line of business includes both virtual and blended public schools where a district, independent charter board, or other entity contracts with K12 for a full-time program of educational products and services. These programs offer an integrated package of systems, services, products, and professional expertise that we administer to support an online or blended public school, including: administrative support (e.g., budget proposals, financial reporting, student data reporting, and staff recruitment), information technology and provisioning, academic support services, curriculum, learning systems, and instructional services. In fiscal year 2020, our Managed Public School Programs accounted for approximately 88% 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 courses, course materials and, in certain cases, student computers, we also offer these schools a variety of administrative support, technology and academic support services. The majority of our revenue is derived from multi-year service and product agreements with the governing authorities of these virtual public schools.

Blended Public Schools. Blended public schools combine online learning and face-to-face instruction in a physical learning center.

For both virtual and blended Managed Public School Programs, the governing authority that exercises ultimate control over the schools negotiates contractual terms with us for specific aspects of the administration of the schools, which can include: the creation and implementation of the academic plan; monitoring academic achievement; recommendations for teacher hires; teacher training; recommended compensation plans for school personnel; financial management; enrollment processing; and development and procurement of curriculum, equipment and required services. The scope of services we provide may also vary in accordance with applicable state regulations and each governing authority’s policies. The schools receive funding on a per student basis from the state in which the public school or school district is located. In earlier years, we grew primarily by entering into service and product agreements with schools that offered statewide programs in new states and reported that growth by citing the number of states having these programs and by enrollments. Our Managed Public School Programs now involve the opening of multiple schools within the same state, as well as closures that can occur with contract terminations, non-renewals, or charter revocations. In fiscal year 2017, we adopted a metric based on the number of schools served by our Managed Public School Programs. For fiscal year 2020, we provided these Managed Public School Programs to 76 schools in 30 states and the District of Columbia. In addition, we report on a quarterly basis the aggregate number of enrollments and associated revenue for the Managed Public School Programs.

Institutional

We work closely as a partner with school districts, public schools, charter schools, private companies, and private schools to provide them with educational solutions. The Institutional business includes Non-managed Public School Programs and Institutional software and services where K12 offers curriculum, including career technical education (“CTE”) electives, and technology for full-time virtual and blended programs. In addition, we offer options for the school to contract with us for instruction, curriculum, supplemental courses, marketing, enrollment and other educational services and products. Unlike Managed Public School Programs, the Institutional business does not offer primary administrative support services, which remain the responsibility of the school district or the school customer. In addition to curriculum, platforms and programs, the services we offer to Institutional clients also can assist them in launching their own online and blended learning programs tailored to their own requirements and may include instructional support, reporting tools and content libraries. For the 2019-20 school year, we served school districts or schools in all 50 states and the District of Columbia.

Private Pay Schools and Other

We own and operate three accredited, tuition-based private schools: (i) The K12 Private Academy (formerly, K12 International Academy) and its DCA program, (ii) the George Washington University Online High School, and (iii) 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 with students who seek to continue their studies in English and foreign students who may seek admission into a U.S. college or university. 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, and to adult learners who are seeking to complete their high school diploma.

On January 27, 2020, we acquired 100% of Galvanize Inc. (“Galvanize”) in exchange for \$165.0 million, plus working capital. Galvanize provides talent development for individuals and enterprises in information technology fields. The acquisition of Galvanize expands the Company’s offerings to include post-secondary skills training in data science and software engineering, technology staffing and developing talent and capabilities for companies. The Company also plans to use Galvanize’s curriculum to create appropriate content to offer high school students.

Our History

We were founded in 2000 to utilize advances in technology to provide children with access to a high-quality education regardless of their geographic location or socioeconomic background. Given the geographic flexibility of technology-based education, we believed we could help address the growing concerns regarding the regionalized disparity in the quality and breadth of available curriculum and instruction, 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 fiscal year 2020, our customers for Managed Public School Programs consisted of 76 schools in 30 states and the District of Columbia. We also serve schools in all 50 states and the District of Columbia through our Institutional business.

In January 2020, we acquired Galvanize to expand the Company’s offerings to include post-secondary skills training in data science and software engineering, technology staffing and developing talent and capabilities for companies.

Our Market

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

- According to a May 2019 report of the National Education Policy Center (“NEPC”) entitled “Full-Time Virtual and Blended Schools: Enrollment, Student Characteristics, and Performance,” in 2017-18, 501 full-time virtual schools enrolled 297,712 students, and 300 blended schools enrolled 132,960. The NEPC report further states thirty-nine states had either virtual or blended schools. There were four states that allowed blended schools to operate but still have not allowed the opening of full-time virtual schools. A total of six states have full-time virtual schools but do not currently have full-time blended learning schools.
- In 2020, the National Home Education Research Institute reported that there are approximately 2.5 million home-educated students in the United States, which has grown by an estimated 2% per year since 2016.

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

As evidenced by the rapid evolution of education technology and varying educational options being offered to K-12 students, no single learning model has been found that works equally well for every student. Children today utilize technology in all aspects of their lives, and we expect this reality to extend to their education. Our business has been built on the premise that every student, regardless of geographic location or socioeconomic background, is entitled to a high-quality education that is individualized and adaptable based on the student’s unique needs. We also believe all students can benefit from more engaging technology-enriched educational content.

We anticipate that full-time online public schools will meet the needs of a small percentage of the overall United States K-12 student population, but that segment will still represent a large and growing opportunity for us in absolute terms. Across our educational programs, students come from a broad range of social, economic and academic backgrounds, and parents share the desire for individualized instruction to maximize their children’s potential. Examples of students for whom this solution may fit include, but are not limited to, families with: (i) students seeking to learn in a way that better accommodates their individual needs; (ii) safety, social and health concerns about their local school, including students who are being bullied or are subjected to discrimination; (iii) students with disabilities who are seeking alternatives to traditional classrooms; (iv) students for whom the local public school is not meeting their needs; (v) students who seek or need greater flexibility than other alternatives, 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, including adult learners; (viii) high school dropouts who have decided to re-enroll in school to earn a diploma; and (ix) students of military families who desire high-quality, consistent education as they relocate to new locations. Our individualized learning approach allows students to optimize their educational experience and, therefore, their chances of achieving their goals.

Although the COVID-19 pandemic may change the way in which students are educated in the near term in certain locations, we continue to expect most students in the United States to be educated in traditional school buildings and classrooms. However, we believe that certain student segments will benefit from the availability of a choice for an online public education (including blended learning models), and that states and districts will seek to incorporate online and blended solutions into their school-based programs. Our Managed Public School Programs offer a full service, integrated program, and a complete solution for districts and schools that desire a comprehensive option. For public school customers who need less than a full service offering, our Institutional business provides online curriculum and services on a solutions-oriented, customized basis. 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 and individuals’ capabilities and needs. Moreover, we have pursued, and will continue to pursue, selected markets outside the United States where we believe our products and services can address local foreign market needs.

Our Business Lines

Managed Public School Programs

Our Managed Public School Programs offer an integrated package of systems, services, products, and professional expertise that we administer to support an online or blended public school. Customers of these programs can obtain the administrative support, information technology, academic support services, online curriculum, learning system platforms and instructional services under the terms of a negotiated service and product agreement. We provide our Managed Public School Programs and DCA programs to virtual and blended public charter schools and school districts. These contracts are negotiated with, and approved by, the governing authorities of the customer. The duration of the Managed Public School Program service and product agreements are typically 2-5 years, and most provide for automatic renewals absent a customer notification within a negotiated time frame. During any fiscal year, the Company may enter into new Managed Public School agreements, receive non-automatic renewal notices, and negotiate replacement agreements, terminate the contract or receive notice of termination, or transition a school between a Managed Public School Program and a Non-managed Public School Program. The governing boards may also establish school policies and other terms and conditions over the course of a contract, such as enrollment parameters. The authorizers who issue the charters to our Managed Public School customers can renew, revoke, or modify those charters as well.

For the 2019-2020 school year, we provided our Managed Public School Programs to 76 schools in 30 states and the District of Columbia. During this fiscal year, we entered into three new contracts in three states to open Managed Public School Programs, auto-renewed six agreements for schools in five states, mutually agreed to terminate the service agreement with one school, and completed renewal negotiations in five states, with varying degrees of contract modifications. During this fiscal year, at two schools the authorizer invoked its contractual right to not renew its district program for the upcoming 2020-2021 school year. One school elected not to renew their service agreement with us for the 2022-2023 school year and thereafter.

Virtual Public Schools

The majority of our revenue is derived from multi-year service and product agreements with the governing authorities of the virtual public schools we serve. In addition to providing a comprehensive course catalog, related books and physical materials, a learning management system for online learning, and, in certain cases, student computers, we also offer these schools a variety of administrative support, technology and academic support services. Full-time virtual public school students access online lessons over the Internet and utilize offline learning materials we provide. Students receive assignments, complete lessons, take assessments, and are instructed by teachers with whom they interact via email, telephonically, in synchronous virtual classroom environments, and sometimes face-to-face. In either case, for parents who believe their child is not thriving in their current 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. Students attending many of these schools are also provided the opportunity to participate in a wide variety of school activities, including field trips, service learning opportunities, honor societies, 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 serve K-12 students, principally utilize the K12 core curriculum and attract both mainstream and other types of learners. These virtual public schools operate under different brands including Virtual Academies (our original full-time Managed Public School Program), Insight schools (which tend to focus on particular student segments, such as only middle and high school grade levels, at-risk students and career readiness programs), and iQ Academies (which are typically only partially managed by us, with responsibility for academic program and regulatory compliance resting with the host school or school district).

Blended Public Schools

In addition to our full-time virtual public schools, we offer a variety of 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 by students in a physical learning center.

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. Our blended schools bring students and teachers physically together more often than a purely online program.

In some blended schools we support, such as the Hoosier Academies Indianapolis, 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.

Career Readiness Education

CRE at the virtual and blended schools offers online curriculum and career services to middle and high school students. Under the DCA program, students work collaboratively in groups, gain virtual industry exposure, and may have job shadowing opportunities.

Institutional

Our Institutional business consists of: (i) Non-managed Public School Programs and (ii) Institutional software and services. Over the past few years, public schools and school districts have been increasingly adopting online solutions to augment teaching practices, launch new learning models, 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 have also been authorized for the purchase of digital content, including online courses, and in some cases mandated for access to online courses. With the impact of the COVID-19 on education, school districts are seeking more complete virtual learning solutions in addition to curriculum, including virtual instructional delivery, scheduling, attendance monitoring for virtual instructional sessions, teacher professional development, consulting support in effective virtual instruction, and special education accommodations. Additionally, districts are seeking support for implementations that blend virtual and in-person instruction.

To address the growing need for digital solutions and the recently emerging need for comprehensive virtual solutions, our Institutional 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-time Non-managed Public School Programs to individual course sales and supplemental options that can be used in traditional classrooms to differentiate instruction. The goal of the Institutional business is to partner, primarily with U.S.-based public schools and school districts, to provide more options and better tools to empower teachers to improve student achievement through personalized learning in traditional, blended and online learning environments and to provide comprehensive support for teachers and administrators to deliver effective virtual and blended instructions.

Our K12 Learning Solutions and K12 Training Solutions suite of offerings include: our K12 virtual learning platforms, K12 curriculum; Middlebury Interactive Languages; Stride; and the Big Universe literacy solution. This catalog of online curricula can address specific student needs, including AP, honors programs, world languages, English language learners, remediation, credit recovery, alternative education, CTE electives and college readiness. In connection with these solutions, we also offer state-certified teachers, training for school personnel in online instruction methods, and professional development and other support services as needed by our customers.

Private Pay Schools and Other

International and Private Pay Schools

We own and operate three accredited, tuition-based private schools that meet a range of student needs from individual course credit recovery to 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 who wish to study in English and foreign students who desire a U.S. high school diploma. For the 2019-20 school year, we served students in more than 100 countries. In addition, we have entered into agreements that 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.

The K12 Private Academy (formerly, K12 International Academy) is an online private school that serves students in both the United States and overseas. In addition, a DCA program is available that offers the students online curriculum and career services. Through the K12 Private Academy, students may study in a full-time 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 K12 Private 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

online clubs and events that enrich the student experience by allowing students to interact with peers in other countries. The school is accredited by Cognia, 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 providing home-based education and distance learning for over 35 years. Keystone offers middle and high school on a full or part-time basis, as well as adult learning programs. Keystone also sells elementary level (K-5) courses and teacher support, which appeal to families that seek to homeschool or need supplemental instruction. Students take online courses with teacher support as well as print correspondence course programs. Keystone primarily uses our K12 curriculum delivered on the Desire2Learn learning management system and offers 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 Cognia.

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 K-8 online courses and supplemental educational products directly to families. These purchasers desire to educate their children as homeschoolers, outside of the traditional school system or to supplement their child’s existing public or private school education without the aid of an online teacher. Customers of our consumer products have the option of purchasing a complete grade-level curriculum for grades K-8, individual courses, or a variety of other supplemental products, covering various subjects depending on their child’s needs. Typical applications include summer school course work, home-schooling and educational supplements.

Galvanize

Galvanize operates three businesses: (i) bootcamps for data sciences and software engineering, (ii) co-working campuses, and (iii) enterprise training. The full-time bootcamps are designed for post-secondary students looking to advance their technology careers by providing such students with foundational skills and real-world experience needed to succeed in the technology sector. The co-working campuses are locations that serve as a shared workspace for individuals, startups and established companies. Enterprise training addresses the skills gap facing companies in the data science and software engineering sectors by working directly with companies to create a customized, tailored education plan to help each company reach its goals and train its employees according to such plan.

Our Business Strategy

We are committed to maximizing every child’s potential by personalizing their educational experience, delivering a quality education to schools and their students, and supporting our customers in their quest to improve academic outcomes and prepare them for college and career readiness. In furtherance of those objectives, we plan to continue investing in our curriculum and learning systems. These investments include initiatives to create and deploy a next generation curriculum and learning platform, improve the effectiveness of our school workforce, develop new instructional approaches to increase student and parental engagement, and improve our systems and security architecture. This strategy consists of the following key elements:

Affect Better Student Outcomes. We are committed to improving student outcomes for every student in the schools we serve. To achieve this goal we: (i) invest in training and professional development for teachers and school leaders, which may include a competency-based Master’s Graduate Degree in Online Teaching K-12 through our partnership with Southern New Hampshire University; (ii) develop programs and initiatives designed to improve the learning experience, such as our interactive media projects, project-based learning (“PBL”), virtual science labs and AP test prep; (iii) enhance our curriculum to make it more engaging, adaptive and available to all students anywhere; and (iv) update our content as state standards and state assessments change. We also will focus our marketing and enrollment efforts on helping students and families understand the unique demands and challenges of the online learning environment.

We believe better understanding by parents and students will better prepare students for the work and improve their chance at academic 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 families have the option of enrolling their children in a brick and mortar school or another virtual school. We, therefore, continue to refine 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, recognizing that all students are eligible to enroll consistent with state requirements (e.g., enrollment caps, prior public school student). Once students are enrolled, programs such as Strong Start Onboarding, Single Point of Contact Advisors, Social-Emotional Learning and Face-to-Face/Blended Programs provide early intervention and focused engagement and retention strategies, which strive to help students stay on track, improve engagement and, ultimately, give students a better chance at academic success.

Grow DCA Enrollments and Expand Career Training Market. To grow K12's CRE initiative and enrollments we are expanding the Destination Career Academy's brand, introducing PBL and pursuing industry partnerships. We believe this approach will be more advanced than traditional vocational training and broader than enrollment in a series of CTE courses. We seek to expand our addressable market by offering career readiness training beyond our traditional K-12 market and into adult education and corporate training. In 2020, we acquired Galvanize to expand into the information technology fields by providing talent development for individuals and enterprises.

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 products that expand our current portfolio. This includes pursuing development and licensing of curriculum and platforms that are accessible from tablet and mobile devices and leveraging adaptive learning technologies and solutions.

Increase Enrollments at Existing Virtual and Blended Public Schools. Some state regulations, school governing authorities and/or districts limit or cap student enrollment or enrollment growth. At the direction of our school board and school district customers, we seek to provide an opportunity for more students to attend these schools, and support their efforts to work with legislators, state departments of education, educators and parents to increase or remove student enrollment caps.

Expand Virtual and Blended Public School Presence into Additional States and Cities. As laws change and opportunities arise, we work with states, school districts, regional education organizations, and charter schools to authorize and establish new virtual and blended public schools and to contract with them to provide our curriculum, online learning platform, support services, and other related offerings. Traditional school districts are becoming a greater percentage of our customer base.

Grow Our Institutional Business. The breadth of our Learning Solutions course catalog ranges from pre-K to 12th grade, instructional services, supplemental solutions, and teacher development and are the key drivers for Institutional business growth. We work to continue the market adoption of these solutions and services as school districts partner with us to address a variety of academic needs and to facilitate personalized learning in traditional, blended and online learning environments.

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, foreign students who seek a U.S.-style education, and the schools and school systems that serve such students 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, career technical education, supplemental educational products, adult learning, and individual products packaged and sold directly to consumers. We have made strategic investments in other companies to supplement our go-to-market approach in the Institutional business with a focus on advising school districts on their digital classroom transformation efforts.

Pursue Strategic Partnerships and Acquisitions. We may pursue selective acquisitions that complement our existing educational offerings and business capabilities, and that are natural extensions of our core competencies. We may also pursue acquisitions that extend our offerings and business capabilities, such as the acquisition of Galvanize in January 2020, and opportunities with highly respected institutions. We believe we can be a valued-added partner or contribute our expertise in curriculum development and educational services to serve more students. In 2018, we partnered with Southern New Hampshire University to invest in the development of degree-granting programs for online teaching.

Products and Services

Educational Philosophy

A 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 to all state adopted standards and assessments (tests which are designed to measure specific elements of learning), states that have retained the Common Core State Standards (“CCSS”) and states that have adopted the Next Generation Science Standards. 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:

- *Provide Learning Systems to Facilitate the Delivery of Our Products and Services.* Our products and services are largely delivered through online learning systems that facilitate the delivery of courses, communication with teachers, synchronous and asynchronous class sessions, tracking of progress, assessment of student performance and other key aspects of our offering.
- *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 it is appropriate and can enhance the learning process, with the amount of online content increasing at higher grades. In addition to online content, our curriculum includes a rich mix of courses with and without materials. Furthermore, teachers utilize a variety of collaboration and communication tools to help support student and family communication. We believe our balanced use of technology and more traditional approaches helps to maximize the effectiveness of our learning systems.
- *Assess Objectives 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. We are exploring new tools, such as machine learning, automated scoring and game-like capabilities to integrate into our curriculum to support individualized learning.
- *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.

Greater instructional effort is focused on the most important and most challenging concepts (as revealed by experience and research). We use existing and ongoing research, feedback from parents and students, and experienced teacher judgments to determine these priorities, to modify our learning systems to guide the allocation of each student's time and effort, and to align with evolving state curriculum and testing blueprints.

- *Facilitate Flexibility to Accommodate Variations in Ability.* We believe that each student should have access to a variety of instructional solutions that help challenge each student appropriately. Generally, meaningful progress for most students is to complete one academic year's curriculum within a traditional school year. Our learning systems are designed to facilitate this flexibility to motivate and challenge each student to master 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 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 administered by us, or a program offered through a school district or a Non-managed school, is to improve his or her academic performance. With the implementation of the federal Every Student Succeeds Act ("ESSA") for the 2017-18 school year, each of the states in which we support virtual public schools has been given the authority to develop a school accountability plan within the confines of a broad federal ESSA framework based on their own conception of the best means to advance college and career readiness. The ESSA requires states to utilize four academic-related indicators in their accountability plans to measure school and student performance: academic achievement, student growth in reading and math, graduation rate, and progress in achieving English language proficiency. The states were given discretion on the weight to give to each indicator and how to apply them. Most of the state ESSA plans submitted in 2017 to the U.S. Department of Education use some form of summative rating method to describe school performance, such as conferring an A-F grade or using a ranking system having a 1-10 scale. A significant new element of this education law is a requirement for states to adopt at least one non-academic indicator in their state's accountability system to measure "school quality or student success," often called the "fifth" indicator. Unlike No Child Left Behind where the only measure of school performance was an Annual Yearly Progress report, there are a wide range of non-academic options enumerated in the ESSA that the states can adopt to advance their own "school quality or student success" accountability objectives. The states may include measures of student engagement, educator engagement, student access to and completion of advanced coursework, post-secondary readiness, school climate and safety, and any other indicator a state may choose for this purpose. For example, a post-secondary readiness accountability indicator can include student participation in and completion of a CTE program of study, or access to dual credit programs. Similarly, a student engagement indicator may focus on teacher observations or ratings that demonstrate improvements in this area.

We share the view taken by many states that assessing a student by his or her learning growth is a more accurate indicator of school and student performance than attaining a static proficiency score. This approach is now reflected in the ESSA as well. All of our schools administer nationally recognized, norm-referenced assessments to measure student growth during the school year, to prepare students for state assessments and to guide instruction. To ensure all schools are utilizing best practices learned from the successful schools we manage and from other high performing schools across the country, we continue to encourage the school boards of our customers to implement our Academic Excellence Framework, a standardized guide available to all of our Managed Public School Programs that addresses teacher preparation, delivery of instruction, and student assessment. Effective instruction is informed by and evaluated based on student-level data. As part of the academic framework guidelines, schools implement plans to collect student-level data throughout the year through the use of norm-referenced growth measures at least three times per year, along with strategically placed formative interims, benchmarks, and summative assessments.

In addition to the complexities involved in measuring academic performance of students, we believe that the 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 students who enter behind grade level or under-credited, high student mobility, lack of control over the student learning environment and higher than average percentages of students eligible for free or reduced-price lunch in many states. With rare exceptions, the data shows that students identified as eligible for free lunch had lower percentages at or above proficiency levels than students eligible for reduced-price lunch, and both groups usually underperformed students identified as not eligible for subsidized meals. 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.

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 that support students and families, such as Strong Start, Social-Emotional Learning and Advisors. To monitor student learning progress during the school year, we are using multiple equivalent assessments at the lesson, unit and semester level. This is intended to ensure that our measurement is reliable and valid. We provide more synchronous sessions for at-risk students based on data driven instruction that provides for targeted teacher intervention to assist students with lesson challenges.

In furtherance of our goal to improve academic performance, the Academic Committee of the K12 Board of Directors is charged with making recommendations to management to foster continuous improvement in academic outcomes for the public and private schools served by the Company. With input and oversight from the Academic Committee, our K12 Educational Advisory Committee (“EAC”) consists of industry experts who provide additional academic expertise and advice. The EAC met three times in fiscal year 2020. The members of the EAC were:

- Dr. David Driscoll, former Commissioner of Education, Commonwealth of Massachusetts;
- Ms. Millie Fornell, former Chief of Staff, Miami-Dade School District;
- Ms. Ann Foster, former Senior Vice President Strategy, Business Development and Connected Learning for Harcourt Education Group;
- Dr. Mary Futrell, retired Dean of the George Washington University School of Education and former President of the National Education Association;
- Dr. Beverly Hutton, Deputy Executive Director of the National Association of Secondary School Principals;
- Dr. Ildiko Laczko-Kerr, Chief Academic Officer, Arizona Charter Schools Association;
- Dr. Andrew Porter, former Dean of the Graduate School of Education, University of Pennsylvania; and
- Dr. Elanna Yalow, CEO of Knowledge Universe Early Learning Programs.

Our Products

We continue to invest in curriculum and technology to educate students more effectively and efficiently. Much of our investment has been in the development of improved functionality of our curriculum and systems. Areas of focus include: (i) integration and user experience—making sure that all of our systems and solutions are easy for teachers, administrators, students, and parents to use; (ii) mobile enabled products; (iii) portability—making sure that our platforms integrate with and onto third-party platforms; (iv) features which personalize learning for all students we serve; (v) courses that are flexible enough to provide assistance to struggling students; (vi) reading and oral fluency scoring; (vii) alignment with state standards; (viii) built-in tutoring and support functionality; and (ix) a virtual learning platform which supports the scheduling and delivery of instruction, tracking of attendance, recording of instructional sessions, and allows student group work.

As school districts evolve and look for digital solutions in their classrooms, we believe that our products have applicability across a broader range of schools. We are continuing to develop new courses and materials aimed at engaging a broad spectrum of learners with potential applicability from virtual classrooms to brick and mortar schools.

The goal of our products is to assist teachers, schools and districts in implementing individualized education programs to better serve students. This can take a variety of forms including turnkey solutions, partnerships, vendor relationships, enterprise licenses, and purchases of curriculum and services.

Curriculum

K12 has one of the largest digital curriculum portfolios for the K-12 online education industry. Our school customers can select from hundreds of core elementary, middle, and high school courses, as well as many state customized versions of those courses, electives, lesson guides, and offline instructional kits and materials. A single year-long K12 course generally consists of 120 to 180 unique instructional lessons. Each lesson is designed to last approximately 45 to 120 minutes, although students are able to work at their own pace to master a lesson's objectives.

Since our inception, we have built core courses in English Language Arts ("ELA"), 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. State standards are continually evolving and we continually invest in our curriculum to meet these changing requirements.

Online Lessons. Our K12 online lessons are accessed by K-5 students through a proprietary learning management platform, which we call our Online School ("OLS"). For grades 6-12, lessons are accessed through a third-party platform, Desire2Learn. Students can also access Learning Solutions courses through other platforms used in school districts. 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 help 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 in our Managed Public Schools receives a shipment of materials that generally include 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. We have also created and/or converted additional K12 textbooks and resources used across our core courses in K-12 into an electronic format, enabling us to offer options to enhance the student experience at all grade levels without physical books.

Lesson Guides. Our K-5 courses are generally paired with a lesson guide and/or teacher resources. These resources are designed to 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: ELA, mathematics, science, history, art, music and world languages. Our online 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 EmbarK¹², 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 and succeed on the applicable state tests. Unlike a traditional classroom education, and in conjunction with school teachers and counselors, 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, consistent with authorizer and state requirements.

We continue to invest behind our core curriculum in grades K-5 by improving the user experience, building in additional educational tools into the courses and aligning to state standards. For example, we are introducing additional game-based practice into the curriculum that can provide practice problems at lower skill levels and build up to the current lesson plan. All of the courses are being designed to include a modern, mobile user experience.

High School Courses

The curriculum available to high school students offers increased flexibility in course selection including a wide range of electives. These include AP courses, a diverse selection of foreign language offerings and CRE course pathways. Much like our K-8 offerings, we continue to invest in these courses to meet state standards and provide additional tools that will help remediate the problems of struggling students. For example, we introduced a “Help Me” section that will provide additional online instruction in certain course areas at the click of the button.

Learning Solutions Online Courses. We also offer curriculum to schools and school districts marketed as our Learning Solutions Online Courses (formerly FuelEd) product line. Most Learning Solutions Online Courses are aligned to state and national standards, including many to the CCSS, and include a large number of courses for middle and high school students, featuring core, AP, elective, and credit recovery courses. Learning Solutions Online Courses are developed by subject matter experts, designed by multimedia teams and may be taught by Company-provided instructors at the customers’ option. Learning Solutions classes are primarily delivered over the Internet in a classroom or virtual setting, and use a variety of interactive elements to keep students engaged. A deep understanding of K-12 pedagogy, as well as the human factors associated with online technology, is integrated into Learning Solutions courses. We also offer a wide range of supplemental and credit recovery courses across most subject areas. These courses provide students with the ability to augment their learning experience with additional online materials to help catch up in a subject area if they have fallen behind or “make-up” for a course they were not able to effectively complete.

Middlebury Interactive Languages (“MIL”). We offer digital world language courses and residential summer language academies through MIL, which became a wholly owned subsidiary in FY 2017 through our purchase of Middlebury College’s interest in the joint venture. As part of that transaction, we retained the right to use the MIL name in its products through April 2028. 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, we offer digital, supplemental English language learner (“ELL”) courses for middle and high school students 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, as well as in France, Spain and China in their respective local languages.

Supplemental Courses. We offer Stride, an independent, self-paced, adaptive, game-based supplemental offering that covers math, ELA, and science. In fiscal year 2018, we acquired Big Universe, a digital library solution, that includes more than 18,000 trade books, and we are making enhancements to that product, including the integration of automated reading level scoring.

Innovative Learning Applications

In order to continue to enhance the user experience and instructional methods of our learning systems, we strive to leverage new technologies and adapt our curriculum to new devices and platforms while developing algorithms and models to build an effective curriculum.

- *Mobile Device Learning:* We offer mobile applications that create the ability for a student to learn “on-the-go,” allowing for more continuous learning, engagement and mastery of content. The courses and solutions we are producing are increasingly mobile-ready.

- *Interactive Learning Activities and Games:* We have created a growing catalog of interactive learning activity and game templates for use throughout our courses. Our Stride offering is built around a motivating reward system to engage students and create learning incentives.
- *Virtual Labs:* We have delivered alternatives for our educational partners who desire a materials-free curriculum. This includes converting many of our 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.
- *Adaptive Learning:* We have developed a proprietary adaptive learning algorithm that uses ongoing practice activity and assessment results to offer suggestions on additional practice. This is utilized in our math and ELA courses to offer on-demand help matched to each learner's characteristics. In addition, we have added integrated adaptive learning at four learner levels in grades 3-5 ELA and Math, and we have integrated an adaptive reading capability at 5 levels into our grade 6-10 ELA courses through a partnership with Newsela.
- *Engaging Videos:* We continue to explore opportunities to enhance student engagement through strategic use of relevant multimedia. For example, we introduce concepts in our Summit math curriculum with a 60-second video that illustrates the application of a specific math concept in practical applications to provide context for students.

Learning Management Systems

For our K12 curriculum users in grades K-5, we provided a proprietary learning management system, our OLS platform. The OLS platform is a significant part of our ongoing effort to provide a productive learning experience for students. The OLS platform is a 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 platform is also the central system through which students, parents, teachers and administrators interact using an integrated email solution and Class Connect (our integrated synchronous session scheduler).

- *Lesson Planning and Scheduling Tools.* During a school year, a typical full-time K-5 student will complete hundreds of lessons across six or more subject areas. In the OLS platform, 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. 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 platform. 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 platform 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 tracking tool regarding attendance and other pertinent data are transferred to our proprietary TotalView system for use in providing administrative support services. This instructional program includes several processes and educational techniques that embrace proactive intervention. As a result, we can provide high-quality instruction and intervention aligned to student needs.

We use the Desire2Learn platform for grades 6-12. This platform enables lesson planning, scheduling, tracking student progress and conducting assessments. The platform includes an assessment tracking tool that enables teachers to easily view assessment data for their students so that they can proactively provide additional instruction to students as needed. Our assessment tools help us improve learning programs by providing information on the effectiveness of instructional activities and curriculum. Furthermore, our learning programs make use of a variety of formative and summative assessment instruments:

- Lesson assessments that verify mastery of the objectives for that lesson and help determine whether further study of the lesson is necessary;
- Unit assessments that 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; and
- Diagnostic assessments for placement and interim assessments to measure progress.

The platform also provides additional tools and reports that enable teachers to have better insights into students' progress and enable students to manage their day more effectively.

TotalView

TotalView is our proprietary student information system. TotalView is integrated with the OLS, the Desire2Learn system, 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 attendance, truancy management, graduation planning, communications, and learning kit shipment tracking.

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.

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 administrative and technology services.

Academic Support Services

Teachers and Related Services. Teachers are critical to students' educational success. Many teachers in the virtual and blended public schools that we manage are employed by the school, with the ultimate authority over these teachers residing with the school's governing body, including final hiring and termination decisions. As part of our service agreements, we typically are engaged to recruit, train and provide administrative support for these school-employed teachers. For our Institutional business customers, we provide instructors as needed using our staff of state-certified teachers and trainers.

We use a rigorous evaluation process for making teacher hiring recommendations to the schools we support. 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. Throughout a teacher's employment in a managed program, we provide tools for teacher management and evaluation. In most Managed Public School Programs, we have a personalized

teacher training program, where experienced educators provide training, coaching and professional development to other teachers at the schools to help improve the quality of instruction to students.

New teachers participate in our comprehensive onboarding and training program during which, among other things, they are introduced to our educational philosophy, our curriculum and 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 can be appropriate to 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 with special needs, 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 supports the special education programs at the schools we serve. While compliance with federal and state special education laws resides primarily with our managed public school customers, we periodically review and, in cooperation with the schools, may assist and facilitate the development and implementation of Individualized Education Plans for students with special needs and for ELL. Each student with special needs 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 advanced and talented students through our advanced learner program.

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, students are given both formative and summative assessments during the course of the school year in order to identify those students needing specific remedial support and measure the effectiveness of the support. We also offer a program designed for academically at-risk students, particularly those who have previously dropped out of high school, and which includes more counseling, social-emotional learning programs and support services.

Student Support Services. We provide students attending virtual or blended public schools that we support and their families with a variety of support services as a means to help them meet their educational needs and goals, and 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 where practical. 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.

For the school year 2019-20, most of the managed public schools we served implemented the complete Students First program. Students First is a series of programs that encompass the entire student experience, from on-boarding to personalized outreach to academic and support services for struggling students and surveys for gauging satisfaction and adapting support services for students and families in the schools.

Administrative and Technology Services

Administrative Services. For most Managed Public School Programs, we provide a package of services whereby we take responsibility for all aspects of the administration of the schools, including the provision of online curriculum and lesson materials, monitoring academic achievement, teacher hiring recommendations and training, financial management and regulatory compliance, marketing and enrollment support, and provision of computers and curriculum materials, state testing technology, and site support as well as other required products and services.

Accreditation. In 2018, Cognia renewed our corporate accreditation for another five years. Cognia (formerly known as AdvancED) is a non-profit organization that serves more than 30,000 public and private schools and districts across the United States. It was created by the merger of the preK-12 divisions of the North Central Accreditation Association Commission on Accreditation and School Improvement and the Southern Association of Colleges and Schools Council on Accreditation and School Improvement, and the subsequent addition of the Northwest Accreditation Commission. Many of the schools we manage also maintain school accreditation through Cognia and also through 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 applicable charter provisions 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 provide planning and implementation support for proctored state tests. Further, as we have added new schools and expanded into new states, we continue to update our compliance policies and procedures. We employ 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 makes recommendations to our managed public schools on applicable regulatory and legal developments. The CSCO provides a school compliance report semi-annually to the Audit Committee, or more frequently on various matters as requested by the Committee.

Financial Management Services. For the schools to which we provide administrative support services, we oversee the preparation of the annual budget and coordinate with the school’s governing body to determine its annual objectives. In addition, we implement an internal control framework, develop policies and procedures, provide accounting services and payroll administration, oversee all federal entitlement programs, and arrange for external audits and support state and local financial compliance reporting by the schools.

Facility, Operations and Technology Support Services. We generally operate administrative offices and all other facilities on behalf of the schools to which we provide administrative support services. We provide these schools with 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 a full suite offering including online curriculum and school support services to K-12 virtual and blended public schools and school districts, including those with a career orientation. These companies include Pearson PLC (Connections Academy), Lincoln Learning Solutions, StrongMind, Pansophic Learning, Inspire Charter Schools, and Charter Schools USA, among others. We also face competition from digital and print curriculum developers. The digital curriculum providers include Apex Learning Inc., Curriculum Associates, Achieve 3000, Weld North LLC, Edmentum Inc., Renaissance Learning, Inc., Rosetta Stone Inc. and traditional textbook publishers such as Houghton Mifflin Harcourt and McGraw Hill. Other competing digital curriculum providers, including Khan Academy, Duolingo, IXL Learning, Inc. and LearnZillion, Inc., offer a different pricing model which provides curriculum at a lower cost (sometimes free) but may charge for additional products or services. We also compete with institutions such as The Laurel Springs School (Nobel Learning Communities, Inc.) and Penn Foster Inc. for online private pay school students. Additionally, we compete with state-administered online programs.

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

- extensive experience in, and understanding of, K-12 virtual schooling;
- comprehensive suite of academic programs;
- customer satisfaction with our curriculum, school teachers and the managed public schools we serve;
- quality of integrated curriculum and materials with an online delivery platform;

- qualifications, experience and training teachers for online instruction;
- comprehensiveness of school management and student support services;
- integrated K-12 solutions, with components designed and built to work together;
- ability to leverage our assets across our lines of business; and
- sophisticated government affairs knowledge and experience in virtual school regulatory environments.

Broadly speaking, we participate in the market for K-12 education. In states where we enter into multi-year service and product agreements with 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 business 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 elementary and middle school students, and some 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 our 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 focused on promoting the K-12 online education category and generating enrollments for the Company's virtual school customers within that category. This is achieved by creating awareness among families with K-12 students through integrated marketing campaigns that include offline and digital media, as well as web assets. These campaigns are continuously optimized using data analytics and market research. In addition, the marketing team assists in enhancing the onboarding experience of new students to online schooling.

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.

Over our 20 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 systems, including our Order Management System, to automatically

translate the curriculum selected by each enrolled student into a personalized order to fulfill the corresponding learning kits to ship to each student. 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. In order to ensure that students in virtual and blended public schools have access to our OLS, we often provide students with a computer, where applicable or required and all necessary support. We source computers and ship them to students when they enroll and reclaim the computers 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 proven Enterprise Technologies. 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 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 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.

Cybersecurity. Our cybersecurity 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 have contracted with an outside network and information cybersecurity firm to assist us with monitoring traffic and potential threats that may target our services and systems. We protect sensitive information through policy and control governance that is validated on a semi-annual basis, and maintain a layered security architecture. Third-party firms are engaged to test our networks, servers and applications for vulnerabilities. We have prepared an incident response plan that is designed to escalate information regarding material data breaches and cybersecurity attacks to the senior management of the Company. A business-centric information security program has also been adopted that is tailored to adjust to an ever-changing IT compliance and information security threat landscape. Although distributed denial-of-service attacks are frequently attempted, we have not experienced a significant disruption to our business as a result of these attacks.

Physical Infrastructure. We utilize leading vendors, such as Amazon Web Services, 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 are also in the process of migrating our entire application portfolio to Amazon Web Services. Amazon Web Services provides a robust technological framework, such as auto-scaling, which aligns with our business. Our Network Operations Center (NOC) monitors our application and infrastructure ecosystem on a 7 X 24 X 365 basis, tracking our availability, scalability and performance. We also leverage Amazon Web Services Advanced Security technologies and framework, as well as third party security services, to ensure our networks, databases, applications and servers are secure and protected.

Other Information

Intellectual Property

We continue to invest in our intellectual property through internal development and by acquisitions as we aim to offer more courses for new grades and expand into adjacent education markets, both in the United States and overseas.

Through acquisitions, we have also obtained 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 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 five U.S.-issued patents and two foreign-issued patents directed towards various aspects of our educational products and offerings. Three of the U.S.-issued patents and one of the foreign-issued patents encompass our system and methods of virtual schooling and online foreign language instruction. The other two U.S.-issued patents and other one foreign-issued patent encompass our system and method for producing, delivering and managing educational material.

We own copyrights related to the lessons contained in the courses that comprise our proprietary curriculum. We also have obtained federal, state and foreign 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.

We grant licenses to individuals to use our software and access our online learning systems. Similarly, schools are granted licenses to utilize our online learning systems and 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, 2020, we had approximately 4,950 employees, including approximately 2,320 teachers. Substantially all of these employees are located in the United States. In addition, there are approximately 2,400 teachers who are employed by virtual or blended public schools that we manage under 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.

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. Information contained on our website is expressly not incorporated by reference into this Annual Report.

REGULATION

We and the virtual and blended public schools that we serve are subject to regulation by and laws of 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, the applicable funding mechanisms for the schools and the increasing number of states with their own, unique privacy laws. 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.

Obtaining new legislation in the remaining states where we do not have virtual and blended public schools 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 policy 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 policy 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 as not-for-profit charters exempt from taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended. 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 to student ratios, specific credentialing of teachers and administrators, 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 the 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. State labor laws applicable to public-sector employees and their rights to organize may also apply to virtual charter schools, such as teachers they employ. 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. States such as California and Nevada are also enacting more general laws about personal information that apply regardless of whether the individual is a student.

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, accounting and financial management, and marketing 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 future funding or repayment of past 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 families seeking this alternative. Statutes, regulations or policies that control the growth of virtual and blended public schools range from setting caps on 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.

Statutes or 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; (iii) teacher contact time—some states have regulations that specify minimum levels of teacher-student face-to-face time; and (iv) completion of course work. 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.

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:

Every Student Succeeds Act (“ESSA”). The ESSA, which took effect on August 2, 2016 and is authorized through 2020, represents a major change in federal education law by shifting much of education policy decision making back to the states and by providing most funding through block grants. Of particular significance to the Company is that the states have the discretion to develop and design their own accountability systems within a broad federal framework. In addition, states have been given the authority to adopt different types of annual accountability plans for school performance, including proficiency and growth standards for all students and subgroups. The ESSA makes clear that the U.S. Department of Education has a more limited role to impose federal mandates, direction or control over the authority given to the states. Finally, there are provisions that provide significant grants to support the start-up of new charter schools with priority to states that serve at-risk students through dropout prevention and recovery and other grants to support language instruction for ELLs and immigrant students. Notwithstanding these federal limitations, states are still required under ESSA to test students in reading or language arts and math annually in grades 3-8 and once in grades 10-12, and in science once in each of the following grade spans: 3-5, 6-9 and 10-12. States had until September 2017 to submit plans to the U.S. Department of Education to demonstrate compliance with ESSA. All states met that deadline and plans have been approved and implemented.

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 specific disabilities that fit within any of the disability categories 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. IDEA 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 IDEA are met. The virtual public schools and blended schools are required to comply with certain requirements in IDEA concerning teacher certification and training. We, the virtual public school or the blended school could be required to provide additional staff, related services, supplemental aids and services or a private school option 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 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.

The Rehabilitation Act of 1973 and the Americans with Disabilities Act. 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 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 of 1973 (“Section 508”) or standards adopted by the world-wide web consortium, such as Web Content Accessibility Guidelines (“WCAG”) Level A and Level AA. 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. Because there is no federal rule setting a uniform technical standard for determining web accessibility under Section 508 and Title II of the ADA, online service providers have no uniform standard of compliance. Some states have adopted the standards promulgated under Section 508 while others require WCAG Level A and/or Level AA or their own unique standards.

Family Educational Rights and Privacy Act (“FERPA”). Virtual public schools and blended schools are also subject to the 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 also apply to virtual managed schools, in some cases depending on the demographics associated with a 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. Title IX of the Education Amendments of 1972 also applies, which prohibits discrimination on the basis of gender in education programs, activities and employment, applies to all schools that receive federal funds. There are also other federal laws and regulations that affect other aspects of our business such as the Children’s Online Privacy Protection Act (“COPPA”), which imposes certain parental notice and other requirements on us that are directed to children under 13 years of age who access the web-based schools we manage. In addition, the Children’s Internet Protection Act requires that school districts that receive certain types of federal funding must ensure that they have technology which blocks or filters certain material from being accessed through the Internet. We have developed procedures by which computers that we ship to students meet this requirement. Many other federal and state laws, such as deceptive trade practices laws, the Lanham Act and others apply to us, just as they do to other businesses. 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.

Laws and Regulations Applicable to Consumer Education Products offered by Galvanize

In January 2020, we expanded our educational product offering to include post-secondary data science and software engineering programs through the acquisition of Galvanize. Galvanize offers business services such as co-working and managed-office services, bespoke enterprise training and consulting services. Galvanize also offers career-readiness training to consumers at physical campuses in major cities nationwide and online.

State Laws Authorizing or Restricting Private Post-secondary Schools. The authority to operate a private post-secondary 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, with regulatory authority vesting under various state agencies. Galvanize currently operates in a multi-jurisdictional regulatory environment, maintaining licenses in several states. In states that have implemented specific legislation to license and oversee private post-secondary schools, Galvanize is able to operate under these statutes. State laws and regulations affect many aspects of operating a private post-secondary school, including, but not limited to, requiring the content and sequence of the curriculum, the methodology for counting student enrollments and reporting outcomes, graduation requirements, the duration of the approved program, the length of the school day, the accessibility of curriculum and technology to students with disabilities, teacher to student ratios, specific credentialing of teachers and administrators, the assessment of student performance, accountability requirements, and compliance with student record collection and retention requirements.

Other types of state regulations applicable to private post-secondary schools include, but are not limited to, restrictions on the use of scholarships and tuition discounts, student payment policies and the collection of and use of student fees, accounting and financial management, and limitations on marketing and advertising practices. States also have laws and regulations concerning the certification, training, experience and continued professional development of teachers and staff with which private post-secondary schools may be required to comply. Additionally, state unfair competition and consumer protection laws and regulations apply to Galvanize in its dealings with the public, which include limitations on advertising and disclosures, and the structure of financing methods for consumer customers.

Federal Laws Applicable to Galvanize.

Galvanize does not qualify or receive Title IV funding under the Higher Education Act but is eligible for federal funding through its veteran's education and workforce programs. As such, Galvanize is required to comply with the anti-discrimination provisions of Title VI of the Civil Rights Act of 1964, Title IX of the Education Amendments of 1972, as amended, Section 504 of the Rehabilitation Act of 1973, the Age Discrimination Act of 1975, and all Federal regulations adopted to carry out such laws. If we fail to comply with these federal laws, we could be determined ineligible to receive funds from federal programs or face penalties.

ITEM 1A. RISK FACTORS

Risks Related to Government Funding and Regulation of Public Education

The majority of our revenues come from Managed 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, or new restrictions are 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 with over 88% of our revenue coming from the Managed Public School line of business. Budget appropriations for education at all levels of government are determined through a legislative process, which may be affected by negative views of for-profit education companies, recessionary conditions in the economy at large, or significant declines in public school funding. The results of federal and state elections can also result in shifts in education policy and the amount of funding available for various education programs.

The political process and potential variability in general economic conditions, including due to the recent COVID-19, 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, including current and future business disruptions and debt and equity market volatility caused by the recent COVID-19 outbreak, could reduce state education funding for all public schools or cause a delay in the payment of government funding to schools and school districts or a delay in payments to us for our products or services, the effects of which 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 2008 recession, many states reduced per pupil funding for public education affecting many of the public schools we serve, including even abrupt midyear 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 and product 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 agreements with 13 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 10% 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. The specific level of federal, state and local funding for the coming years is not yet known for specific states and, when 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 economic conditions or political conditions change.
- 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 and school districts 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 2016, the Commonwealth of Pennsylvania was unable to approve a budget, including funding for public school education, and thus the Agora Cyber Charter School received no funds and could not make timely contractual payments to the Company for our products and services, even though we continued to incur the costs to keep the school operating.

- An increase in the licensing or sale of our curriculum or services under our Institutional business given the COVID-19 pandemic may be temporary and may not significantly increase our revenues over the long-term (e.g., there may be a high level of Learning Solutions' sales in 2020 followed by a decline in sales or increase in cancellations given the reopening of physical classrooms).

Failure to comply with regulatory requirements, poor academic performance, or misconduct by us or operators of other virtual public schools could tarnish the reputation of all the school operators in our industry, which could have a negative impact on our business or lead to punitive legislation.

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 schools 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, or the perception of poor performance, could also lead to closure of an online public school or termination of an approved provider status in some jurisdictions, or to passage of legislation empowering the state to restructure or close low-performing schools. For example, a 2016 Nevada law expanded a charter authorizer's ability to terminate a charter based upon academic performance or to reconstitute a school's governing board, and a 2013 Tennessee law with academic performance criteria applying only to virtual schools.

Beyond academic performance issues, some virtual school operators, including us, have been subject to governmental investigations alleging, among other things, false attendance reporting, the misuse of public funds or failures in regulatory compliance. These allegations have attracted significant adverse media coverage and have prompted legislative hearings and regulatory responses. Investigations have focused on specific companies and individuals, or even entire industries, such as the industry-wide investigation of for-profit virtual schools initiated by the Attorney General of California in 2015. The precise impact of these governmental investigations on our current and future business is difficult to discern, in part because of the number of states in which we operate, the range of purported malfeasance or performance issues involved, or interest by state regulatory authorities. If these situations, or any additional alleged misconduct, cause all virtual public schools to be viewed by the public and/or policymakers unfavorably, we may find it difficult to expand into new states or renew our contracts to manage these schools.

Opponents of public charter schools, including virtual and blended, 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 by those who do not share our belief in the value of this form of public education or the involvement of for-profit education management companies. Whether 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 that can potentially affect us. For example, the Louisiana Association of Educators, an affiliate of a national teachers union, sought to terminate funding on state constitutional grounds to certain types of charter schools through the judicial process (including to a managed public school we serve), and while the teachers union was initially successful, the Louisiana Supreme Court reversed that decision in March 2018. *See Iberville Parish School Board v. Louisiana State Board of Elementary and Secondary Education*, 2018 WL 1319404 (March 13, 2018).

Should we fail to comply with the laws and regulations applicable to our Managed Public School Programs and Institutional business, 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 business. These regulations cover specific program standards and financial requirements including, but not limited to: (i) student eligibility standards; (ii) numeric and geographic limitations or caps

on enrollments; (iii) state-specific curriculum requirements and standards; (iv) restrictions on open-enrollment policies by and among districts; (v) prescribed teacher to student ratios and teacher funding allocations from per pupil funding; (vi) teacher certification and reporting requirements; and (vii) virtual school attendance reporting. 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.

As an emerging form of public education with unique attributes, enabling legislation for online public schools 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 such state's enabling legislation often does not address specific issues, such as what constitutes proper documentation for enrollment eligibility or attendance reporting in a virtual or blended school. From time to time there are changes to the regulators' approach to determining the eligibility of 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 or daily attendance requirements. These regulatory uncertainties may lead to disputes over our ability to invoice and receive payments for services rendered or to disputes with auditors of managed public schools, which could adversely affect our business, financial condition and results of operations. For example, in October 2017, the California Department of Education commenced an audit covering, among other things, the average daily attendance records and associated funding provided to the California Virtual Academies ("CAVAs"), dependent on the proper method of counting the time-value and daily engagement of students enrolled in independent study programs provided by non-classroom based charter schools and the regulations applicable to such programs and schools.

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 2020, approximately 88% of our revenue was derived from Managed Public School Programs, the majority of which were virtual and blended public schools operating under a charter. The service and products 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 Internal Revenue 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, many state public charter school statutes require periodic reauthorization. If a virtual or blended public school we support 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 fiscal year 2018, the Buckeye Community Hope Foundation terminated the charter of Insight School of Ohio.

Actual or alleged misconduct by current or former directors, officers, key employees 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, policy or business practice 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 education industry sectors. For example, for-profit education companies that own and operate post-secondary colleges and programs depend in significant respect on student loans provided by the federal government to cover tuition expenses and income sharing agreements, 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 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 recruitment or other restrictions. In keeping with good business practices, we do not award or permit incentive compensation to be paid to our public school program enrollment staff or contractors based on the number of students enrolled. New laws that specifically target for-profit education companies or education management organizations from operating public charter schools could also adversely affect our business, financial condition and results of operation.

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 that are adverse to us and to the students who attend the school programs we administer, or they may 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 or the students enrolled in those schools. The governing boards of the schools we serve in which we hire the Principal or Head of School (“HoS”) may seek to employ their own HoS as a condition for contract renewal. This decision may potentially reduce the value of the programs they purchase from us by structurally separating the HoS from regular involvement with our virtual school management experts, employee-based professional development programs, and internal understanding of the proprietary curriculum and innovations we develop to improve academic performance. As these independent boards shift their priorities or change objectives, reduce or modify the scope of services and products we provide, or terminate their relationship with us, our ability to generate revenues consistently over time or to improve academic outcomes would be adversely affected.

Our contracts with the managed public schools we serve are subject to periodic renewal, and each year some 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 2020, we had contracts to provide our full range of products and services to 76 schools in 30 states and the District of Columbia under our Managed Public School Programs. A portion of these Managed Public School 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. Most of these contracts include auto renewal provisions having significant advance notice deadlines. The advance notice provisions are intended to allow sufficient time to engage in renewal negotiations before and during the final year of these contracts. A 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. When the customer prefers the existing contract terms to be extended, it can elect to disregard the advance notice provision and have the contract automatically renew. 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 re-enroll 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 Managed Public School Programs, the number of school districts and students who subscribe to the programs offered in our Institutional 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 many of our Managed 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 Managed 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, results of operations and financial condition 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 the terminal grade in a school or have left our Managed Public School Programs for any number of reasons. To the extent our Managed 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 school 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 Public School 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 Public School 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.

Because the independent governing authorities of our customers may shift priorities or incur new obligations which have financial consequences, we may be exposed to the risk of loss resulting from the nonpayment or nonperformance by our customers and our financial condition, results of operations and cash flows could suffer.

If our customers were to cause or be subjected to situations that lead to a weakened financial condition, dispute our invoices, withhold payments, or file for bankruptcy, we could experience difficulty and prolonged delays in collecting receivables, if at all. Any nonpayment or nonperformance by our customers could adversely affect our business, financial condition, results of operations and cash flows. For example, in fiscal year 2017, as the Agora Cyber Charter School continued to operate as a self-managed charter school, it delayed its payments to us and our accounts receivable from the school have grown significantly, resulting in a revised payment schedule agreement, which accompanied a contract extension.

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

As parents evaluate public school choices for their children, we are segmenting our marketing efforts to better attract students who 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. Our research leads us to believe that students with parents who are active and regularly engaged in their education are more likely to be successful in a virtual school. In some cases, the governing authorities of these schools may request different enrollment policies or criteria. Our marketing efforts, therefore, may not be wholly successful, and could lead to an overall decline in enrollment for our Managed Public School Programs, thus adversely affecting our revenue and results of operations.

The student demographics of the schools we serve 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 Managed Public School Programs have experienced in recent years a higher academically at-risk student population, requiring supplemental student and family support 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. We consider students academically at-risk if they were not proficient on the previous year's state assessment, are credit-deficient, have previously dropped out, have failed courses, or score lower than average on diagnostic norm-referenced assessments. Some states have additional or different indicators to determine students who are at risk. These factors are used by the state to identify at-risk students in several states and have been found through research to impact future student performance. The schools we serve also enroll a significant percentage of special needs students with learning and/or physical disabilities, which also adds to the total costs incurred by the schools.

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 Managed Public School Programs, our costs are likely to increase.

As our cost structure evolves due to the demographics, educational profile and mix of the students enrolled in our Managed 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 modified graduation requirements, 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. Like many traditional brick and mortar public schools, not all of the managed public schools we serve meet the requirements of their applicable 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 obligation to educate any child regardless of circumstance, the performance of these students can adversely affect a school's standing under applicable accountability standards. 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 or experience low graduation rates. For example, at-risk students who attended the Electronic Classroom of Tomorrow (ECOT) schools in Ohio which were closed in mid-school year 2017-18 by state regulators, and who then transferred to other public schools, including the Ohio Virtual Academy supported by us, could negatively impact a receiving school's overall academic performance ratings absent a different accountability measure applicable to such students or waiver of such standards. Moreover, under ESSA, state authorities may change their accountability frameworks in ways that negatively impact the schools we serve.

Students in the managed public schools we serve are required to complete standardized state testing, and the frequency and the results of this testing may have an impact on school enrollment. The significant increase of testing undertaken at the state level has led some parents to opt out of state assessments, a parental right which is now codified in the ESSA, thereby resulting in an incomplete and potentially inaccurate assessment of school and student performance. To avoid the consequences of failing to meet applicable required proficiency, growth or accountability standards, teachers or school administrators may engage in improperly altering student test scores or graduation standards especially if teacher performance and compensation are 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 from a federally mandated approach for curriculum standards and assessments to individual state determinations under the ESSA may create ongoing challenges to ensure that our curriculum products align with state requirements, which could possibly cause academic performance to decline and dissatisfaction by our school customers which could limit our growth and profitability.

Under the ESSA, states will set their own curriculum standards in reading, math and science, and the federal government is prohibited from mandating or incentivizing states to adopt any set of particular standards, such as Common Core. States were also given the authority under the ESSA to craft their own assessment programs to measure the proficiency of their students for college and career readiness, and may also choose to offer already available nationally recognized assessments at the high school level, such as the SAT or ACT tests. As implementation proceeds at the state level, and use of the assessments previously developed by the Partnership for Assessment of Readiness for College and Careers and Smarter Balanced Assessment Consortium consortia continues to erode, a multitude of different standards and assessments may emerge and result in temporary misalignments of our curriculum offerings with state standards, cause academic performance to decline, create a need for additional teacher training and product investments, all of which could adversely affect our relationship with our managed public school and school district customers, financial condition, contract renewals and reputation.

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, such as the acquisition of Galvanize in January 2020. 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 on a timely basis, or at all, or further the strategic purpose of any acquisition if our forecasts do not materialize. The pursuit of acquisitions and their integrations may divert the resources that could otherwise be used to support and grow our existing lines of business. The combination of two independent enterprises is a complex, costly and time-consuming process. Acquisitions may create multiple and overlapping product lines that are offered, priced and supported differently, which could cause customer confusion and delays in service. We may have difficulties coordinating sales and marketing efforts to effectively position the combined company's capabilities. 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 and their integrations 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, including but not limited to, financial accounting systems, information technology systems, transaction processing systems, internal controls and standards, and procedures and policies, 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 operating expenses, unexpected accounting treatment, unexpected increases in taxes due or a loss of anticipated tax benefits. The acquired companies, including Galvanize, may not be able to achieve the levels of revenue, earnings or operating efficiency that we expect. Galvanize's business and financial performance are subject to certain risks and uncertainties, including, among others, growing its enterprise business and expanding the geographical footprint of its campuses. 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 offerings. Our operating results may be adversely 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.

To execute our business plans, we depend upon the experience and industry knowledge of our officers and other key employees, including those who joined us as part of the Galvanize acquisition. The combined company's success will depend, in part, upon our ability to retain key management personnel and other key employees, some of which may experience uncertainty about their future roles with the combined company as a result of the Galvanize acquisition. This may have a material adverse effect on our ability to attract and retain key personnel.

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, such as Galvanize, or several concurrent acquisitions.

Our business could be negatively affected as a result of actions by activist stockholders, and such activism could impact the trading value of our securities and harm our business, financial condition and results of operations.

Responding to actions by activist stockholders can be costly and time consuming, disrupting our operations and diverting the attention of management and our employees. If activist stockholders were to emerge, their activities could interfere with our ability to execute our strategic plan and divert resources from our business. In addition, a proxy contest for the election of directors at our annual meeting would require us to incur significant legal fees and proxy solicitation expenses and require significant time and attention of management and our Board of Directors. Any perceived uncertainties as to our future direction also could affect the market price and volatility of our securities, cause key executives to leave the Company, adversely affect the relationships we have with our school board customers, and harm existing and new business prospects.

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.

While historically we grew by opening new virtual public schools in new states, in recent years the pace of state expansion has declined while opening more schools in existing states has increased. In fiscal year 2020, we served 76 managed virtual public schools and blended schools in 30 states and the District of Columbia. Without adding additional states, our Managed Public School Program revenues may become increasingly dependent on serving more virtual schools in existing states. We may also 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 of operations and financial condition 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, job placement and industry-certified content, and school performance and compliance management. In our Managed Public School Programs, CRE, and Institutional businesses, we compete with companies that provide online curriculum and support services. We also compete with public school districts and state departments of education that offer K-12 online programs of their own or in partnership with other online curriculum vendors. As we pursue our CRE strategic initiatives, we will be competing with corporate training businesses and some employers that offer education as an employee benefit. We anticipate intensifying competition from such competitors and by new entrants. Our competitors may adopt superior curriculum content, technology and learning platforms, school support and marketing approaches, with different pricing and service packages that may have greater appeal than our offerings. For example, the Institutional business continues to face significant price pressure due to intense competition. In addition, some of our Managed Public School Programs could seek to transition to a self-managed school by inviting 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. Many of these traditional publishers, or new market entrants, have developed their own online curriculum products and teaching materials that compete directly with our Institutional business products. As a result, they may be able to devote more 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 websites, computers and other display devices connected to the Internet. The website platforms and online curriculum include a combination of software applications that include graphics, pictures, videos, animations, sounds and interactive content that may present challenges to individuals with disabilities. A number of states and federal authorities have considered or are considering how web-based information should be made accessible to persons with such disabilities. To the extent they enact or interpret laws and regulations to require greater accessibility than we currently provide, we may have to modify our offerings to satisfy those requirements. Because there is no federal rule setting a uniform technical standard for determining web accessibility under Section 508 and Title II of the ADA, online service providers have no uniform standard of compliance. Some states have adopted the standards promulgated under Section 508 while others require WCAG Level A and/or Level AA or their own unique standards. In addition, Section 504 of the Rehabilitation Act of 1973 is designed to ensure that students with disabilities have an equal opportunity to access each school's website and online learning environment. To the extent that we enter into federal government contracts, different standards of compliance could be imposed on us under Section 508 of the Rehabilitation Act, or by states who apply these federal standards under Section 508 or other standards to education providers, which standards may be changed from time to time. Beyond the significant product development costs associated with these evolving regulations, a failure to meet such requirements could also result in loss or termination of material contracts, inability to secure new contracts, or in potential legal liability.

Our Managed Public School 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 Public School 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 expected funds each school will receive in a particular school year. Additionally, we take responsibility for any operating deficits incurred at most of the Managed Public School 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 net operating loss. We review our estimates of total funds and operating expenses periodically, and we revise as necessary, by adjusting our year-to-date earned revenues to be proportional to the expected revenues to be earned during 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 of operations and cash flows.

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 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. 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 April through September.

We expect quarterly fluctuations in our 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 continual efforts to innovate and pilot new programs to enhance student learning and to foster college and career opportunities, such as our Destination Career Academy schools which offer pathways for CTE, may not receive sufficient market acceptance to be economically viable;
- the ongoing transition of our curriculum from Flash to HTML, and our use of third party educational platforms that we do not control, could create issues with customer satisfaction, early withdrawals and declines in re-registrations, and potentially harm our reputation;
- the acquisition or opening of additional managed public schools in states where we already have a contract with such schools can potentially complicate the school selection process for prospective parents, and present marketing differentiation challenges depending on the facts and circumstances in that state;
- our development of public blended schools has raised different operational challenges than those we face with full-time virtual schools. Blended schools require us to lease facilities for classrooms, staff classrooms with teachers, sometimes provide meals and kitchen facilities, adhere to local safety and fire codes, purchase additional insurance and fulfill many other responsibilities;
- 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 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; and

- 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.

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 benefits packages to attract and retain such qualified teachers.

The teachers in many managed public schools we serve are not our employees and the ultimate authority relating to those teachers resides with an independent not-for-profit governing body, which oversees the schools. However, under many of our service and product 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 Managed 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 needs, 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 and course assignments in each state, or decreases in the quality of our instruction, whether actual or perceived, could have an adverse effect on our Managed Public School Programs and Institutional businesses.

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 the public schools we serve were to unionize, as is the case in California, the employer would become subject to a collective bargaining agreement with union representatives. A collective bargaining agreement could impact teacher salaries, benefits, work rules, teacher tenure and provide for restrictions on the teaching work-day and the time devoted to online instruction delivery or communications with students, and place limitations on the flexibility to reassign or remove teachers for inadequate performance. This could result in higher school-related expenses and could impede the sustainability of, or growth in, enrollment at the school due to the loss of management flexibility and innovation. The outcome could result in higher costs to us in providing educational support and curriculum services to the school, which may adversely affect our operating margins, overall revenues and academic performance results.

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 proprietary and third-party LMSs 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 the 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, Oracle-hosted, 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 system 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, discrete student populations, the educational community at large, key policy 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 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 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. 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 patents, trademarks, trade secrets, copyrights, domain names and other intellectual property rights are important assets. For example, we have been granted three U.S. patents related to our provision of virtual schooling, including the system components for creating and administering assessment tests and our lesson progress tracker, and two U.S. patents related to foreign language instruction. Additionally, we are the copyright owner of courses in 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. If we fail to protect adequately our intellectual property through patents, trademarks and copyrights, license agreements, employment agreements, confidentiality agreements, nondisclosure agreements or similar agreements, our intellectual property rights may be misappropriated by others, invalidated or challenged, and our competitors could duplicate our technology or may otherwise limit any competitive technology advantage we may have. 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. For example, a non-practicing entity sued us alleging that our proprietary learning systems infringed three of its patents although its lawsuit was ultimately dismissed on the merits in 2014. 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 may also 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.

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.

We operate in markets that are dependent on Information Technology (IT) systems and technological change. Failure to maintain and support customer facing services, systems, and platforms, including addressing quality issues and execution on time of new products and enhancements, could negatively impact our revenues and reputation.

We use complex IT systems and products to support our business activities, including customer-facing systems, back-office processing and infrastructure. We face several technological risks associated with online product service delivery, information technology security (including virus and cyber-attacks), e-commerce and enterprise resource planning system implementation and upgrades. From time to time we have experienced verifiable attacks on our system by unauthorized parties, and our plans and procedures to reduce such risks may not be successful. Thus, our business could be adversely affected if our systems and infrastructure experience a significant failure or interruption in the event of future attacks on our system by unauthorized parties.

Failure to prevent or detect a malicious cyber-attack on our systems and databases could result in a disruption of our services, misappropriation of confidential information or access to highly sensitive information, and may adversely affect the demand for our services and products, our reputation, and financial performance.

Cyber-attacks are becoming more sophisticated and pervasive. Although we dedicate personnel and resources to maintain multiple levels of protection to minimize the risk of a cybersecurity attack, malware intrusion or breach, such measures cannot provide an absolute guarantee as hackers continue to become more sophisticated. Across our business we store large volumes of personally identifiable information including that of employees, customers, students and parents and legal guardians. Individuals may try to gain unauthorized access to our data to misappropriate such information for

potentially fraudulent purposes, and our security measures may fail to prevent such attacks or unauthorized access. A significant attack or breach could result in a devastating impact on our reputation, financial condition or student experience. In addition, if we were unable to prove that our systems are properly designed to detect an intrusion, we could be subject to severe penalties and loss of existing or future business.

We rely on the Internet to enroll students and to deliver our products and services to children and to market ourselves and schools that contract with us, all of 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, state and other jurisdictional laws that could have an impact on our business include the following:

- the COPPA, 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 FERPA, which imposes parental or student consent requirements for specified disclosures of student information to third parties, and emerging state student data privacy laws;
- the CDA, 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;
- rapidly emerging state student data privacy laws which require schools to adopt privacy policies and/or require certain contractual commitments from education technology providers are applicable to virtual schools and can significantly vary from one state to another;
- federal and state laws that govern schools' obligations to ELL students and students with disabilities; and
- the European Union General Data Protection Regulation ("GDPR") which may apply to certain aspects of our Private Pay schools.

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.

Failure to comply with data privacy regulations could result in reputational damage to our brands and adversely affect our business, financial condition and results of operations.

Any perceived or actual unauthorized disclosure of personally identifiable information, whether through breach of our network or a vendor's network by an unauthorized party, employee theft, misuse or error or otherwise, could harm our reputation, impair our ability to attract and retain our customers, or subject us to claims or litigation arising from damages suffered by individuals. Failure to adequately protect personally identifiable information could potentially lead to penalties, significant remediation costs, reputational damage, the cancellation of existing contracts and difficulty in competing for future business. In addition, we could incur significant costs in complying with relevant laws and regulations regarding the unauthorized disclosure of personal information, which may be affected by any changes to data privacy legislation at both the federal and state levels. Because we serve students residing in foreign countries, we may be subject to privacy laws of other countries and regions, such as the GDPR. In addition to the possibility of penalties, remediation costs and reputational damage, the cost of compliance with foreign laws may outweigh revenue from those countries to such an extent that we may discontinue or restrict our offerings to certain countries.

We utilize a single logistics vendor 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 second 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 one warehouse facility, which is operated by a third-party logistics vendor that 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.

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 and 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 in Herndon, Virginia 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, and 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. In our capacity planning processes, 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 communication systems, enterprise hardware and software systems, and enrollment centers. In the absence of compatible 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 ubiquitous use 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.

We may be unable to attract and retain key executives and skilled employees, and because our employees are located throughout the United States, we may incur additional compliance and litigation costs that could adversely impact our business, financial condition and our results of operations.

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 experienced executive management and employees with specialized skills and knowledge across many disciplines. If any of these employees leave us 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 condition 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.

We are subject to the Fair Labor Standards Act and other state and federal employment laws. These laws govern such matters as minimum wage, overtime, leave, and other working conditions that can increase our labor costs or subject us to liabilities to our employees. In addition, many state and local jurisdictions are adopting their own laws, such as paid sick leave, to address conditions of employment not covered by federal law and/or to provide additional rights and benefits to employees. These developments and disparate laws could increase our costs of doing business, lead to litigation, or have a material adverse effect on our business, financial condition and results of operations.

We partially self-insure our group health insurance program and actual claims may differ from our estimates, which could materially impact our results of operations.

We self-insure our group health insurance program for all eligible employees and their family members subject to a stop loss insurance policy with a per person limit of \$550,000 and an aggregate limit of 125% of expected claims

based on a formulaic determination of the expected claims. Liabilities associated with the risks that are retained by the Company are estimated, in part, by considering historical claims experience, demographic factors, severity factors and other actuarial assumptions. Our results could be materially impacted by claims and other expenses related to our group health insurance program if future occurrences and claims differ from these assumptions and historical trends and exceed the limitations of liability under the stop loss insurance policy. Other factors, such as pandemics and epidemics, including the COVID-19 pandemic, may adversely affect the cost, retentions, limits and availability of stop loss insurance coverage.

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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. *PROPERTIES*

Our headquarters is located in approximately 129,000 square feet of office space in Herndon, Virginia. The facility is under a lease that expires in May 2022. In addition, we lease approximately 624,000 square feet in multiple locations throughout the United States under individual leases that expire between August 2020 and August 2030.

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.

On May 10, 2019, K12 Virtual Schools LLC filed a demand for arbitration with the American Arbitration Association (“AAA”), Case No. 01-19-001-4778, naming Georgia Cyber Academy, Inc. (“GCA”) as the respondent. The demand asserted claims for GCA’s breach and anticipatory breach of the Educational Products and Services Agreement between GCA and K12 Virtual Schools LLC, as amended on January 4, 2019, based on GCA’s engagement of other educational products and service providers for the school year 2019-2020. On May 29, 2019, GCA filed counterclaims against K12 Virtual Schools, LLC for breach of contract, fraud, breach of the duty of good faith and fair dealing, and negligent misrepresentation. The AAA appointed an arbitrator on June 12, 2019, and the parties presented evidence in support of their respective claims during merits hearings in March and June 2020. On July 8, 2020, the parties executed an agreement, effective June 30, 2020, to resolve all of their claims. Under the terms of the settlement agreement, GCA will pay the Company \$19 million over a period of two years, of which \$10 million was paid in July 2020. The Company recorded revenues of \$4.6 million for services provided by the Company during fiscal year 2020 and the remaining \$14.4 million reflected a prior year receivable, as part of a comprehensive settlement agreement.

ITEM 4. *MINE SAFETY DISCLOSURES*

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

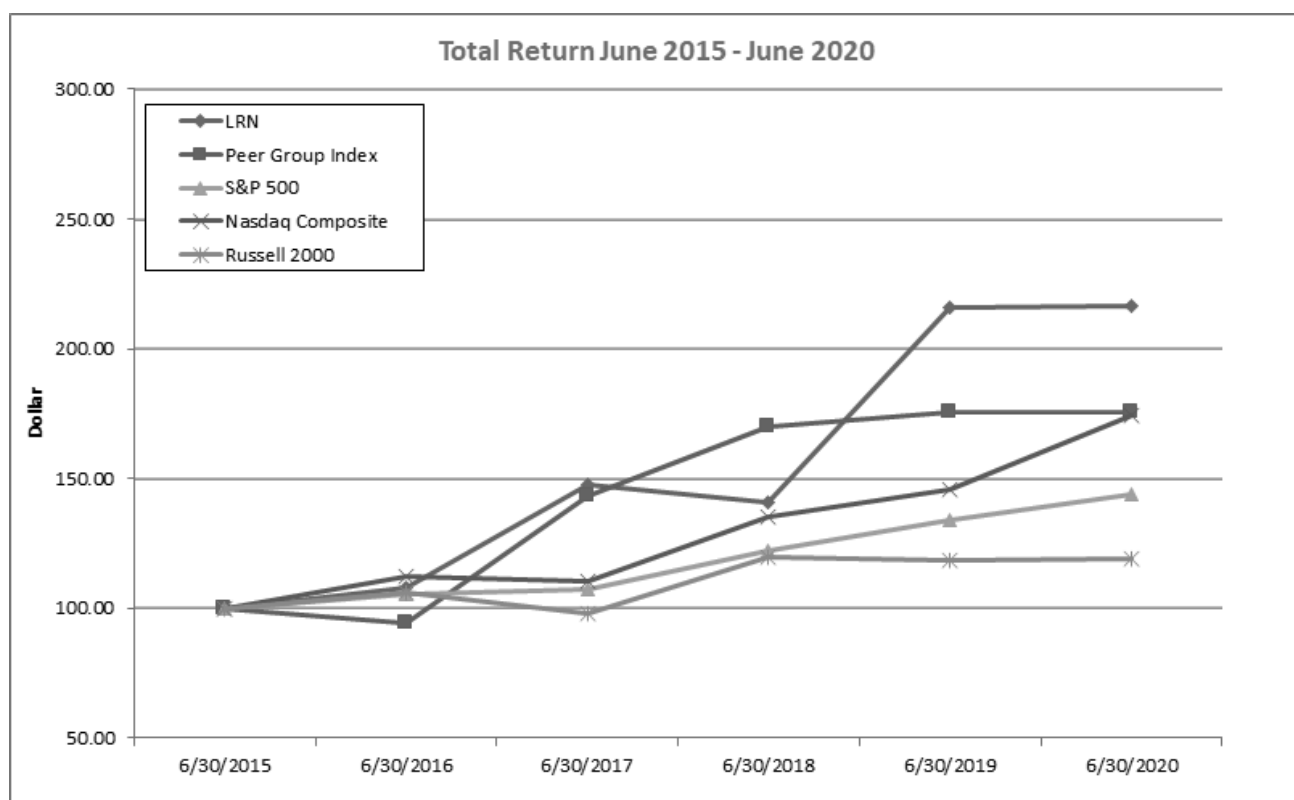
Our common stock, par value \$0.0001 per share, is traded on the New York Stock Exchange (the "NYSE") under the symbol "LRN." As of July 31, 2020, there were 26 registered holders of our common stock.

Stock Performance Graph

The graph below compares 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 2U, Inc., Adtalem Global Education Inc., American Public Education Inc., Career Education Corporation, Chegg, Inc., Grand Canyon Education Inc., Houghton Mifflin Harcourt Company, Pearson PLC, Pluralsight, Inc., Rosetta Stone Inc., Strategic Education Inc., and Zovio Inc. 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, 2015 and tracks it through June 30, 2020. All prices reflect closing prices on the last day of trading at the end of each calendar quarter.

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN(1)(2)

Among K12 Inc., S&P 500 Index, NASDAQ Composite Index, Russell 2000 Index and Peer Group Index



| | 30-Jun-15 | 30-Jun-16 | 30-Jun-17 | 30-Jun-18 | 30-Jun-19 | 30-Jun-20 |
|-------------------------|-----------|-----------|-----------|-----------|-----------|-----------|
| LRN | 100 | 108 | 147 | 141 | 216 | 217 |
| Peer Group Index | 100 | 94 | 144 | 170 | 176 | 175 |
| S&P 500 | 100 | 105 | 107 | 122 | 134 | 144 |
| Nasdaq Composite | 100 | 113 | 110 | 135 | 146 | 174 |
| Russell 2000 | 100 | 106 | 98 | 120 | 118 | 119 |

- (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

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 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, and 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.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth our selected consolidated statements of operations, balance sheets 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 June 30, 2020, and the selected consolidated balance sheet data as of June 30, 2020 and 2019, 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, 2017 and 2016 and selected consolidated balance sheet data as of June 30, 2018, 2017 and 2016, 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.

| | Year Ended June 30, | | | | |
|--|---------------------|------------------|------------------|---------------|-----------------|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| | (In thousands) | | | | |
| Consolidated Statement of Operations Data: | | | | | |
| Revenues | \$ 1,040,765 | \$ 1,015,752 | \$ 917,734 | \$ 888,519 | \$ 872,700 |
| Instructional costs and services | 693,232 | 663,437 | 592,495 | 557,316 | 546,510 |
| Gross margin | 347,533 | 352,315 | 325,239 | 331,203 | 326,190 |
| Selling, general and administrative expenses | 315,076 | 306,829 | 299,694 | 318,074 | 312,276 |
| Income from operations | 32,457 | 45,486 | 25,545 | 13,129 | 13,914 |
| Impairment of investment in Web International Education Group, Ltd. | — | — | — | (10,000) | — |
| Interest income (expense), net | 698 | 2,761 | 965 | 1,808 | (439) |
| Other income (expense), net | 272 | 114 | — | — | (178) |
| Income before income taxes, loss from equity method investments and noncontrolling interest | 33,427 | 48,361 | 26,510 | 4,937 | 13,297 |
| Income tax (expense) benefit | (8,541) | (10,520) | 910 | (5,396) | (4,746) |
| Loss from equity method investments | (380) | (632) | — | — | — |
| Net income (loss) | 24,506 | 37,209 | 27,420 | (459) | 8,551 |
| Add net loss attributable to noncontrolling interest | — | — | 200 | 910 | 484 |
| Net income attributable to common stockholders | <u>\$ 24,506</u> | <u>\$ 37,209</u> | <u>\$ 27,620</u> | <u>\$ 451</u> | <u>\$ 9,035</u> |

| | Year Ended June 30, | | | | |
|---|---------------------|------------|------------|------------|------------|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| (In thousands except share and per share data) | | | | | |
| Net income attributable to common stockholders per share: | | | | | |
| Basic | \$ 0.62 | \$ 0.96 | \$ 0.70 | \$ 0.01 | \$ 0.24 |
| Diluted | \$ 0.60 | \$ 0.91 | \$ 0.68 | \$ 0.01 | \$ 0.23 |
| Weighted average shares used in computing per share amounts: | | | | | |
| Basic | 39,478,928 | 38,848,780 | 39,282,674 | 38,298,581 | 37,613,782 |
| Diluted | 40,663,224 | 40,944,800 | 40,637,744 | 39,500,934 | 38,850,388 |
| Other Data: | | | | | |
| Net cash provided by operating activities | \$ 80,415 | \$ 141,606 | \$ 105,446 | \$ 88,728 | \$ 121,778 |
| Depreciation and amortization | \$ 72,091 | \$ 71,400 | \$ 75,260 | \$ 74,280 | \$ 68,225 |
| Stock-based compensation expense | \$ 23,609 | \$ 16,676 | \$ 20,817 | \$ 22,598 | \$ 18,617 |
| Adjusted EBITDA (1) | \$ 128,157 | \$ 133,562 | \$ 121,622 | \$ 110,007 | \$ 100,755 |
| Capital Expenditures: | | | | | |
| Capitalized curriculum development costs | \$ 19,332 | \$ 16,611 | \$ 9,927 | \$ 19,132 | \$ 21,627 |
| Purchases of property, equipment and capitalized software development costs | \$ 25,665 | \$ 31,795 | \$ 33,276 | \$ 29,092 | \$ 41,273 |
| New finance lease obligations (2) (4) | \$ 17,160 | \$ 19,664 | \$ 17,414 | \$ 14,469 | \$ 10,878 |
| Total capital expenditures | \$ 62,157 | \$ 68,070 | \$ 60,617 | \$ 62,693 | \$ 73,778 |

| | As of June 30, | | | | |
|--|----------------|------------|------------|------------|------------|
| | 2020 | 2019 | 2018 | 2017 | 2016 |
| (In thousands) | | | | | |
| Consolidated Balance Sheet Data: | | | | | |
| Cash and cash equivalents | \$ 212,299 | \$ 283,121 | \$ 231,113 | \$ 230,864 | \$ 213,989 |
| Total assets | \$ 1,073,263 | \$ 819,606 | \$ 741,963 | \$ 735,284 | \$ 734,055 |
| Credit facility | \$ 100,000 | \$ — | \$ — | \$ — | \$ — |
| Current portion of operating lease liability | \$ 20,689 | \$ — | \$ — | \$ — | \$ — |
| Long-term operating lease liability | \$ 96,544 | \$ — | \$ — | \$ — | \$ — |
| Current portion of finance lease liability (4) | \$ 13,304 | \$ 19,588 | \$ 13,353 | \$ 11,880 | \$ 13,210 |
| Long-term finance lease liability (4) | \$ 4,634 | \$ 5,060 | \$ 12,665 | \$ 10,025 | \$ 9,922 |
| Total K12 Inc. stockholders' equity | \$ 675,329 | \$ 633,365 | \$ 587,189 | \$ 574,346 | \$ 558,720 |
| Working capital (3) | \$ 227,855 | \$ 374,069 | \$ 337,790 | \$ 355,831 | \$ 322,843 |

(1) Adjusted EBITDA is a non-GAAP measure that we define as income (loss) from operations as adjusted for stock-based compensation and depreciation and amortization. We use Adjusted EBITDA in addition to income (loss) from operations and net income (loss) as a measure of operating performance. However, Adjusted EBITDA is not a recognized measurement under U.S. generally accepted accounting principles, or GAAP, and when analyzing our operating performance, investors should use Adjusted EBITDA in addition to, and not as an alternative for, net income (loss) as determined in accordance with GAAP. Because not all companies use identical calculations, our presentation of Adjusted EBITDA may not be comparable to similarly titled measures of other companies. Furthermore, Adjusted 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 Adjusted EBITDA is useful to investors because it removes such things as stock-based compensation, which is a non-cash charge that varies based on market volatility and the terms and conditions of the awards. Adjusted EBITDA also removes depreciation and amortization, which can vary depending upon accounting methods and the

book value of assets, and can provide a measure of corporate performance exclusive of capital structure and the method by which assets were acquired. Our management uses Adjusted EBITDA:

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

(2) New finance lease obligations are primarily for student computers and related equipment.

(3) Working capital is calculated by subtracting current liabilities from current assets.

(4) Previously, the reference was to capital lease obligations.

The following table provides a reconciliation of income from operations to Adjusted EBITDA:

| | Year Ended June 30, | | | | |
|----------------------------------|----------------------------|-------------------|-------------------|-------------------|-------------------|
| | <u>2020</u> | <u>2019</u> | <u>2018</u> | <u>2017</u> | <u>2016</u> |
| | (In thousands) | | | | |
| Income from operations | \$ 32,457 | \$ 45,486 | \$ 25,545 | \$ 13,129 | \$ 13,914 |
| Stock-based compensation expense | 23,609 | 16,676 | 20,817 | 22,598 | 18,616 |
| Depreciation and amortization | 72,091 | 71,400 | 75,260 | 74,280 | 68,225 |
| Adjusted EBITDA | <u>\$ 128,157</u> | <u>\$ 133,562</u> | <u>\$ 121,622</u> | <u>\$ 110,007</u> | <u>\$ 100,755</u> |

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 Exchange Act. 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 year ended June 30, 2020.
- *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 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 and offer proprietary and third-party curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade, or K-12. Our learning systems combine curriculum, instruction and related support services to create an individualized learning approach. Our learning systems are well suited for virtual and blended public schools, school districts, charter schools, and private schools that utilize varying degrees of online and traditional classroom instruction, and other educational applications. These products and services are provided through three lines of business: (i) Managed Public School Programs; (ii) Institutional; and (iii) Private Pay Schools and Other.

K12's career readiness education ("CRE") initiative offers online curriculum and career services to middle and high school students, under the Destinations Career Academy ("DCA") brand name, which can provide services to all of our lines of business. The initiative is designed to give students a head start on their career goals by providing them with content pathways toward an industry certification, college credits, and work experiences.

| Managed Public School Programs | Institutional | Private Pay Schools and Other |
|--|---|---|
| <ul style="list-style-type: none"> Virtual public schools | <ul style="list-style-type: none"> Non-managed public school programs | <ul style="list-style-type: none"> Private schools <ul style="list-style-type: none"> —K12 Private Academy (formerly, K12 International Academy) |
| <ul style="list-style-type: none"> Blended public schools | <ul style="list-style-type: none"> Institutional software and services | <ul style="list-style-type: none"> —George Washington University Online High School |
| <ul style="list-style-type: none"> Destinations Career Academies / Career readiness education | <ul style="list-style-type: none"> Destinations Career Academies / Career readiness course offerings | <ul style="list-style-type: none"> —The Keystone School Destinations Career Academies (Private) Galvanize |

Our Managed Public School Programs offer an integrated package of systems, services, products, and professional expertise that we administer to support an online or blended public school. Customers for these programs can obtain the administrative support, information technology, academic support services, online curriculum, learning system platforms and instructional services under the terms of a negotiated service agreement. We provide our Managed Public School Programs and DCA programs to virtual and blended public charter schools and school districts. These contracts are negotiated with and approved by the governing authorities of the customer. The duration of the Managed Public School Program service and product agreements are typically 2-5 years, and most provide for automatic renewals absent a customer notification within a negotiated time frame. During any fiscal year, we may enter into new Managed Public School agreements, receive non-automatic renewal notices, and negotiate replacement agreements, terminate the contract or receive notice of termination, or transition a school between a Managed Public School Program and a Non-managed Public School Program. The governing boards may also establish school policies and other terms and conditions over the course of a contract, such as enrollment parameters. The authorizers who issue the charters to our Managed Public School customers can renew, revoke, or modify those charters as well.

For the 2019-2020 school year, we provided our Managed Public School Programs to 76 schools in 30 states and the District of Columbia. During this fiscal year, we entered into three new contracts in three states to open Managed Public School Programs, auto-renewed six agreements for schools in five states, mutually agreed to terminate the service agreement with one school, and completed renewal negotiations in five states, with varying degrees of contract modifications. During this fiscal year, at two schools the authorizer invoked its contractual right to not renew its district program for the upcoming 2020-2021 school year. One school elected not to renew their service agreement with us for the 2022-2023 school year and thereafter.

Our Institutional business includes Non-managed public school programs and Institutional software and services where K12 offers curriculum, including career technical education (“CTE”) electives, and technology for full-time virtual and blended programs. In addition, we offer options whereby the school contracts with us for instruction, curriculum, supplemental courses, marketing, enrollment and other educational services and products. Unlike Managed Public School Programs, the Institutional business does not offer primary administrative support services, which remain the responsibility of the school district or the school customer. In addition to curriculum, platforms and programs, the services we offer to Institutional clients also can assist them in launching their own online and blended learning programs tailored to their own requirements and may include instructional support, reporting tools and content libraries. We work closely as a partner with school districts, public schools, charter schools, private companies, and private schools to provide them with educational solutions. For the 2019-20 school year, we served school districts or schools in all 50 states and the District of Columbia.

Our Private Pay Schools and Other business includes three accredited, tuition-based private schools that meet a range of student needs from individual course credit recovery to college preparatory programs. These schools are: (i) K12 Private Academy (formerly, K12 International Academy) and its DCA program, 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, (ii) The Keystone School, a private school that offers online and correspondence courses, and (iii) the George Washington University Online High School, a school that offers a college preparatory program and is designed for middle and high school students who are seeking a challenging academic experience. Our Private Pay Schools and Other business also includes Galvanize, Inc. (“Galvanize”), which is discussed in more detail below.

For the year ended June 30, 2020, revenues increased to \$1,040.8 million from \$1,015.8 million for the year ended June 30, 2019, an increase of 2.5% primarily due to our Managed Public School Programs. Over the same period, operating income decreased to \$32.5 million from \$45.5 million for the year ended June 30, 2019, a decrease of 28.6%; net income attributable to common stockholders decreased to \$24.5 million from \$37.2 million for the year ended June 30, 2019, a decrease of 34.1%; and Adjusted EBITDA, a non-GAAP measure (see reconciliation of income from operations to Adjusted EBITDA in “Item 6—Selected Financial Data”), decreased to \$128.2 million from \$133.6 million for the year ended June 30, 2019, a decrease of 4.0%.

Recent Developments

On January 27, 2020, we acquired Galvanize in exchange for \$165.0 million, plus working capital. Galvanize provides talent development for individuals and enterprises in information technology fields. The acquisition of Galvanize expands the Company’s offerings to include post-secondary skills training in data science and software engineering, technology staffing and developing talent and capabilities for companies. The Company also plans to use Galvanize’s curriculum to create appropriate content to offer high school students.

Key Aspects and Trends of Our Operations

Revenues—Overview

We generate a significant portion of our revenues from the sale of curriculum, administration support and technology services to virtual and blended public schools. 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 stabilize, then increase over time 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 business, and pursuing international opportunities to offer our learning systems. Combined revenues from these other sectors were significantly smaller than those from the Managed Public School Programs in the year ended June 30, 2020. Our success in executing our strategies will impact future growth. We provide products and services primarily to three lines of business: Managed Public School Programs; Institutional; and Private Pay Schools and Other.

Factors affecting our revenues include:

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

Managed Public School Programs

We define an enrollment as any student enrolled in a virtual or blended public school which qualifies as a Managed 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 2020, total average student enrollments in Managed Public School Programs increased by 3,030 or 2.6%, to 118,591 as compared to total average student enrollments of 115,561 in fiscal year 2019. 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 2020 and 2019, the growth rate of our Managed Public School Program revenues exceeded the growth in our Managed Public School Programs average student enrollments primarily due to increases in the per pupil achieved funding, 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 student. During the years ended June 30, 2020 and 2019, we had zero and one contracts, respectively, that represented greater than 10% of total revenues. Approximately 88% of our revenues were derived from Managed Public School Programs during the year ended June 30, 2020.

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

Institutional

While Managed Public School Programs constitute the majority of our revenues, there is potential 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 Managed Public School Programs. Sales to those entities are conducted through our Institutional business organization. While we pursue opportunities in our Institutional business, the sector continues to experience significant competitive pricing pressures.

The Institutional business portfolio provides 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 Non-managed Public School Programs to individual course sales and supplemental options that can be used in traditional classrooms to differentiate instruction. The Institutional business course catalog is extensive and addresses specific student needs, including Advanced Placement (“AP”), honors programs, world languages, English language learners, adaptive math, remediation, credit recovery, alternative education, career and technology electives and college readiness. In connection with these solutions, we also offer state-certified teachers, training for school personnel in online instruction methods, and 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 business is revenues. The customers served by the Institutional business 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 business. Therefore, our efforts to do so led us to the conclusion that at this time, revenues are the best performance metric for the Institutional business.

Sales opportunities in the Institutional business 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 school district, private school, charter school, early childhood learning center or corporate partner.
- *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.
- *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 may 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.

Private Pay Schools and Other

Private schools are 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 accredited private online schools at differing price points and service levels. Our revenues are 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 K12 private school course as a supplement to the student’s regular on-campus instruction. In such cases, the third-party school may pay the K12 private school tuition.

Our Private Pay Schools and Other business also includes Galvanize, which provides talent development for individuals and enterprises in information technology fields.

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 K12 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 that enable us to distribute our products and services to our international school partners who use our courses to provide electives offerings and dual diploma 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 administer 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 business and Private Pay Schools and Other 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 revenues 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, General and Administrative Expenses

Selling, general, and administrative 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.

Also included are product development expenses which 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. We capitalize selected costs incurred to develop our curriculum, beginning with application development, 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:

Contracts with Customers

Revenues are principally earned from contractual agreements to provide educational services to students through an integrated package of online curriculum, books, materials, computers and management services to virtual and blended schools, traditional public schools, school districts, and private schools through our three lines of business: Managed Public School Programs, Institutional, and Private Pay Schools and Other.

We provide an integrated package of systems, services, products, and professional expertise that are administered together to support an online or blended public school. Contractual agreements generally span multiple years with performance obligations being isolated to annual periods which generally coincide with our fiscal year. Customers of these programs can obtain the administrative support, information technology, academic support services, online curriculum, learning systems platforms and instructional services under the terms of a negotiated service agreement. 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 revenue.

To determine the pro rata amount of revenue to recognize in a fiscal quarter, we estimate the total expected 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 update as necessary, by adjusting our year-to-date earned revenues to be proportional to the total expected revenues to be earned during the fiscal year. Actual school funding may vary from these estimates and the impact of these differences could impact 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). 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 for the current and prior periods. For the years ended June 30, 2019, 2018 and 2017, our aggregate funding estimates differed from actual reimbursements impacting total reported revenue by approximately 0.6%, 0.4%, and (0.3)%, respectively.

Each state and/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 we estimate funding for each school, we take into account 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, withdrawal rates, average daily attendance, special needs enrollment, academic progress and historical completion, student location, funding caps and other state specified categorical program funding.

Under the contracts where we provide products and services to schools, we are responsible for substantially all of the expenses incurred by the school and 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 (the school's expected funding), as reflected in its respective financial statements, including our charges to the schools. To the extent a school does not receive sufficient 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 revenues 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's net operating loss may reduce our ability to collect our management fees in full and recognized revenues are constrained to reflect the expected cash collections from such schools. We record the school's estimated net operating loss against revenues based upon the percentage of actual revenues in the period to total estimated revenues for the fiscal year. Actual school net operating losses may vary from these estimates or revisions, and the impact of these differences could have a material impact on results of operations.

Allowance for Doubtful Accounts

We maintain an allowance for uncollectible accounts primarily for estimated losses resulting from the inability or failure of individual customers to make required payments. We analyze accounts receivable, historical percentages of uncollectible accounts, and changes in payment history when evaluating the adequacy of the allowance for uncollectible accounts. We write-off accounts receivable based on the age of the receivable and the facts and circumstances surrounding the customer and reasons for non-payment. We record an allowance for estimated uncollectible accounts in an amount approximating probable losses. Actual write-offs might differ from the recorded allowance.

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”). 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. 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.

Capitalized Software Costs

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. Capitalized costs are recorded in capitalized software costs and are generally amortized over three years.

Impairment of Long-Lived Assets

Long-lived assets include property, equipment, right-of-use assets, capitalized curriculum and software developed or obtained for internal use. In accordance with ASC 360, *Property, Plant and Equipment* (“ASC 360”), we review our 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.

Leases

Our principal leasing activities include student computers and peripherals, classified as finance leases, and facilities, classified as operating leases.

Finance Leases

We enter into agreements to finance the purchase of student computers and peripherals provided to students of our schools. Individual leases typically include 1 to 3-year payment terms, at varying rates, with a \$1 purchase option at the end of each lease term. We pledge the assets financed to secure the outstanding leases.

Operating Leases

We enter into agreements for facilities that serve as offices for our headquarters, sales and enrollment teams, and school operations. Initial lease terms vary between 1 and 17 years. Certain leases include renewal options, usually based upon current market rates, as well as termination rights. We perform an evaluation of each lease to determine if the lease payments included in the renewal option should be included in the initial measurement of the lease liability. As of the adoption date, the remaining lease terms varied between 1 and 5 years and we concluded that renewal options on the existing leases would be excluded from the determination of the initial lease liability. The remaining lease terms related to leases acquired from Galvanize vary between 1 and 11 years.

Discount Rate

For our finance leases, the stated rate is defined within the lease terms; while for our operating leases, the rate is not implicit. For operating leases, we use our incremental borrowing rate as the discount rate; determined as our borrowing rate on a collateralized basis for a similar term and amount to the term and amount of the lease. Based on our current population of operating lease liabilities, a 1% change in the incremental borrowing rate would result in a \$4.3 million change in the initial present value of the operating lease liability.

Income Taxes

We account for income taxes in accordance with ASC 740, *Income Taxes* (“ASC 740”). 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 \$5.0 million and \$4.5 million as of June 30, 2020 and 2019, respectively, for the amount that will likely not be realized.

Stock-based Compensation

We recognize stock-based compensation expense under the provisions of ASC 718, *Compensation—Stock Compensation* (“ASC 718”). The fair value of restricted stock awards is the fair market value on the date of grant. Certain restricted stock awards with a market-based performance component are valued using a Monte Carlo simulation model that considers a variety of factors including, but not limited to, our common stock price, risk-free rate, and expected stock price volatility over the expected life of awards. We recognize these compensation costs on a straight-line basis over the requisite service period, which is generally the vesting period of the award.

Goodwill and Other Intangible Assets

We record as goodwill the excess of the 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, acquired customers and distributors, developed technology and non-compete agreements. 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, based on one reporting unit.

ASC 350 prescribes a two-step process for impairment testing of goodwill and intangibles with indefinite lives are assessed for impairment 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 is referred to as “Step 0”. We perform our annual assessment on May 31st, which is then updated for any changes in conditions as of June 30th. Under the two-step process, the first step tests for potential impairment by comparing the fair value of reporting units with reporting units’ net asset values. If the fair value of a reporting unit exceeds the carrying value of the reporting unit’s net assets, then goodwill is not impaired and no further testing is required. If the fair value of reporting unit is below the reporting unit’s carrying value, then the second step is required to measure the amount of potential impairment. The second step requires an assignment of the reporting unit’s fair value to the reporting unit’s assets and liabilities, using the initial acquisition accounting guidance related to business combinations, to determine the implied fair value of the reporting unit’s goodwill. The implied fair value of the reporting unit’s goodwill is then compared with the carrying amount of the reporting unit’s goodwill to determine the goodwill impairment loss to be recognized, if any. If the carrying value of a reporting unit’s goodwill exceeds its implied fair value, an impairment loss equal to the difference is recorded.

Results of Operations

Impact of COVID-19 to K12’s Business

The impact of the global emergence of COVID-19 on our business is currently not estimable or determinable. We are conducting business as usual with some modifications to employee travel, employee work locations, and cancellation of certain events. We will continue to actively monitor the situation and may take further actions that alter our business operations as may be required by federal, state or local authorities or that we determine are in the best interests of our employees, customers, partners, suppliers and stockholders. It is not clear what the potential effects any such alterations or modifications may have on our business, including the effects on our customers and prospects, or on our financial results for fiscal year 2021.

Lines of Business

We operate in one operating and reportable business segment as a technology-based education company providing proprietary and third-party 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 on consolidated results. We have three lines of business: (1) Managed Public School Programs; (2) Institutional; and (3) Private Pay Schools and Other.

Consolidation of Noncontrolling Interest

Our consolidated financial statements reflect the results of operations of our LearnBop joint venture. In January 2018, we consummated the acquisition of the remaining 49% of LearnBop. Earnings or losses attributable to our partner 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.

Enrollment Data

The following table sets forth total enrollment data for students in our Managed Public School Programs and Non-managed Public School Programs. Our Managed Public School Programs offer an integrated package of systems,

services, products, and professional expertise that we administer to support an online or blended public school. Customers for these programs can obtain the administrative support, information technology, academic support services, online curriculum, learning system platforms and instructional services under the terms of a negotiated service agreement. Unlike Managed Public School Programs, Non-managed Public School Programs do not offer comprehensive administrative support services, which remain the responsibility of the school district or the school customer. Rather, Non-Managed Public School Programs offer options whereby the school can contract for instruction, curriculum, supplemental courses, marketing, enrollment and other educational services. Enrollments in Managed Public School Programs on average generate more revenues than enrollments served through our Institutional business where we provide limited or no management services. We do not award or permit incentive compensation to be paid to our public school program enrollment staff or contractors based on the number of students enrolled. If the mix of enrollments changes, our revenues will be impacted to the extent the average revenues per enrollments are significantly different.

| | Year Ended June 30, | | | 2020 / 2019 | | 2019 / 2018 | |
|--|---------------------|-------|-------|-------------|----------|-------------|----------|
| | 2020 | 2019 | 2018 | Change | Change % | Change | Change % |
| Managed Public School Programs (1)(2) | 118.6 | 115.6 | 108.7 | 3.0 | 2.6% | 6.9 | 6.3% |
| Non-managed Public School Programs (1) | 15.8 | 23.9 | 23.9 | (8.1) | (33.9%) | — | 0.0% |

(In thousands, except percentages)

- (1) If a school changes from a Managed to a Non-managed Public School Program, the corresponding enrollment classification would change in the period in which the contract arrangement changed.
- (2) Managed Public School Programs include enrollments for which K12 receives no public funding or revenue.

Revenue by Business Lines

Revenues are captured by business line based on the underlying customer contractual agreements. Periodically, a customer may change business line classification. Alternatively, a Managed Public School may become a Non-managed Public School and seek to renegotiate an existing contract or the scope of services we provide to the school. A re-classification of a public school from one business line to another would be reflected in our disclosure of revenues and total student enrollment between the two business lines. For example, a district that purchases a single course (Institutional business customer) may decide to convert to a full-time virtual school program (Managed Public School customer). Changes in business line classification occur at the time the contractual agreement is modified. The mix of our revenue between our Managed Public School Programs and our Institutional business could change as one or more of our managed schools transitions to a self-managed model such that we would provide only selected services to the school. This transition could occur due to a change in focus sought by the independent school board, or by state legislative or regulatory developments, and thus reducing revenue we generate from the school. The following represents our revenues for each of the periods indicated:

| | Year Ended June 30, | | | Change 2020 / 2019 | | Change 2019 / 2018 | |
|------------------------------------|---------------------|--------------|------------|--------------------|---------|--------------------|---------|
| | 2020 | 2019 | 2018 | \$ | % | \$ | % |
| Managed Public School Programs | \$ 920,080 | \$ 890,275 | \$ 780,797 | \$ 29,805 | 3.3% | \$ 109,478 | 14.0% |
| Institutional | | | | | | | |
| Non-managed Public School Programs | 36,195 | 50,623 | 56,784 | (14,428) | (28.5%) | (6,161) | (10.8%) |
| Institutional Software & Services | 38,765 | 39,330 | 43,852 | (565) | (1.4%) | (4,522) | (10.3%) |
| Total Institutional | 74,960 | 89,953 | 100,636 | (14,993) | (16.7%) | (10,683) | (10.6%) |
| Private Pay Schools and Other | 45,725 | 35,524 | 36,301 | 10,201 | 28.7% | (777) | (2.1%) |
| Total Revenues | \$ 1,040,765 | \$ 1,015,752 | \$ 917,734 | \$ 25,013 | 2.5% | \$ 98,018 | 10.7% |

Financial Information

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, | | | | | |
|---|------------------------------------|---------|--------------|---------|------------|---------|
| | 2020 | | 2019 | | 2018 | |
| | (In thousands, except percentages) | | | | | |
| Revenues | \$ 1,040,765 | 100.0 % | \$ 1,015,752 | 100.0 % | \$ 917,734 | 100.0 % |
| Instructional costs and services | 693,232 | 66.6 | 663,437 | 65.3 | 592,495 | 64.6 |
| Gross margin | 347,533 | 33.4 | 352,315 | 34.7 | 325,239 | 35.4 |
| Selling, general, and administrative expenses | 315,076 | 30.3 | 306,829 | 30.2 | 299,694 | 32.7 |
| Income from operations | 32,457 | 3.1 | 45,486 | 4.5 | 25,545 | 2.8 |
| Interest income, net | 698 | 0.1 | 2,761 | 0.3 | 965 | 0.1 |
| Other income, net | 272 | 0.0 | 114 | 0.0 | — | — |
| Income before income taxes and loss from equity method investments | 33,427 | 3.2 | 48,361 | 4.8 | 26,510 | 2.9 |
| Income tax (expense) benefit | (8,541) | (0.8) | (10,520) | (1.0) | 910 | 0.1 |
| Loss from equity method investments | (380) | (0.0) | (632) | (0.1) | — | — |
| Net income | 24,506 | 2.4 | 37,209 | 3.7 | 27,420 | 3.0 |
| Add net loss attributable to noncontrolling interest | — | — | — | — | 200 | 0.0 |
| Net income attributable to common stockholders | \$ 24,506 | 2.4 % | \$ 37,209 | 3.7 % | \$ 27,620 | 3.0 % |

Comparison of the Years Ended June 30, 2020 and 2019

Revenues. Our revenues for the year ended June 30, 2020 were \$1,040.8 million, representing an increase of \$25.0 million, or 2.5%, from \$1,015.8 million for the year ended June 30, 2019. Managed Public School Program revenues increased \$29.8 million, or 3.3%, year over year. The increase in Managed Public School Program revenues was primarily due to the 2.6% increase in enrollments and increases in the per pupil achieved funding, school mix (distribution of enrollments by school), and other factors.

Total Institutional revenues decreased \$15.0 million, or 16.7%, primarily due to a 33.9% decline in enrollments in our Non-managed Public School Programs. Private Pay Schools and Other revenues increased \$10.2 million, or 28.7%, over the prior year period as a result of the acquisition of Galvanize.

Instructional costs and services expenses. Instructional costs and services expenses for the year ended June 30, 2020 were \$693.2 million, representing an increase of \$29.8 million, or 4.5%, from \$663.4 million for the year ended June 30, 2019. This increase in expense was primarily due to the incremental personnel and related benefit costs associated with supporting higher enrollments, as well as costs associated with serving Galvanize's customers. Instructional costs and services expenses were 66.6% of revenues during the year ended June 30, 2020, an increase from 65.3% for the year ended June 30, 2019.

Selling, general, and administrative expenses. Selling, general and administrative expenses for the year ended June 30, 2020 were \$315.1 million, representing an increase of \$8.3 million, or 2.7% from \$306.8 million for the year ended June 30, 2019. This increase was primarily due to an increase in professional services expenses. Selling, general, and administrative expenses were 30.3% of revenues during the year ended June 30, 2020, an increase from 30.2% for the year ended June 30, 2019.

Income tax (expense) benefit. We had an income tax expense of \$8.5 million for the year ended June 30, 2020, or 25.8% of income before taxes, as compared to \$10.5 million, or 22.0% of income before taxes for the year ended June 30, 2019. The increase in the effective tax rate for the year ended June 30, 2020 was primarily due to the increase in the amount of non-deductible compensation, which was partially offset by the increase in excess tax benefit of stock-based

compensation.

Net income. Net income was \$24.5 million for the year ended June 30, 2020, compared to \$37.2 million for the year ended June 30, 2019, representing a decrease of \$12.7 million. The decrease was due to Galvanize's net loss of \$18.1 million.

Comparison of the Years Ended June 30, 2019 and 2018

Revenues. Our revenues for the year ended June 30, 2019 were \$1,015.8 million, representing an increase of \$98.1 million, or 10.7%, from \$917.7 million for the year ended June 30, 2018. Managed Public School Program revenues increased \$109.5 million, or 14.0%, year over year. The increase in Managed Public School Programs revenues was primarily due to the 6.3% increase in enrollments and increases in the per pupil achieved funding, school mix (distribution of enrollments by school), and other factors.

Institutional revenues decreased \$10.7 million, or 10.6%, primarily due to a change in mix of enrollments in our Non-managed Public Schools Programs, as well as a decline in software sales. Private Pay Schools and Other revenues decreased \$0.8 million, or 2.1%, over the prior year period.

Instructional costs and services expenses. Instructional costs and services expenses for the year ended June 30, 2019 were \$663.4 million, representing an increase of \$70.9 million, or 12.0%, from \$592.5 million for the year ended June 30, 2018. This increase in expense was primarily due to the incremental personnel and related benefit costs due to supporting higher enrollments. Instructional costs and service expenses were 65.3% of revenues during the year ended June 30, 2019, an increase from 64.6% for the year ended June 30, 2018.

Selling, general, and administrative expenses. Selling, general, and administrative expenses for the year ended June 30, 2019 were \$306.8 million, representing an increase of \$7.1 million, or 2.4%, from \$299.7 million for the year ended June 30, 2018. This increase was primarily due to increases in professional services, advertising and marketing expenses, partially offset by a decrease in salaries. Selling, general, and administrative expenses were 30.2% of revenues during the year ended June 30, 2019, a decrease from 32.7% for the year ended June 30, 2018.

Income tax (expense) benefit. We had an income tax expense of \$10.5 million for the year ended June 30, 2019, or 22.0% of income before taxes, as compared to a benefit of \$0.9 million, or (3.4%) of income before taxes for the year ended June 30, 2018. The increase in the effective tax rate for the year ended June 30, 2019 was primarily due to the impact of the Tax Cuts and Job Act (the "Tax Act") in the prior year.

Net income. Net income was \$37.2 million for the year ended June 30, 2019, compared to \$27.4 million for the year ended June 30, 2018, representing an increase of \$9.8 million.

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.

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, 2020, we had net working capital, or current assets minus current liabilities, of \$227.9 million. Our working capital includes cash and cash equivalents of \$212.3 million and accounts receivable of \$236.1 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, 2020.

On January 27, 2020, we entered into a \$100.0 million senior secured revolving credit facility (“Credit Facility”) to be used for general corporate operating purposes with PNC Capital Markets LLC. The Credit Facility has a five-year term and incorporates customary financial and other covenants, including, but not limited to, a maximum leverage ratio and a minimum interest coverage ratio. The majority of our borrowings under the Credit Facility are at LIBOR plus an additional rate ranging from 0.875% - 1.50% based on our leverage ratio as defined in the agreement. The Credit Facility is secured by our assets. As of June 30, 2020, we were in compliance with the financial covenants. As of June 30, 2020, we had \$100.0 million outstanding on the Credit Facility. The Credit Facility also includes a \$200.0 million accordion feature.

We are a lessee under finance lease obligations for student computers and peripherals under loan agreements with PNC Equipment Finance, LLC (“PNC”) and Banc of America Leasing & Capital, LLC (“BALC”). As of June 30, 2020 and 2019, the finance lease liability (“capital leases” as of June 30, 2019) was \$17.9 million and \$24.6 million, respectively, with lease interest rates ranging from 1.52% to 3.87%.

Individual leases under the agreement with PNC include 36-month payment terms at varying rates, with a \$1 purchase option at the end of each lease term. We have pledged the assets financed to secure the outstanding leases.

We entered into an agreement with BALC in February 2019 for \$25.0 million to provide financing for our leases through December 2019 at varying rates. We entered into an additional \$25.0 million agreement in April 2020 to provide financing for our leases through March 2021 at varying rates. In July 2020, the limit was increased from \$25.0 million to \$41.0 million at the same terms. Individual leases with BALC include 12-month and 36-month payment terms, fixed rates ranging from 1.52% to 3.58%, and a \$1 purchase option at the end of each lease term. We pledged the assets financed to secure the outstanding leases.

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, borrowing on our Credit Facility and net working capital on hand will be adequate to finance our ongoing operations for the foreseeable future. In addition, to a lesser degree, we continue to explore acquisitions, strategic investments and joint ventures related to our business that we may acquire using cash, stock, debt, contribution of assets or a combination thereof.

Operating Activities

Net cash provided by operating activities for the years ended June 30, 2020, 2019 and 2018 was \$80.4 million, \$141.6 million and \$105.4 million, respectively.

Net cash provided by operating activities for the year ended June 30, 2020 was \$80.4 million compared to \$141.6 million for the year ended June 30, 2019. The \$61.2 million decrease in cash provided by operations between periods was primarily due to a decrease in working capital of \$63.3 million. The decrease in other assets and liabilities was primarily due to decreases in accounts payable, as well as increases in accounts receivable, and inventory, prepaid expenses and other assets.

Net cash provided by operating activities for the year ended June 30, 2019 was \$141.6 million compared to \$105.4 million for the year ended June 30, 2018. The \$36.2 million increase in cash provided by operations between periods was primarily due to an increase in net income and an increase in working capital of \$25.3 million. The increase in other assets and liabilities was primarily due to increases in accounts payable and accrued liabilities, as well as a decrease in inventory, prepaid expenses and other assets; partially offset by an increase in accounts receivable.

Net cash provided by operating activities for the year ended June 30, 2018 was \$105.4 million compared to \$88.7 million for the year ended June 30, 2017. The \$16.7 million increase in cash provided by operations between periods was primarily due to an increase in net income, partially offset by a decrease in working capital of \$3.5 million. The decrease in other assets and liabilities was primarily due to decreases in payables, deferred revenue and other liabilities, partially offset by an increase in accrued compensation and benefits.

Investing Activities

Net cash used in investing activities for the years ended June 30, 2020, 2019 and 2018 was \$217.4 million, \$61.1 million and \$50.5 million, respectively.

Net cash used in investing activities for the year ended June 30, 2020 increased \$156.3 million from the year ended June 30, 2019. The increase is primarily due to our investment in Galvanize of \$165.0 million, plus working capital, net of cash.

Net cash used in investing activities for the year ended June 30, 2019 increased \$10.6 million from the year ended June 30, 2018. This increase was primarily due to an increase in capitalized expenditures of \$5.3 million and our \$11.7 million investment in Tallo in the year ended June 30, 2019 compared to the \$4.0 million investment in Modern Teacher and the \$2.8 million investment in Big Universe in the year ended June 30, 2018.

Net cash used in investing activities for the year ended June 30, 2018 decreased \$6.7 million from the year ended June 30, 2017. This decrease was due primarily to the \$9.1 million payment to Middlebury College in the year ended June 30, 2017 for the remaining 40% interest in Middlebury Interactive Languages and the \$11.6 million decrease in capitalized software and curriculum development expenses as a result of lower unit costs of producing curriculum, partially offset by the \$6.5 million increase in the purchase of property and equipment. We also made \$7.3 million of investments during the year ended June 30, 2018.

Financing Activities

Net cash provided by financing activities for the year ended June 30, 2020 was \$65.6 million. Net cash used in financing activities for the years ended June 30, 2019 and 2018 was \$29.0 million and \$52.7 million, respectively.

For the year ended June 30, 2020, our cash provided by financing activities consisted primarily of borrowings from the credit facility of \$105.0 million offset by payments on finance lease obligations incurred for the acquisition of student computers totaling \$27.7 million and for the purchase of restricted stock from employees for income tax withholdings upon vesting of \$6.8 million.

For the year ended June 30, 2019, our cash used in financing activities consisted primarily of the payments on finance lease obligations incurred for the acquisition of student computers totaling \$21.0 million and for the purchase of restricted stock from employees for income tax withholdings upon vesting of \$10.0 million.

For the year ended June 30, 2018, our cash used in financing activities consisted primarily of the purchase of treasury stock totaling \$27.5 million, payments on finance lease obligations incurred for the acquisition of student computers totaling \$13.3 million and for the purchase of restricted stock from employees for income tax withholdings upon vesting of \$10.3 million.

Contractual Obligations

Our contractual obligations consist primarily of operating leases for office facilities and finance leases for equipment. The following summarizes our long-term contractual obligations as of June 30, 2020, which increased from \$46.9 million as of June 30, 2019:

| | Contractual Obligations—Payments due by period | | | | |
|---|--|------------------|------------------|------------------|------------------|
| | Total | < 1 year | 1 - 3 years | 3 - 5 years | > 5 years |
| Contractual obligations at June 30, 2020 | | | | | |
| Finance leases (1) | \$ 18,280 | \$ 13,587 | \$ 4,693 | \$ — | \$ — |
| Operating leases (1) | 129,055 | 23,626 | 38,167 | 28,718 | 38,544 |
| Total | <u>\$ 147,335</u> | <u>\$ 37,213</u> | <u>\$ 42,860</u> | <u>\$ 28,718</u> | <u>\$ 38,544</u> |

(1) Includes interest.

For the schools to which we provide administrative 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

As of June 30, 2020, we provided guarantees of approximately \$1.0 million related to lease commitments on the buildings for certain of our schools.

In addition, 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 did 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, 2020. We cannot be sure that future inflation will not have an adverse impact on our operating results and financial condition in future periods.

Recent Accounting Pronouncements

For information regarding, “Recent Accounting Pronouncements,” please refer to Note 3, “Summary of Significant Accounting Policies,” contained within our consolidated financial statements in Part II, Item 8, of this Annual Report on Form 10-K.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

At June 30, 2020 and 2019, we had cash and cash equivalents totaling \$212.3 million and \$283.1 million, respectively. Our excess cash has been invested primarily in U.S. Treasury money market funds although we may also invest in money market accounts, government securities, corporate debt securities and similar investments. Future interest and investment income is subject to the impact of interest rate changes, and we may be subject to changes in the fair value of our investment portfolio as a result of changes in interest rates. At June 30, 2020, a 1% gross increase in interest rates earned on cash would result in a \$2.1 million annualized increase in interest income.

Our short-term debt obligations under our Credit Facility are subject to interest rate exposure. At June 30, 2020, a 1% gross increase in interest rates would result in a \$1.0 million annualized increase in 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. 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 operations in a foreign currency, we will be exposed to currency transaction risk and/or currency translation risk. Exchange rates between U.S. dollars and many foreign currencies have fluctuated significantly over the last few years and may continue to do so in the future. Accordingly, we may decide in the future to undertake hedging strategies to minimize the effect of currency fluctuations on our financial condition and results of operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
K12 Inc.
Herndon, Virginia

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of K12 Inc. (the “Company”) as of June 30, 2020 and 2019, 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, 2020, and the related notes and financial statement schedule listed in the accompanying index (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at June 30, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2020, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of June 30, 2020, 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 12, 2020 expressed an unqualified opinion thereon.

Change in Accounting Principal

As discussed in Note 3 to the consolidated financial statements, the Company has changed its method of accounting for leases as of July 1, 2019, due to the adoption of Accounting Standards Codification (“ASC”) Topic 842, *Leases*.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Managed Public Schools Revenues

As described in Note 3 to the Company's consolidated financial statements, for the year ended June 30, 2020, the Company's consolidated revenue attributable to Managed Public Schools was \$920.1 million. The computation of Managed Public Schools revenue generated from state sources is based upon the amount of eligible funding expected to be provided by the state where the public school or school district is located. Total eligible funding from all sources represents the maximum value to be recognized for Managed Public School revenues and is adjusted as necessary for individual school financial deficits and surpluses.

We identified management's judgments related to Managed Public Schools revenues as a critical audit matter. The critical input used to calculate state eligible funding is enrollment, which is defined by the state governing authorities, varies by school and by funding metric, and often requires management to perform complex calculations including the use of significant estimates and assumptions. Assumptions and inputs used to determine enrollment figures may include withdrawal rates, new registrations, average daily attendance, special needs enrollment, student demographics, academic progress, historical completion rate, and student location among others. Changes to these inputs and assumptions could have a material impact on the amount of expected annual funding, and thus revenues recognized. Auditing enrollment figures involved especially challenging auditor judgment due to the nature and extent of audit effort required to properly address inputs within the enrollment calculations tested.

The primary procedures we performed to address this critical audit matter included:

- Testing the design and operating effectiveness of internal controls relating to the determination of enrollment figures including the monthly review of projected student counts and review of schools' funding calculations. These controls include review of the reasonableness of assumptions used and the appropriateness of methodologies used to determine enrollment figures pursuant to the Company's interpretation of the states' enrollment definitions.
- Testing the completeness, existence, and accuracy of enrollment calculations by validating a sample of underlying student data and assumptions used as inputs through the inspection of relevant source documents including admission records, evidence of access to the learning platforms, course activity reports, and third-party support.
- Testing the Company's computations of enrollment figures and state eligible funding for a sample of schools through recalculating the mathematical accuracy of the calculations.
- Performing a retrospective review of funding on a school by school basis and investigating variances outside of predetermined thresholds through the inspection of relevant source documents.

/s/ BDO USA, LLP

We have served as the Company's auditor since 2005.
Potomac, Maryland
August 12, 2020

K12 INC.

CONSOLIDATED BALANCE SHEETS

| | June 30, | |
|--|---------------------|-------------------|
| | 2020 | 2019 |
| (In thousands except share and per share data) | | |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 212,299 | \$ 283,121 |
| Accounts receivable, net of allowance of \$6,808 and \$11,766 at June 30, 2020 and 2019, respectively | 236,134 | 191,639 |
| Inventories, net | 28,300 | 29,946 |
| Prepaid expenses | 13,058 | 12,643 |
| Other current assets | 11,480 | 12,307 |
| Total current assets | 501,271 | 529,656 |
| Operating lease right-of-use assets, net | 111,768 | — |
| Property and equipment, net | 38,668 | 31,980 |
| Capitalized software, net | 48,493 | 51,165 |
| Capitalized curriculum development costs, net | 48,849 | 53,297 |
| Intangible assets, net | 77,451 | 14,981 |
| Goodwill | 174,939 | 90,197 |
| Deposits and other assets | 71,824 | 48,330 |
| Total assets | \$ 1,073,263 | \$ 819,606 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 40,428 | \$ 50,488 |
| Accrued liabilities | 27,351 | 20,685 |
| Accrued compensation and benefits | 47,227 | 41,998 |
| Deferred revenue | 24,417 | 22,828 |
| Credit facility | 100,000 | — |
| Current portion of finance lease liability | 13,304 | 19,588 |
| Current portion of operating lease liability | 20,689 | — |
| Total current liabilities | 273,416 | 155,587 |
| Long-term finance lease liability | 4,634 | 5,060 |
| Long-term operating lease liability | 96,544 | — |
| Deferred tax liability | 13,771 | 16,670 |
| Other long-term liabilities | 9,569 | 8,924 |
| Total liabilities | 397,934 | 186,241 |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Preferred stock, par value \$0.0001; 10,000,000 shares authorized; zero shares issued or outstanding at June 30, 2020 and 2019 | — | — |
| Common stock, par value \$0.0001; 100,000,000 shares authorized; 46,341,627 and 45,575,236 shares issued; and 41,006,884 and 40,240,493 shares outstanding at June 30, 2020 and 2019, respectively | 4 | 4 |
| Additional paid-in capital | 730,761 | 713,436 |
| Accumulated other comprehensive income (loss) | 93 | (40) |
| Retained earnings | 46,953 | 22,447 |
| Treasury stock of 5,334,743 shares at cost at June 30, 2020 and 2019 | (102,482) | (102,482) |
| Total stockholders' equity | 675,329 | 633,365 |
| Total liabilities and stockholders' equity | \$ 1,073,263 | \$ 819,606 |

See accompanying notes to consolidated financial statements.

K12 INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

| | Year Ended June 30, | | |
|---|--|--------------|------------|
| | 2020 | 2019 | 2018 |
| | (In thousands except share and per share data) | | |
| Revenues | \$ 1,040,765 | \$ 1,015,752 | \$ 917,734 |
| Instructional costs and services | 693,232 | 663,437 | 592,495 |
| Gross margin | 347,533 | 352,315 | 325,239 |
| Selling, general, and administrative expenses | 315,076 | 306,829 | 299,694 |
| Income from operations | 32,457 | 45,486 | 25,545 |
| Interest income, net | 698 | 2,761 | 965 |
| Other income, net | 272 | 114 | — |
| Income before income taxes and loss from equity method investments | 33,427 | 48,361 | 26,510 |
| Income tax (expense) benefit | (8,541) | (10,520) | 910 |
| Loss from equity method investments | (380) | (632) | — |
| Net income | 24,506 | 37,209 | 27,420 |
| Add net loss attributable to noncontrolling interest | — | — | 200 |
| Net income attributable to common stockholders | \$ 24,506 | \$ 37,209 | \$ 27,620 |
| Net income attributable to common stockholders per share: | | | |
| Basic | \$ 0.62 | \$ 0.96 | 0.70 |
| Diluted | \$ 0.60 | \$ 0.91 | \$ 0.68 |
| Weighted average shares used in computing per share amounts: | | | |
| Basic | 39,478,928 | 38,848,780 | 39,282,674 |
| Diluted | 40,663,224 | 40,944,800 | 40,637,744 |

See accompanying notes to consolidated financial statements.

K12 INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Year Ended June 30, | | |
|--|---------------------|------------------|------------------|
| | 2020 | 2019 | 2018 |
| | (In thousands) | | |
| Net income | \$ 24,506 | \$ 37,209 | \$ 27,420 |
| Other comprehensive income (loss), net of tax: | | | |
| Foreign currency translation adjustment | 133 | 212 | (82) |
| Total other comprehensive income, net of tax | 24,639 | 37,421 | 27,338 |
| Comprehensive loss attributable to noncontrolling interest | — | — | 200 |
| Comprehensive income attributable to common stockholders | <u>\$ 24,639</u> | <u>\$ 37,421</u> | <u>\$ 27,538</u> |

See accompanying notes to consolidated financial statements.

K12 INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

| (In thousands except share data) | K12 Inc. Stockholders' Equity | | | | | | | Total |
|---|-------------------------------|--------|----------------------------------|--|--|----------------|--------------|------------|
| | Common Stock | | Additional Paid-in Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Accumulated Deficit) | Treasury Stock | | |
| | Shares | Amount | | | | Shares | Amount | |
| Balance, June 30, 2017 | 44,325,772 | \$ 4 | \$ 690,488 | \$ (170) | \$ (40,976) | (3,502,598) | \$ (75,000) | \$ 574,346 |
| Adjustment related to new stock-based compensation guidance | — | — | 112 | — | (76) | — | — | 36 |
| Net income | — | — | — | — | 27,620 | — | — | 27,620 |
| Foreign currency translation adjustment | — | — | — | (82) | — | — | — | (82) |
| Stock-based compensation expense | — | — | 22,869 | — | — | — | — | 22,869 |
| Purchase of treasury stock | — | — | — | — | — | (1,832,145) | (27,482) | (27,482) |
| Exercise of stock options | 14,600 | — | 196 | — | — | — | — | 196 |
| Vesting of performance share units, net of tax withholding | 199,769 | — | — | — | — | — | — | — |
| Issuance of restricted stock awards | 1,210,502 | — | — | — | — | — | — | — |
| Forfeiture of restricted stock awards | (335,150) | — | — | — | — | — | — | — |
| Repurchase of restricted stock for tax withholding | (512,926) | — | (10,314) | — | — | — | — | (10,314) |
| Balance, June 30, 2018 | 44,902,567 | \$ 4 | \$ 703,351 | \$ (252) | \$ (13,432) | (5,334,743) | \$ (102,482) | \$ 587,189 |
| Adjustment related to new revenue recognition guidance | — | — | — | — | (1,330) | — | — | (1,330) |
| Net income | — | — | — | — | 37,209 | — | — | 37,209 |
| Foreign currency translation adjustment | — | — | — | 212 | — | — | — | 212 |
| Stock-based compensation expense | — | — | 17,013 | — | — | — | — | 17,013 |
| Exercise of stock options | 150,290 | — | 3,030 | — | — | — | — | 3,030 |
| Vesting of performance share units, net of tax withholding | 258,263 | — | — | — | — | — | — | — |
| Issuance of restricted stock awards | 828,833 | — | — | — | — | — | — | — |
| Forfeiture of restricted stock awards | (235,485) | — | — | — | — | — | — | — |
| Repurchase of restricted stock for tax withholding | (329,232) | — | (9,958) | — | — | — | — | (9,958) |
| Balance, June 30, 2019 | 45,575,236 | \$ 4 | \$ 713,436 | \$ (40) | \$ 22,447 | (5,334,743) | \$ (102,482) | \$ 633,365 |
| Net income | — | — | — | — | 24,506 | — | — | 24,506 |
| Foreign currency translation adjustment | — | — | — | 133 | — | — | — | 133 |
| Stock-based compensation expense | — | — | 24,022 | — | — | — | — | 24,022 |
| Exercise of stock options | 4,000 | — | 64 | — | — | — | — | 64 |
| Vesting of performance share units, net of tax withholding | — | — | — | — | — | — | — | — |
| Issuance of restricted stock awards | 1,126,227 | — | — | — | — | — | — | — |
| Forfeiture of restricted stock awards | (79,541) | — | — | — | — | — | — | — |
| Repurchase of restricted stock for tax withholding | (284,295) | — | (6,761) | — | — | — | — | (6,761) |
| Balance, June 30, 2020 | 46,341,627 | \$ 4 | \$ 730,761 | \$ 93 | \$ 46,953 | (5,334,743) | \$ (102,482) | \$ 675,329 |

See accompanying notes to consolidated financial statements.

K12 INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended June 30, | | |
|---|---------------------|-------------------|-------------------|
| | 2020 | 2019 | 2018 |
| | (In thousands) | | |
| Cash flows from operating activities | | | |
| Net income | \$ 24,506 | \$ 37,209 | \$ 27,420 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization expense | 72,091 | 71,400 | 75,260 |
| Stock-based compensation expense | 23,609 | 16,676 | 20,817 |
| Deferred income taxes | (1,305) | 3,693 | (4,015) |
| Provision for doubtful accounts | 2,882 | 6,325 | 4,089 |
| Other | 19,578 | 3,985 | 4,822 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (37,772) | (21,637) | 11,987 |
| Inventories, prepaid expenses, deposits and other current and long-term assets | (16,181) | (3,321) | (28,491) |
| Accounts payable | (6,213) | 20,174 | (2,336) |
| Accrued liabilities | 7,424 | 8,295 | (6,273) |
| Accrued compensation and benefits | 3,103 | 5,948 | 6,672 |
| Operating lease liability | (13,124) | — | — |
| Deferred revenue and other liabilities | 1,817 | (7,141) | (4,506) |
| Net cash provided by operating activities | 80,415 | 141,606 | 105,446 |
| Cash flows from investing activities | | | |
| Purchase of property and equipment | (1,677) | (5,477) | (8,743) |
| Capitalized software development costs | (23,988) | (26,318) | (24,533) |
| Capitalized curriculum development costs | (19,332) | (16,611) | (9,927) |
| Sale of long-lived assets | — | 389 | — |
| Acquisition of Galvanize, Inc., net of cash acquired | (167,995) | — | — |
| Other acquisitions and investments, net of distributions | (4,373) | (13,092) | (7,274) |
| Net cash used in investing activities | (217,365) | (61,109) | (50,477) |
| Cash flows from financing activities | | | |
| Repayments on finance lease obligations | (27,675) | (21,034) | (13,301) |
| Borrowing from credit facility | 105,000 | — | — |
| Repayments on credit facility | (5,000) | — | — |
| Payments of contingent consideration | — | (1,027) | (1,819) |
| Purchase of treasury stock | — | — | (27,482) |
| Proceeds from exercise of stock options | 64 | 3,030 | 196 |
| Repurchase of restricted stock for income tax withholding | (6,761) | (9,958) | (10,314) |
| Net cash provided by (used in) financing activities | 65,628 | (28,989) | (52,720) |
| Net change in cash, cash equivalents and restricted cash | (71,322) | 51,508 | 2,249 |
| Cash, cash equivalents and restricted cash, beginning of period | 284,621 | 233,113 | 230,864 |
| Cash, cash equivalents and restricted cash, end of period | \$ 213,299 | \$ 284,621 | \$ 233,113 |
| Reconciliation of cash, cash equivalents and restricted cash to balance sheet as of June 30th: | | | |
| Cash and cash equivalents | \$ 212,299 | \$ 283,121 | \$ 231,113 |
| Other current assets (restricted cash) | 500 | 500 | — |
| Deposits and other assets (restricted cash) | 500 | 1,000 | 2,000 |
| Total cash, cash equivalents and restricted cash | \$ 213,299 | \$ 284,621 | \$ 233,113 |

See accompanying notes to consolidated financial statements.

K12 Inc.

Notes to Consolidated Financial Statements

1. Description of the Business

K12 Inc., together with its subsidiaries (“K12” or the “Company”), is a technology-based education company. The Company offers proprietary and third-party curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade, or K-12. The Company’s learning systems combine curriculum, instruction and related support services to create an individualized learning approach. The Company’s learning systems are well-suited for virtual and blended public schools, school districts, charter schools, and private schools that utilize varying degrees of online and traditional classroom instruction, and other educational applications. These products and services are provided through three lines of business:

- Managed Public School Programs – programs which offer an integrated package of systems, services, products, and professional expertise that K12 administers to support an online or blended public school, including: administrative support (e.g., budget proposals, financial reporting, student data reporting, and staff recruitment), information technology and provisioning, academic support services, curriculum, learning systems, and instructional services;
- Institutional – Non-managed Public School Programs – programs which provide instruction, curriculum, supplemental courses, marketing, enrollment and other educational services where K12 does not provide primary administrative support services, and Institutional Software and Services – educational software and services provided to school districts, public schools and other educational institutions; and
- Private Pay Schools and Other – private schools for which the Company charges student tuition and makes direct consumer sales; and Galvanize, Inc. (“Galvanize”), which provides talent development for individuals and enterprises in information technology fields.

The Company’s acquisition of Galvanize is discussed in more detail in Note 14, “Acquisitions and Investments.”

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

2. Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The Company operates in one operating and reportable business segment as a technology-based education company providing proprietary and third-party 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 on consolidated results.

3. Summary of Significant Accounting Policies

Recent Accounting Pronouncements

Accounting Standards Adopted

On July 1, 2019, the Company adopted Accounting Standards Codification (“ASC”) Topic 842, *Leases* (“ASC 842”), which supersedes most existing lease guidance under ASC Topic 840, *Leases* (“ASC 840”). The core principal of ASC 842 establishes a right-of-use model that requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases are classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of operations.

The most significant impact to the Company was its accounting for operating leases, which under ASC 840, were

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

not recorded on the balance sheet. The Company reviewed its rent expense to ensure all leases were captured. The Company concluded that these leases were operating leases under ASC 842. Additionally, the Company's capital leases under ASC 840 were reviewed and determined to be finance leases under ASC 842.

The Company adopted this standard using the modified retrospective approach. Under this method, the Company applied ASC 842 to existing leases that had commenced as of July 1, 2019. The comparative information for prior periods has not been restated and continues to be reported under ASC 840. The Company has provided the required disclosures under ASC 840 for the comparative periods. The Company elected to apply the package of practical expedients that was available upon adoption of ASC 842 to not reassess (1) whether any expired or existing contracts contain a lease, (2) the lease classification of any expired or existing lease, and (3) the initial direct costs for existing leases. The adoption of ASC 842 resulted in the recognition of a new lease liability for its operating leases of \$22.7 million and a right-of-use asset of \$17.7 million (net of existing deferred rent and lease impairment liabilities) on July 1, 2019.

On July 1, 2019, the Company adopted Accounting Standards Update ("ASU") 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software* (Subtopic 350-40) ("ASU 2018-15") on a prospective basis. ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. It requires an entity in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. As a result of the adoption, during the year ended June 30, 2020, the Company capitalized \$11.9 million of implementation costs that would have been expensed previously. These costs are included in prepaid expenses (\$0.8 million) and deposits and other assets (\$11.1 million) in the consolidated balance sheets. The implementation costs incurred during the year ended June 30, 2020 were related to updates to the Company's IT infrastructure and its enterprise resource planning ("ERP") system. During the year ended June 30, 2019, the Company expensed \$1.2 million of implementation costs.

Accounting Standards Not Yet Adopted

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses* (Topic 326) ("ASU 2016-13") related to the methodology for recognizing credit losses. The new standard revises the accounting requirements related to the measurement of credit losses and will require organizations to measure all expected credit losses for financial assets based on historical experience, current conditions and reasonable and supportable forecasts about collectability. Assets must be presented in the financial statements at the net amount expected to be collected. The Company adopted this standard in the first quarter of fiscal year 2021 and expects to record an allowance for credit losses in the range of \$7 million to \$9 million related to its accounts receivable (current and long-term). The allowance will be based upon historical losses, customer-specific information, current economic conditions, and reasonable and supportable forecasts of future economic conditions.

In January 2017, the FASB issued ASU 2017-04, *Intangibles – Goodwill and Other* (Topic 350) ("ASU 2017-04"). This amendment simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The update is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. An entity should apply the amendments in this update on a prospective basis. An entity is required to disclose the nature of and reason for the change in accounting principle upon transition. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company adopted this standard in the first quarter of fiscal year 2021 without a material impact to its consolidated financial statements.

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Notes to Consolidated Financial Statements (Continued)

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 the 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, accrual for incurred but not reported (“IBNR”) claims, contingencies, income taxes and stock-based compensation expense. The Company bases its estimates on historical 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.

Contracts with Customers

Revenues are principally earned from contractual agreements to provide educational services to students through an integrated package of online curriculum, books, materials, computers and management services to virtual and blended schools, traditional public schools, school districts, and private schools through its three lines of business: Managed Public School Programs, Institutional, and Private Pay Schools and Other.

Under ASC Topic 606, *Revenue from Contracts with Customers* (“ASC 606”), revenue is recognized when control of the promised goods or services is transferred to the Company’s customers, in an amount that reflects the consideration it expects to be entitled to in exchange for those goods or services using the following steps:

- identify the contract, or contracts, with a customer;
- identify the performance obligations in the contract;
- determine the transaction price;
- allocate the transaction price to the performance obligations in the contract; and
- recognize revenue when, or as, the Company satisfies a performance obligation.

Revenue Recognition

Managed Public School Programs

The Company provides an integrated package of systems, services, products, and professional expertise that are administered together to support an online or blended public school. Contractual agreements generally span multiple years with performance obligations being isolated to annual periods which generally coincide with the Company’s fiscal year. Customers of these programs can obtain the administrative support, information technology, academic support services, online curriculum, learning systems platforms and instructional services under the terms of a negotiated service agreement. 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 revenue.

The Company generates revenues under contracts with virtual and blended public schools and include the following components, where required:

- providing each of a school’s students with access to the Company’s online school and lessons;
- offline learning kits, which include books and materials to supplement the online lessons;
- the use of a personal computer and associated reclamation services;
- internet access and technology support services;
- instruction by a state-certified teacher; and

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Notes to Consolidated Financial Statements (Continued)

- management and technology services necessary to support a virtual public or blended school. In certain contracts, revenues are determined directly by per enrollment funding.

To determine the pro rata amount of revenue to recognize in a fiscal quarter, the Company estimates the total expected 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. The Company reviews its estimates of funding periodically, and updates as necessary, by adjusting its year-to-date earned revenues to be proportional to the total expected revenues to be earned during the fiscal year. Actual school funding may vary from these estimates and the impact of these differences could impact the Company's results of operations. Since the end of the school year coincides with the end of the Company's fiscal year, 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). 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 for the current and prior periods. For the years ended June 30, 2019, 2018 and 2017, the Company's aggregate funding estimates differed from actual reimbursements impacting total reported revenue by approximately 0.6%, 0.4%, and (0.3)%, respectively.

Each state and/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 estimates funding for each school, it takes into account 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, academic progress and historical completion, student location, funding caps and other state specified categorical program funding.

Under the contracts where the Company provides products and services to schools, the Company is responsible for substantially all of the expenses incurred by the school and 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 (the school's expected funding), as reflected in its respective financial statements, including Company charges to the schools. To the extent a school does not receive sufficient 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 revenues 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's net operating loss may reduce the Company's ability to collect its management fees in full and recognized revenues are constrained to reflect the expected cash collections from such schools. The Company records the school's estimated net operating loss against revenues based upon the percentage of actual revenues in the period to total estimated revenues for the fiscal year. Actual school net operating losses may vary from these estimates or revisions, and the impact of these differences could have a material impact on results of operations. For the years ended June 30, 2020, 2019 and 2018, the Company's revenues included a reduction for net operating losses at the schools of \$45.4 million, \$54.7 million, and \$66.7 million, respectively. Because the Company has agreed to absorb any operating losses of the schools, the Company records the expenses incurred by the school as both revenue and expenses in the consolidated statements of operations. Amounts recorded as revenues and expenses for the years ended June 30, 2020, 2019 and 2018, were \$325.5 million, \$342.7 million and \$314.8 million, respectively.

Institutional

The products and services delivered to the Company's Institutional customers include curriculum and technology for full-time virtual and blended programs, as well as instruction, curriculum and associated materials, supplemental courses, marketing, enrollment and other educational services. Each of these contracts are considered to be one performance obligation under ASC 606, and revenues are recorded over the access period based on the agreed upon contract price.

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Notes to Consolidated Financial Statements (Continued)

In addition, the Company provides certain online curriculum and services to schools and school districts under subscription agreements. Revenues from the licensing of curriculum under subscription arrangements are recognized on a ratable basis over the subscription period. Revenues from professional consulting, training and support services are deferred and recognized ratably over the service period.

Private Pay Schools and Other

Private Pay Schools and Other revenues are generated from individual customers have access for one to two years to company-provided online curriculum and generally prepay for services to be received. For revenue attributable to Galvanize, the majority of the customers are individuals or enterprises that enter into agreements for the Company to provide course instruction or job training over a specified contract period. Each of these contracts are considered to be one performance obligation under ASC 606. The Company recognizes these revenues pro rata over the maximum term of the customer contract based on the defined contract price.

Disaggregated Revenues

The following table presents the Company's revenues disaggregated based on its three lines of business for the years ended June 30, 2020 and 2019:

| | Year Ended June 30, | |
|------------------------------------|---------------------|--------------|
| | 2020 | 2019 |
| | (In thousands) | |
| Managed Public School Programs | \$ 920,080 | \$ 890,275 |
| Institutional | | |
| Non-managed Public School Programs | 36,195 | 50,623 |
| Institutional Software & Services | 38,765 | 39,330 |
| Total Institutional | 74,960 | 89,953 |
| Private Pay Schools and Other | 45,725 | 35,524 |
| Total Revenues | \$ 1,040,765 | \$ 1,015,752 |

Concentration of Customers

During the years ended June 30, 2020, 2019 and 2018, approximately 88%, 88% and 85%, respectively, of the Company's revenues were recognized from schools that contracted with the Company for Managed Public School Programs. During the years ended June 30, 2020, 2019 and 2018, the Company had zero, one and zero contracts, respectively, that represented greater than 10% of total revenues.

In fiscal year 2018, the Company and the Agora Cyber Charter School entered into an agreement related to its outstanding receivable of \$28.7 million at June 30, 2018 to be paid over a four-year period. In addition, the term of the service agreement was extended through June 30, 2022. The Company reclassified the long-term portion of \$23.2 million to deposits and other assets on the consolidated balance sheets as of June 30, 2018. The aggregate current and long-term balance as of June 30, 2020 was \$18.6 million. The Company accrues interest on its long-term receivables based on contracted terms.

Contract Balances

The timing of revenue recognition, invoicing, and cash collection results in accounts receivable, unbilled receivables (a contract asset) and deferred revenue (a contract liability) in the consolidated balance sheets. Accounts receivable are recorded when there is an executed customer contract and the customer is billed. The collectability of outstanding receivables is evaluated regularly by the Company and an allowance is recorded to reflect probable losses.

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Notes to Consolidated Financial Statements (Continued)

Unbilled receivables are created when revenue is earned prior to the customer being billed. Deferred revenue is recorded when customers are billed or cash is collected in advance of services being provided.

The opening and closing balance of the Company's accounts receivable, unbilled receivables and deferred revenue are as follows:

| | June 30, | |
|---|----------------|------------|
| | 2020 | 2019 |
| | (In thousands) | |
| Accounts receivable | \$ 236,134 | \$ 191,639 |
| Unbilled receivables (included in accounts receivable) | 15,688 | 16,189 |
| Deferred revenue | 24,417 | 22,828 |
| Deferred revenue, long-term (included in other long-term liabilities) | 2,236 | — |

The difference between the opening and closing balance of the accounts receivable and unbilled receivables relates to the timing of the Company's billing in relation to month end and contractual agreements, as well as \$8.4 million acquired in the purchase of Galvanize. The difference between the opening and closing balance of the deferred revenue relates to the timing difference between billings to customers and the service periods under the contract, as well as \$3.4 million acquired in the purchase of Galvanize. Typically, each of these balances are at their highest during the first quarter of the fiscal year and lowest at the end of the fiscal year. The amount of revenue recognized during the years ended June 30, 2020 and 2019 that was included in the previous July 1st deferred revenue balance was \$21.5 million and \$23.7 million, respectively. During the years ended June 30, 2020 and 2019, the Company recorded revenues of \$5.9 million and \$4.1 million, respectively, related to performance obligations satisfied in prior periods.

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. For the majority of its contracts, the Company's performance obligations are satisfied over time, as the Company delivers, and the customer receives the services, over the service period of the contract. The Company's payment terms are generally net 30 or net 45, but can vary depending on the customer or when the school receives its funding from the state.

The Company has elected, as a practical expedient, not to report the value of unsatisfied performance obligations for contracts with customers that have an expected duration of one year or less. The amount of unsatisfied performance obligations for contracts with customers which extend beyond one year as of June 30, 2020 was \$2.2 million.

Significant Judgments

The Company determined that the majority of its contracts with customers contain one performance obligation. The Company markets the products and services as an integrated package building off its curriculum offerings. It does not market distinct products or services to be sold independently from the curriculum offering. The Company provides the significant service of integrating the goods and services into the operation of the school and education of its students, for which the customer has contracted.

The Company has determined that the time elapsed method as described under ASC 606 is the most appropriate measure of progress towards the satisfaction of the performance obligation. The Company delivers the integrated products and services package related to its Managed Public School Programs largely over the course of the Company's fiscal year. This package includes enrollment, marketing, teacher training, etc. in addition to the core curriculum and instruction. All of these activities are necessary and contribute to the overall education of its students, which occurs evenly throughout the year. Accordingly, the Company recognizes revenue on a straight-line basis.

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Notes to Consolidated Financial Statements (Continued)

The Company determined that the expected value method is the most appropriate method to account for variable consideration and the Company's forecasting method is an estimation process that uses probability to determine expected funding. On a monthly basis, the Company estimates the total funds each school will receive in a particular school year and the amount of full-year school revenues and operating expenses to determine the amount of revenue the Company will recognize. Enrollment and state funding rates are key inputs to this estimate. The estimates are adjusted monthly, and a cumulative catch-up adjustment is recorded to revenue as necessary to reflect the total revenues earned to date to be proportional to the total revenues to be earned in the fiscal year. The Company builds in known constraints (i.e. enrollment, funding, net operating losses, etc.) into the estimate of the variable consideration to record the most probable amount.

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.

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.

Research and Development Costs

All research and development costs, including patent application costs, are expensed as incurred. Research and development costs totaled \$9.7 million, \$9.5 million and \$9.2 million for the years ended June 30, 2020, 2019 and 2018, respectively, and are included within selling, general and administrative expenses in the consolidated statements of operations.

Cash, Cash Equivalents and Restricted Cash

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. The Company periodically has cash balances which exceed federally insured limits.

Restricted cash consists of amounts held in escrow related to the Company's settlement agreement with the Agora Cyber Charter School. The restricted cash which is short-term in nature is included in other current assets, while the portion that is long-term is included in deposits and other assets on the consolidated balance sheets.

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 writes-off accounts receivable based on the age of the receivable and the facts and circumstances surrounding the customer and reasons for non-payment. The Company records an allowance for estimated uncollectible accounts in an amount approximating probable losses. Actual write-offs might differ from the recorded allowance.

Inventories

Inventories consist primarily of textbooks and curriculum materials, a majority of which are supplied to virtual public schools and blended public schools, and utilized directly by students. Inventories represent items that are purchased and held for sale and are recorded at the lower of cost (first-in, first-out method) or net realizable value. The Company

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

classifies its inventory as current or long-term based on the holding period. As of June 30, 2020 and 2019, \$5.2 million and \$4.1 million, respectively, of inventory, net of reserves, was deemed long-term and included in deposits and other assets on the consolidated balance sheets.

The provision for excess and obsolete inventory is established based upon the evaluation of the quantity on hand relative to demand. During the years ended June 30, 2020, 2019 and 2018, the Company increased the provision for excess and obsolete inventory by \$0.7 million, \$0.6 million, and \$1.2 million, respectively, primarily related to inventory in excess of anticipated demand and the decision to discontinue certain products. The excess and obsolete inventory reserve was \$4.8 million and \$4.1 million at June 30, 2020 and 2019, respectively.

Other Current Assets

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

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization 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 the finance lease). Amortization of assets capitalized under finance lease arrangements is included in depreciation expense. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful life of the asset. The determination of the lease term is discussed below under "Leases."

Property and equipment are depreciated over the following useful lives:

| | Useful Life |
|-------------------------------------|---|
| Student and state testing computers | 3 - 5 years |
| Computer hardware | 3 - 7 years |
| Computer software | 3 - 5 years |
| Web site development | 3 years |
| Office equipment | 5 years |
| Furniture and fixtures | 7 years |
| Leasehold improvements | Shorter of useful life or term of the lease |

The Company makes an estimate of unreturned student computers based on an analysis of recent trends of returns. The Company recorded accelerated depreciation of \$2.4 million, \$2.3 million and \$2.1 million for the years ended June 30, 2020, 2019 and 2018, respectively, related to the leases exited and unreturned student computers.

The Company fully expenses computer peripheral equipment (e.g. keyboards, mouses) upon purchase as recovery has been determined to be uneconomical. These expenses totaled \$3.8 million, \$4.1 million and \$3.4 million for the years ended June 30, 2020, 2019 and 2018, respectively, and are recorded as instructional costs and services.

Capitalized Software Costs

The Company develops software for internal use. The Company capitalizes software development costs incurred during the application development stage in accordance with ASC 350, *Intangibles – Goodwill and Other* ("ASC 350"). 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.

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Notes to Consolidated Financial Statements (Continued)

Capitalized software additions totaled \$24.0 million, \$26.3 million and \$24.5 million for the years ended June 30, 2020, 2019 and 2018, respectively. There were no material write-downs of capitalized software projects for the years ended June 30, 2020, 2019 and 2018.

During the three months ended September 30, 2017, the Company recorded an out of period adjustment related to the capitalization of software and curriculum development. The adjustment increased capitalized software development costs and capitalized curriculum development costs by \$2.3 million and \$0.6 million, respectively, and increased net income by \$1.4 million for the year. The Company assessed the materiality of these errors on its prior quarterly and annual financial statements, assessing materiality both quantitatively and qualitatively, in accordance with the Securities and Exchange Commission's ("SEC") Staff Accounting Bulletin ("SAB") No. 99 and SAB No. 108 and concluded that the errors were not material to any of its previously issued financial statements.

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. 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 are amortized is generally five years.

Total capitalized curriculum development additions were \$19.3 million, \$16.6 million and \$9.9 million for the years ended June 30, 2020, 2019 and 2018, respectively. These amounts are recorded on the accompanying consolidated balance sheets, net of amortization charges. There were no material write-downs of capitalized curriculum development costs for the years ended June 30, 2020, 2019 and 2018.

As mentioned above, capitalized curriculum development additions included an out of period adjustment of \$0.6 million.

Leases

The Company's principal leasing activities include student computers and peripherals, classified as finance leases, and facilities, classified as operating leases.

Under ASC 842, for a lessee, leases are classified as operating leases unless they meet any of the criteria below to be classified as a finance lease:

- the lease transfers ownership of the asset at the end of the lease;
- the lease grants an option to purchase the asset which the lessee is expected to exercise;
- the lease term reflects a major part of the asset's economic life;
- the present value of the lease payments equals or exceeds the fair value of the asset; or
- the asset is specialized with no alternative use to the lessor at the end of the term.

Finance Leases

The Company enters into agreements to finance the purchase of student computers and peripherals provided to students of its schools. Individual leases typically include 1 to 3-year payment terms, at varying rates, with a \$1 purchase option at the end of each lease term. The Company pledges the assets financed to secure the outstanding leases.

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

Operating Leases

The Company enters into agreements for facilities that serve as offices for its headquarters, sales and enrollment teams, and school operations. Initial lease terms vary between 1 and 17 years. Certain leases include renewal options, usually based upon current market rates, as well as termination rights. The Company performs an evaluation of each lease to determine if the lease payments included in the renewal option should be included in the initial measurement of the lease liability. As of the adoption date, the remaining lease terms varied between 1 and 5 years and the Company concluded that renewal options on the existing leases would be excluded from the determination of the initial lease liability. The remaining lease terms related to leases acquired from Galvanize vary between 1 and 11 years.

Discount Rate

Under ASC 842, the present value of the lease payments is calculated using either the rate implicit in the lease, or the lessee's incremental borrowing rate, over the lease term. For the Company's finance leases, the stated rate is defined within the lease terms; while for the Company's operating leases, the rate is not implicit. For operating leases, the Company uses its incremental borrowing rate as the discount rate; determined as the Company's borrowing rate on a collateralized basis for a similar term and amount to the term and amount of the lease.

For its adoption of ASC 842, the Company utilized its agreements used for its finance leases as the basis for calculating its incremental borrowing rate. The rate was collateralized and its term reflected a similar term of the remaining lease payments of the Company's largest operating lease. As of the adoption date, the incremental borrowing rate was 3.86%. Upon the execution of its senior secured revolving credit facility (see Note 7, "Credit Facility"), the Company has reassessed its incremental borrowing rate as 2.55%. The Company used 2.55% to calculate the present value of the leases acquired from Galvanize. The incremental borrowing rate is subsequently reassessed upon modification of its leasing arrangements or with the execution of a new lease agreement.

Policy Elections

Short-term Leases

The Company has elected as an on-going accounting policy election not to apply ASC 842 to short-term facility leases of 12 months or less. By making this election, the Company will not record a right-of-use asset or lease liability at the commencement of the lease, and will continue to expense its lease payments on a straight-line basis over the lease term. The accounting policy election is made by class of underlying asset to which the right of use relates. The Company has elected to apply the accounting policy election only to operating leases.

Goodwill and Intangible Assets

The Company records as goodwill the excess of the 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 distributors, developed technology and non-compete agreements. Such intangible assets are amortized on a straight-line basis over their estimated useful lives. Amortization expense for the years ended June 30, 2020, 2019 and 2018 was \$6.1 million, \$3.0 million and \$3.0 million, respectively, and is included within selling, general, and administrative expenses in the consolidated statements of operations. Future amortization of intangible assets is expected to be \$8.0 million, \$7.9 million, \$7.7 million, \$6.7 million and \$5.5 million in the fiscal years ending June 30, 2021 through June 30, 2025, respectively and \$41.4 million thereafter. As of June 30, 2020 and 2019, the goodwill balance was \$174.9 million and \$90.2 million, respectively.

The Company reviews its 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. The Company performed a qualitative assessment of coronavirus disease

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Notes to Consolidated Financial Statements (Continued)

2019 (“COVID-19”) as a triggering event related to the value of its finite-lived intangible assets and concluded that there was no impairment during the year ended June 30, 2020.

The Company has one reporting unit. Goodwill and intangible assets deemed to have an indefinite life are tested for impairment annually, or earlier when events or changes in circumstances suggest the carrying amount may not be fully recoverable. Examples of such events or circumstances include, but are not limited to, significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of acquired assets or the strategy for the Company’s business, significant negative industry or economic trends, and/or a significant decline in the Company’s stock price for a sustained period.

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.” The Company performs its annual assessment on May 31st, which is then updated for any changes in conditions as of June 30th. Under the two-step process, the first step tests for potential impairment by comparing the fair value of reporting units with reporting units’ net asset values. If the fair value of a reporting unit exceeds the carrying value of the reporting unit’s net assets, then goodwill is not impaired and no further testing is required. If the fair value of the reporting unit is below the reporting unit’s carrying value, then the second step is required to measure the amount of potential impairment. The second step requires an assignment of the reporting unit’s fair value to the reporting unit’s assets and liabilities, using the initial acquisition accounting guidance related to business combinations, to determine the implied fair value of the reporting unit’s goodwill. The implied fair value of the reporting unit’s goodwill is then compared with the carrying amount of the reporting unit’s goodwill to determine the goodwill impairment loss to be recognized, if any. If the carrying value of a reporting unit’s goodwill exceeds its implied fair value, an impairment loss equal to the difference is recorded.

As of June 30, 2020, the Company performed “Step 0” of the impairment test, which included a qualitative assessment of the impact of COVID-19 as a triggering event, and determined that there were no facts and circumstances that indicated that the fair value of the reporting unit may be less than its carrying amount, and as a result, the Company determined that no impairment was required.

On October 2, 2017, the Company acquired 100% interest in Big Universe, Inc. for \$3.3 million and contingent consideration. On January 27, 2020, the Company acquired Galvanize for \$165.0 million and working capital. The Company’s acquisition of Galvanize is discussed in more detail in Note 14, “Acquisitions and Investments.”

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

The following table represents goodwill additions/reductions resulting from the acquisitions mentioned above during the years ended June 30, 2020, 2019 and 2018:

| (\$ in millions) | Amount |
|-----------------------------------|-----------------|
| Goodwill | |
| Balance as of June 30, 2017 | \$ 87.2 |
| Acquisition of Big Universe, Inc. | 3.0 |
| Balance as of June 30, 2018 | \$ 90.2 |
| Adjustments | — |
| Balance as of June 30, 2019 | \$ 90.2 |
| Acquisition of Galvanize, Inc. | 84.7 |
| Balance as of June 30, 2020 | <u>\$ 174.9</u> |

The following table represents the balance of the Company's intangible assets as of June 30, 2020 and 2019:

| (\$ in millions) | June 30, 2020 | | | June 30, 2019 | | |
|--|-----------------------------|-----------------------------|--------------------------|-----------------------------|-----------------------------|--------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
| Trade names | \$ 77.9 | \$ (12.0) | \$ 65.9 | \$ 17.6 | \$ (9.4) | \$ 8.2 |
| Customer and distributor relationships | 25.3 | (17.2) | 8.1 | 20.5 | (14.7) | 5.8 |
| Developed technology | 6.6 | (3.5) | 3.1 | 3.2 | (2.8) | 0.4 |
| Other | 1.4 | (1.0) | 0.4 | 1.4 | (0.8) | 0.6 |
| Total | <u>\$ 111.2</u> | <u>\$ (33.7)</u> | <u>\$ 77.5</u> | <u>\$ 42.7</u> | <u>\$ (27.7)</u> | <u>\$ 15.0</u> |

Impairment of Long-Lived Assets

Long-lived assets include property, equipment, right-of-use assets, capitalized curriculum and software developed or obtained for internal use. In accordance with ASC 360, *Property, Plant and Equipment* ("ASC 360"), 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. The Company performed a qualitative assessment of COVID-19 as a triggering event related to the value of its long-lived assets and concluded that there was no impairment during the year ended June 30, 2020.

Income Taxes

Deferred tax assets and liabilities are computed based on the difference between the financial reporting and income tax bases of assets and liabilities using the enacted marginal tax rate. ASC 740, *Income Taxes* ("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.

Stock-Based Compensation

The Company estimates the fair value of share-based awards on the date of grant. The fair value of restricted stock awards is based on the closing price of the Company's common stock on the date of grant. Certain restricted stock awards with a market-based performance component are valued using a Monte Carlo simulation model that considers a variety of factors including, but not limited to, the Company's common stock price, risk-free rate, and expected stock price volatility over the expected life of awards. The Company recognizes forfeitures of share-based awards as they occur in the

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Notes to Consolidated Financial Statements (Continued)

period of forfeiture rather than estimating the number of awards expected to be forfeited at the grant date and subsequently adjusting the estimate when awards are actually forfeited.

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. Advertising costs totaled \$32.7 million, \$38.0 million and \$37.5 million for the years ended June 30, 2020, 2019 and 2018, respectively, and are included within selling, general, and administrative expenses in the consolidated statements of operations.

Net Income Per Common Share

The Company calculates net income (loss) per share in accordance with ASC 260, *Earnings Per Share* (“ASC 260”). 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”) reflects the potential dilution that could occur assuming conversion or exercise of all dilutive unexercised stock options and vesting of all dilutive unvested restricted stock awards. The dilutive effect of stock options and restricted stock awards was determined using the treasury stock method. Under the treasury stock method, the proceeds received from the exercise of stock options and restricted stock awards, the amount of compensation cost for future service not yet recognized by the Company and the amount of tax benefits that would be recorded as income tax expense 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 includes restricted stock awards outstanding.

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

| | Year Ended June 30, | | |
|--|---|-------------|-------------|
| | 2020 | 2019 | 2018 |
| | (In thousands except share and per share data) | | |
| Basic net income per share computation: | | | |
| Net income attributable to common stockholders | \$ 24,506 | \$ 37,209 | \$ 27,620 |
| Weighted average common shares — basic | 39,478,928 | 38,848,780 | 39,282,674 |
| Basic net income per share | \$ 0.62 | \$ 0.96 | \$ 0.70 |
| Diluted net income per share computation: | | | |
| Net income attributable to common stockholders | \$ 24,506 | \$ 37,209 | \$ 27,620 |
| Share computation: | | | |
| Weighted average common shares — basic | 39,478,928 | 38,848,780 | 39,282,674 |
| Effect of dilutive stock options and restricted stock awards | 1,184,296 | 2,096,020 | 1,355,070 |
| Weighted average common shares — diluted | 40,663,224 | 40,944,800 | 40,637,744 |
| Diluted net income per share | \$ 0.60 | \$ 0.91 | \$ 0.68 |

For the years ended June 30, 2020, 2019 and 2018, shares issuable in connection with stock options and restricted stock of 729,008, 140,657 and 1,026,472, respectively, were excluded from the diluted income per common share calculation because the effect would have been antidilutive. As of June 30, 2020, the Company had 46,341,627 shares of common stock issued and 41,006,884 shares outstanding.

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Notes to Consolidated Financial Statements (Continued)

Fair Value Measurements

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

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

- Level 1: Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.
- Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Inputs reflect management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instrument’s valuation.

The carrying values reflected in the accompanying consolidated balance sheets for cash and cash equivalents, receivables, and short- and long-term debt approximate their fair values, as they are largely short-term in nature. The lease exit liability is discussed in more detail in Note 12, “Restructuring.” The Tallo, Inc. convertible note is discussed in more detail in Note 14, “Acquisitions and Investments.”

There were no assets or liabilities measured at fair value on a nonrecurring basis at June 30, 2020 – see Note 12, “Restructuring.”

The following table summarizes certain fair value information at June 30, 2019 for assets or liabilities measured at fair value on a nonrecurring basis.

| <u>Description</u> | <u>Fair Value</u> | <u>Fair Value Measurements Using:</u> | | |
|----------------------|-------------------|---|---|--|
| | | <u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u> | <u>Significant Other Observable Input (Level 2)</u> | <u>Significant Unobservable Inputs (Level 3)</u> |
| (In thousands) | | | | |
| Lease exit liability | \$ 1,779 | \$ — | \$ — | \$ 1,779 |

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Notes to Consolidated Financial Statements (Continued)

The following table summarizes certain fair value information at June 30, 2020 for assets or 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) | | |
| Convertible note received in acquisition | \$ 5,006 | — | — | 5,006 |

The following table summarizes certain fair value information at June 30, 2019 for assets or 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) | | |
| Convertible note received in acquisition | \$ 5,006 | \$ — | \$ — | \$ 5,006 |

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 year ended June 30, 2020.

| Description | Fair Value June 30, 2019 | Year Ended June 30, 2020 | | Fair Value June 30, 2020 |
|--|-----------------------------|---|------------------------------|-----------------------------|
| | | Purchases, Issuances, and Settlements | Unrealized Gains (Losses) | |
| | | (In thousands) | | |
| Convertible note received in acquisition | 5,006 | — | — | 5,006 |

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 year ended June 30, 2019.

| Description | Fair Value June 30, 2018 | Year Ended June 30, 2019 | | Fair Value June 30, 2019 |
|---|-----------------------------|---|------------------------------|-----------------------------|
| | | Purchases, Issuances, and Settlements | Unrealized Gains (Losses) | |
| | | (In thousands) | | |
| Contingent consideration associated with acquisitions | \$ 1,345 | \$ (1,347) | \$ 2 | \$ — |
| Convertible note received in acquisition | — | 5,006 | — | 5,006 |

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 year ended June 30, 2018.

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Notes to Consolidated Financial Statements (Continued)

| Description | Year Ended June 30, 2018 | | | Fair Value June 30, 2018 |
|---|-----------------------------|---|------------------------------|-----------------------------|
| | Fair Value June 30, 2017 | Purchases, Issuances, and Settlements | Unrealized Gains (Losses) | |
| (In thousands) | | | | |
| Contingent consideration associated with acquisitions | 2,806 | (1,319) | (142) | 1,345 |

Reclassifications

Certain previous year amounts have been reclassified to conform with current year presentations, as related to the impact of the adoption of ASC 842 and the Company's presentation of deferred rent as a separate line item on the consolidated balance sheet as of June 30, 2019. Deferred rent is now included in other long-term liabilities.

4. Property and Equipment and Capitalized Software and Curriculum

Property and equipment consists of the following at:

| | June 30, | |
|--|------------------|------------------|
| | 2020 | 2019 |
| (In thousands) | | |
| Student computers | \$ 48,153 | \$ 43,845 |
| Computer software | 17,268 | 17,999 |
| Computer hardware | 14,505 | 14,118 |
| Leasehold improvements | 17,396 | 10,364 |
| State testing computers | 7,461 | 7,470 |
| Furniture and fixtures | 7,178 | 4,058 |
| Office equipment | 1,372 | 1,382 |
| | 113,333 | 99,236 |
| Less accumulated depreciation and amortization | (74,665) | (67,256) |
| | <u>\$ 38,668</u> | <u>\$ 31,980</u> |

The Company recorded depreciation expense related to property and equipment reflected in selling, general, and administrative expenses of \$4.3 million, \$5.2 million and \$5.1 million during the years ended June 30, 2020, 2019 and 2018, respectively. Depreciation expense of \$17.9 million, \$15.0 million and \$12.4 million related to computers provided to students is reflected in instructional costs and services during the years ended June 30, 2020, 2019 and 2018, respectively. Amortization expense of zero, zero and \$0.5 million related to student software costs is reflected in instructional costs and services during the years ended June 30, 2020, 2019 and 2018, respectively.

The Company incurs maintenance and repair expenses, which are expensed as incurred, and recorded in selling, general, and administrative expenses. Maintenance and repair expenses totaled \$10.3 million, \$13.7 million and \$12.1 million for the years ended June 30, 2020, 2019 and 2018, respectively.

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Notes to Consolidated Financial Statements (Continued)

Capitalized software costs consist of the following at:

| | <u>June 30,</u> | |
|--|------------------|------------------|
| | <u>2020</u> | <u>2019</u> |
| | (In thousands) | |
| Capitalized software | \$ 249,720 | \$ 226,503 |
| Less accumulated depreciation and amortization | (201,227) | (175,338) |
| | <u>\$ 48,493</u> | <u>\$ 51,165</u> |

The Company recorded amortization expense of \$20.8 million, \$22.3 million and \$25.8 million related to capitalized software reflected in instructional costs and services and \$5.5 million, \$7.4 million and \$9.1 million reflected in selling, general, and administrative expenses during the years ended June 30, 2020, 2019 and 2018, respectively.

Capitalized curriculum development costs consist of the following at:

| | <u>June 30,</u> | |
|--|------------------|------------------|
| | <u>2020</u> | <u>2019</u> |
| | (In thousands) | |
| Capitalized curriculum development costs | \$ 156,018 | \$ 156,671 |
| Less accumulated depreciation and amortization | (107,169) | (103,374) |
| | <u>\$ 48,849</u> | <u>\$ 53,297</u> |

The Company recorded amortization expense of \$17.5 million, \$18.5 million and \$19.4 million related to capitalized curriculum development cost reflected in instructional costs and services during the years ended June 30, 2020, 2019 and 2018, respectively.

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.

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Notes to Consolidated Financial Statements (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, | |
|---|----------------|-------------|
| | 2020 | 2019 |
| | (In thousands) | |
| Deferred tax assets | | |
| Net operating loss carryforward | \$ 21,850 | \$ 4,923 |
| Reserves | 3,374 | 4,769 |
| Accrued expenses | 4,117 | 3,492 |
| Stock compensation expense | 7,064 | 5,992 |
| Other assets | 2,252 | 1,524 |
| Deferred rent | — | 1,056 |
| Deferred revenue | 759 | 461 |
| Lease liability | 29,640 | — |
| Federal tax credits | 20 | 20 |
| State tax credits | 44 | 363 |
| Total deferred tax assets | 69,120 | 22,600 |
| Deferred tax liabilities | | |
| Capitalized curriculum development | (9,245) | (10,143) |
| Capitalized software and website development costs | (11,907) | (12,659) |
| Property and equipment | (6,213) | (5,166) |
| Right-of-use assets | (28,273) | — |
| Returned materials | (2,385) | (2,643) |
| Purchased intangibles | (19,877) | (4,110) |
| Total deferred tax liabilities | (77,900) | (34,721) |
| Net deferred tax liability before valuation allowance | (8,780) | (12,121) |
| Valuation allowance | (4,991) | (4,549) |
| Net deferred tax liability | \$ (13,771) | \$ (16,670) |
| Reported as: | | |
| Long-term deferred tax liabilities | \$ (13,771) | \$ (16,670) |

The Company maintained a valuation allowance on net noncurrent deferred tax assets of \$5.0 million and \$4.5 million as of June 30, 2020 and 2019, respectively, predominantly related to foreign income tax net operating losses ("NOL").

At June 30, 2020, the Company had approximately \$65.1 million of available federal NOL carryforwards solely related to the acquisition of Galvanize in January 2020. The federal NOL carryforwards, in the amount of \$18.1 million, generated prior to 2018 will begin to expire, if unused, in 2033. Due to the Tax Cuts and Jobs Act (the "Tax Act"), the federal NOL carryforwards, in the amount of \$47.0 million, generated after 2017 have an indefinite carryforward period. Section 382 of the Internal Revenue Code limits the utilization of NOL carryforwards following a change of control. The Company has performed an analysis of the Section 382 ownership changes and have determined that it will be able to fully utilize its available NOLs subject to the Section 382 limitation.

At June 30, 2020, the Company had tax effected state NOL carryforwards of \$3.2 million, net of valuation allowances, and will expire on various dates.

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Notes to Consolidated Financial Statements (Continued)

The components of the income tax expense (benefit) for the years ended June 30, 2020, 2019 and 2018 were as follows:

| | Year Ended June 30, | | |
|---|---------------------|------------------|-----------------|
| | 2020 | 2019 | 2018 |
| | (In thousands) | | |
| Current: | | | |
| Federal | \$ 6,907 | \$ 3,919 | \$ 887 |
| State | 1,911 | 1,988 | 774 |
| Foreign | 1,028 | 920 | 1,444 |
| Total current | 9,846 | 6,827 | 3,105 |
| Deferred: | | | |
| Federal | (1,687) | 3,412 | (4,769) |
| State | 382 | 281 | 754 |
| Total deferred | (1,305) | 3,693 | (4,015) |
| Total income tax expense (benefit) | \$ 8,541 | \$ 10,520 | \$ (910) |

The provision for (benefit from) 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, | | |
|---|---------------------|---------------|---------------|
| | 2020 | 2019 | 2018 |
| U.S. federal tax at statutory rates (1) | 21.0 % | 21.0 % | 28.0 % |
| Permanent items | 1.1 | 0.5 | 0.6 |
| Lobbying | 0.4 | 0.4 | 1.2 |
| Non-deductible compensation | 9.0 | 1.6 | 0.3 |
| State taxes, net of federal benefit | 5.3 | 4.3 | 3.1 |
| Research and development tax credits | (1.8) | (0.5) | - |
| Domestic production activities deduction | - | - | (0.1) |
| Change in valuation allowance | 0.1 | 0.2 | (7.2) |
| Effects of foreign operations | 0.3 | 0.1 | - |
| Reserve for unrecognized tax benefits | (2.4) | (2.1) | 0.9 |
| Noncontrolling interests | - | - | 0.4 |
| Other | (0.8) | (0.4) | (3.9) |
| Impact of federal tax rate reduction | - | - | (25.4) |
| Repatriation transition tax | - | - | 6.4 |
| Stock-based compensation | (6.4) | (3.1) | (7.7) |
| Provision for (benefit from) income taxes | <u>25.8 %</u> | <u>22.0 %</u> | <u>(3.4)%</u> |

- (1) The corporate tax rate was lowered from 35% to 21%, effective as of January 1, 2018. Under IRC §15 which governs rate changes, fiscal year taxpayers are subject to a “blended” tax rate for tax years that include January 1, 2018. Using the weighted average calculation, the Company’s blended federal tax rate for the year ended June 30, 2018 is 28%.

The increase in the effective income tax rate for the year ended June 30, 2020 was primarily due to the increase in the amount of non-deductible compensation, which was partially offset by the increase in excess tax benefit of stock-based compensation.

Tax Uncertainties

The Company follows the provisions of ASC 740 which applies to all tax positions related to income taxes. ASC 740 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 clarifies accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a

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Notes to Consolidated Financial Statements (Continued)

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 related to unrecognized tax benefits.

The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense. As of June 30, 2020, 2019 and 2018, the Company had \$0.1 million, \$0.2 million and \$0.2 million in accrued interest and penalties, respectively.

The unrecognized tax benefits for the years ended June 30, 2020, 2019 and 2018 were as follows:

| | Year Ended June 30, | | |
|--|---------------------|-----------------|-----------------|
| | 2020 | 2019 | 2018 |
| | (In thousands) | | |
| Balance at beginning of the year | \$ 1,545 | \$ 2,392 | \$ 2,260 |
| Additions for prior year tax positions | 161 | 194 | 585 |
| Additions for current year tax positions | 179 | 87 | 8 |
| Reductions for prior year tax positions | (1,035) | (1,128) | (461) |
| Balance at end of the year | <u>\$ 850</u> | <u>\$ 1,545</u> | <u>\$ 2,392</u> |

If recognized, all of the \$0.9 million balance of unrecognized tax benefits as of June 30, 2020 would affect the effective tax rate. The Company does not anticipate a significant increase or decrease in unrecognized tax benefits in the next twelve months.

The Company remains subject to audit by the Internal Revenue Service for federal tax purposes for tax years after June 30, 2016. Certain state and foreign tax jurisdictions are also either currently under audit or remain open under the statute of limitations for the tax years after June 30, 2014.

6. Finance and Operating Leases

Finance Leases

The Company is a lessee under finance leases for student computers and peripherals under loan agreements with PNC Equipment Finance, LLC (“PNC”) and Banc of America Leasing & Capital, LLC (“BALC”). As of June 30, 2020 and 2019, the finance lease liability (“capital leases” as of June 30, 2019) was \$17.9 million and \$24.6 million, respectively, with lease interest rates ranging from 1.52% to 3.87%. As of June 30, 2020 and 2019, the balance of the associated right-of-use assets (“student computers” as of June 30, 2019) was \$19.8 million and \$19.8 million, respectively. The right-of-use asset is recorded within property and equipment, net on the consolidated balance sheets. Lease amortization expense associated with the Company’s finance leases is recorded within selling, general, and administrative expenses on the consolidated statements of operations.

Individual leases under the agreement with PNC include 36-month payment terms at varying rates, 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 Company entered into an agreement with BALC in February 2019 for \$25.0 million to provide financing for its leases through December 2019 at varying rates. The Company entered into an additional \$25.0 million agreement in April 2020 to provide financing for its leases through March 2021 at varying rates. In July 2020, the limit was increased from \$25.0 million to \$41.0 million at the same terms. Individual leases with BALC include 12-month and 36-month

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Notes to Consolidated Financial Statements (Continued)

payment terms, fixed rates ranging from 1.52% to 3.58%, and a \$1 purchase option at the end of each lease term. The Company has pledged the assets financed to secure the outstanding leases.

The following is a summary, as of June 30, 2020 (under ASC 842) and June 30, 2019 (under ASC 840), respectively, of the present value of the net minimum lease payments under the Company's finance leases:

| | <u>June 30,</u> | |
|--|-----------------|-----------------|
| | <u>2020</u> | <u>2019</u> |
| | (in thousands) | |
| 2020 | \$ — | \$ 20,070 |
| 2021 | 13,587 | 4,819 |
| 2022 | 2,653 | 340 |
| 2023 | 2,040 | — |
| Total minimum payments | 18,280 | 25,229 |
| Less: imputed interest | (342) | (581) |
| Finance lease liability | 17,938 | 24,648 |
| Less: current portion of finance lease liability | (13,304) | (19,588) |
| Long-term finance lease liability | <u>\$ 4,634</u> | <u>\$ 5,060</u> |

Operating Leases

The Company is a lessee under operating leases for various facilities to support the Company's operations. As of June 30, 2020, the operating lease liability was \$117.2 million. As of June 30, 2020, the balance of the associated right-of-use assets was \$111.8 million. Each of the above balances as of June 30, 2020 includes the impact of Galvanize's adoption of ASC 842 as part of the purchase price accounting which is discussed in more detail in Note 14, "Acquisitions and Investments." Lease expense associated with the Company's operating leases is recorded within selling, general, and administrative expenses on the consolidated statements of operations.

Individual operating leases range in terms of 1 to 11 years and expire on various dates through fiscal year 2031 and the minimum lease payments are discounted using the Company's incremental borrowing rate of 3.86% or 2.55%.

The following is a summary as of June 30, 2020 (under ASC 842) and June 30, 2019 (under ASC 840), respectively, of the present value of the minimum lease payments under the Company's operating leases:

| | <u>June 30,</u> | |
|--|------------------|-------------|
| | <u>2020</u> | <u>2019</u> |
| | (in thousands) | |
| 2020 | \$ — | \$ 8,441 |
| 2021 | 23,626 | 8,229 |
| 2022 | 22,326 | 6,735 |
| 2023 | 15,841 | 550 |
| 2024 | 14,769 | 137 |
| 2025 | 13,949 | — |
| Thereafter | 38,544 | — |
| Total minimum payments | 129,055 | \$ 24,092 |
| Less: imputed interest | (11,822) | |
| Operating lease liability | 117,233 | |
| Less: current portion of operating lease liability | (20,689) | |
| Long-term operating lease liability | <u>\$ 96,544</u> | |

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Notes to Consolidated Financial Statements (Continued)

The Company is subleasing one of its facilities through June 2021, two others through May 2022 and one through July 2023. Sublease income is recorded as an offset to the related lease expense within selling, general, and administrative expenses on the consolidated statements of operations. The following is a summary as of June 30, 2020 and June 30, 2019, respectively, of the expected sublease income:

| | <u>Year Ended June 30,</u> | |
|-----------------------|----------------------------|-----------------|
| | <u>2020</u> | <u>2019</u> |
| | (in thousands) | |
| 2020 | \$ — | \$ 930 |
| 2021 | 1,960 | 961 |
| 2022 | 1,496 | 528 |
| 2023 | 797 | — |
| 2024 | 66 | — |
| Total sublease income | <u>\$ 4,319</u> | <u>\$ 2,419</u> |

The following is a summary of the Company's lease cost, weighted-average remaining lease term, weighted-average discount rate and certain other cash flows as it relates to its operating leases for the year ended June 30, 2020:

| | <u>June 30, 2020</u> |
|-------------------------------------|----------------------|
| | (in thousands) |
| Lease cost | |
| Finance lease cost: | |
| Amortization of right-of-use assets | \$ 16,740 |
| Interest on lease liabilities | 820 |
| Operating lease cost | 13,129 |
| Short-term lease cost | 1,214 |
| Sublease income | (760) |
| Total lease cost | <u>\$ 31,143</u> |

Other information

| | |
|--|-------------|
| Cash paid for amounts included in the measurement of lease liabilities | |
| Operating cash flows from operating leases | \$ (13,124) |
| Financing cash flows from finance leases | (27,675) |
| Right-of-use assets obtained in exchange for new finance lease liabilities | 17,160 |
| Right-of-use assets obtained in exchange for new operating lease liabilities | 6,311 |
| Weighted-average remaining lease term - finance leases | 0.79 yrs. |
| Weighted-average remaining lease term - operating leases | 7.15 yrs. |
| Weighted-average discount rate - finance leases | 2.86 % |
| Weighted-average discount rate - operating leases | 2.76 % |

7. Credit Facility

On January 27, 2020, the Company entered into a \$100.0 million senior secured revolving credit facility ("Credit Facility") to be used for general corporate operating purposes with PNC Capital Markets LLC. The Credit Facility has a five-year term and incorporates customary financial and other covenants, including, but not limited to, a maximum leverage ratio and a minimum interest coverage ratio. The majority of the Company's borrowings under the Credit Facility are at LIBOR plus an additional rate ranging from 0.875% - 1.50% based on the Company's leverage ratio as defined in

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Notes to Consolidated Financial Statements (Continued)

the agreement. The Credit Facility is secured by the Company's assets. As of June 30, 2020, the Company was in compliance with the financial covenants. As of June 30, 2020, the Company had \$100.0 million outstanding on the Credit Facility. The Credit Facility also includes a \$200.0 million accordion feature.

8. Equity Transactions

The Company's Fourth 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, 2020 or 2019.

Common Stock Repurchases

On May 16, 2018, the Company entered into a stock repurchase agreement pursuant to which the Company repurchased 1,832,145 shares of its common stock in a single transaction at a purchase price of \$15.00 per share, representing aggregate consideration of \$27.5 million.

9. Equity Incentive Plan

On December 15, 2016 (the "Effective Date"), the Company's stockholders approved the 2016 Incentive Award Plan (the "Plan"). The Plan is designed to attract, retain and motivate employees who make important contributions to the Company by providing such individuals with equity ownership opportunities. Awards granted under the Plan may include stock options, stock appreciation rights, restricted stock, restricted stock units, and other stock-based awards. Under the Plan, the following types of shares go back into the pool of shares available for issuance:

- unissued shares related to forfeited or cancelled restricted stock and stock options from Plan awards and Prior Plan awards (that were outstanding as of the Effective Date), and;
- shares tendered to satisfy the tax withholding obligation related to the vesting of restricted stock (but not stock options).

Unlike the Company's 2007 Equity Incentive Award Plan (the "Prior Plan"), the Plan has no evergreen provision to increase the shares available for issuance; any new shares would require stockholder approval. The Prior Plan expired in October 2017, and the Company no longer awards equity from the Prior Plan. At June 30, 2020, the remaining aggregate number of shares of the Company's common stock authorized for future issuance under the Plan was 1,260,352. At June 30, 2020, there were 5,127,245 shares of the Company's common stock that remain outstanding or nonvested under the Plan and Prior Plan.

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, *Compensation—Stock Compensation* ("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. Stock-based compensation expense is recorded within selling, general, and administrative expenses on the consolidated statements of operations.

Stock Options

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 Prior Plan and the Company has also granted stock options to executive officers under stand-alone agreements outside the Prior Plan.

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

Stock option activity including stand-alone agreements during the years ended June 30, 2020, 2019 and 2018 was as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (Years) | Aggregate Intrinsic Value |
|--|-----------|--|---|---------------------------------|
| Outstanding, June 30, 2017 | 1,356,528 | \$ 20.19 | 4.46 | \$ 1,481,585 |
| Granted | — | — | | |
| Exercised | (14,600) | 13.45 | | |
| Forfeited or canceled | (142,621) | 22.71 | | |
| Outstanding, June 30, 2018 | 1,199,307 | \$ 19.97 | 3.55 | \$ 788,277 |
| Granted | — | — | | |
| Exercised | (150,290) | 20.16 | | |
| Forfeited or canceled | (13,000) | 29.82 | | |
| Outstanding, June 30, 2019 | 1,036,017 | \$ 19.82 | 2.64 | \$ 11,312,871 |
| Granted | — | — | | |
| Exercised | (4,000) | 16.07 | | |
| Forfeited or canceled | (10,500) | 30.92 | | |
| Outstanding and exercisable, June 30, 2020 | 1,021,517 | \$ 19.73 | 1.65 | \$ 8,325,869 |

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, 2020. 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, 2020, 2019 and 2018 was \$0.0 million, \$1.2 million, and \$0.0 million, respectively.

As of June 30, 2020, there was no unrecognized compensation expense related to nonvested stock options granted. During the years ended June 30, 2020, 2019 and 2018, the Company recognized \$0.1 million, \$0.6 million and \$1.2 million, respectively, of stock-based compensation expense related to stock options.

Restricted Stock Awards

The Company has approved grants of restricted stock awards ("RSA") pursuant to the Plan and Prior Plan. Under the Plan and Prior 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 RSAs, generally over three years. Under the Plan and Prior Plan, there have been no awards of restricted stock to independent contractors.

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

Restricted stock award activity during the years ended June 30, 2020, 2019 and 2018 was as follows:

| | Shares | Weighted Average Grant-Date Fair Value |
|--------------------------|------------------|---|
| Nonvested, June 30, 2017 | 2,141,047 | \$ 12.34 |
| Granted | 1,210,502 | 16.68 |
| Vested | (1,339,492) | 12.29 |
| Canceled | (335,150) | 14.31 |
| Nonvested, June 30, 2018 | 1,676,907 | \$ 15.12 |
| Granted | 828,833 | 18.44 |
| Vested | (947,703) | 14.72 |
| Canceled | (235,485) | 17.40 |
| Nonvested, June 30, 2019 | 1,322,552 | \$ 17.08 |
| Granted | 1,126,227 | 26.84 |
| Vested | (750,634) | 16.93 |
| Canceled | (79,541) | 21.48 |
| Nonvested, June 30, 2020 | <u>1,618,604</u> | <u>\$ 23.73</u> |

Performance-Based Restricted Stock Awards (included above)

During the year ended June 30, 2020, 499,818 new performance-based restricted stock awards were granted and 559,089 remain nonvested at June 30, 2020. During the year ended June 30, 2020, 210,467 performance-based restricted stock awards vested. Vesting of the performance-based restricted stock awards is contingent on the achievement of certain financial performance goals and service vesting conditions.

During fiscal year 2020, the Company granted 358,294 performance-based restricted stock awards to the Company's CEO with a weighted average grant-date fair value of \$27.91 per share. These awards were granted pursuant to the Plan and are subject to the achievement of target free cash flow metrics in each of the fiscal years 2020 through 2022. The metrics are measured at the end of each fiscal year; however, the first two-thirds of the award will not vest until fiscal year 2021. The remaining one-third will vest in fiscal year 2022, if achieved. Additionally, if either of the first two tranches are not achieved, the awards may still vest if the free cash flow metric in aggregate is met over the three-year life of the award. The Company is currently amortizing the second and third tranches over their vesting periods because it believes that it is probable that the free cash flow targets will be met each year. The free cash flow metric was not met for fiscal year 2020, however, the Company believes that it will be met in aggregate, and therefore is amortizing the first tranche over a three-year period.

During fiscal year 2020, the Company granted 141,524 performance-based restricted stock awards to the Company's named executive officers ("NEOs") with a weighted average grant-date fair value of \$27.91 per share. These awards were granted pursuant to the Plan and are subject to the achievement of Adjusted EBITDA metrics in fiscal year 2020. If achieved, one-third of the award will vest immediately, and the remaining two-thirds will vest annually over two years. The Company is currently amortizing these awards over their vesting periods because it believes that it is probable that the Adjusted EBITDA metric will be achieved and certified by the Compensation Committee at target for fiscal year 2020.

Equity Incentive Market-Based Restricted Stock Awards (included above)

During fiscal year 2017, the Company granted equity incentive market-based restricted stock awards which were subject to the attainment of an average stock price of \$14.35 for 30 consecutive days after the date of the Company's earnings release for the fourth quarter and fiscal year ended June 30, 2017. During the year ended June 30, 2020, the remaining 6,800 equity incentive market-based restricted stock awards vested.

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

Service-Based Restricted Stock Awards (included above)

During the year ended June 30, 2020, 626,409 new service-based restricted stock awards were granted and 1,059,515 remain nonvested at June 30, 2020. During the year ended June 30, 2019, 533,367 service-based restricted stock awards vested.

Summary of All Restricted Stock Awards

As of June 30, 2020, there was \$25.6 million of total unrecognized compensation expense related to nonvested restricted stock awards. The cost is expected to be recognized over a weighted average period of 1.6 years. The fair value of restricted stock awards granted for the years ended June 30, 2020 and 2019 was \$30.2 million and \$15.3 million, respectively. The total fair value of shares vested for the years ended June 30, 2020 and 2019 was \$17.9 million and \$20.6 million, respectively. During the years ended June 30, 2020, 2019 and 2018, the Company recognized \$17.1 million, \$12.3 million and \$15.7 million, respectively, of stock-based compensation expense related to restricted stock awards.

Performance Share Units (“PSU”)

Certain PSUs vest upon achievement of performance criteria associated with a Board-approved Transaction Related Incentive Plan (“TRIP”) and continuation of employee service over a defined period related to employees of Galvanize. The level of performance will determine the number of PSUs earned as measured against threshold, target and outperform achievement levels of the TRIP. The TRIP is a grant of a fixed monetary amount, in which the number of shares to be granted, will be calculated at the end of the performance period based on the value of the Company’s stock. At that time, the Company will issue shares of the Company’s common stock, or at the option of the Company, an equivalent amount of cash, and is classified as a liability award in accordance with ASC 718.

Certain PSUs vest upon achievement of performance criteria associated with a Board-approved Long Term Incentive Plan (“LTIP”) and continuation of employee service over a defined period. The level of performance will determine the number of PSUs earned as measured against threshold, target and outperform achievement levels of the LTIP. Each PSU represents the right to receive one share of the Company’s common stock, or at the option of the Company, an equivalent amount of cash, and is classified as an equity award in accordance with ASC 718.

In addition to the LTIP performance conditions, there is a service vesting condition which is dependent upon continuing service by the grantee as an employee of the Company, unless the grantee is eligible for earlier vesting upon a change in control and qualifying termination, as defined by the PSU agreement. For equity performance awards, including the PSUs, subject to graduated vesting schedules for which vesting is based on achievement of a performance metric in addition to grantee service, stock-based compensation expense is recognized on an accelerated basis by treating each vesting tranche as if it was a separate grant.

Fiscal Year 2020 TRIP

During the third quarter of fiscal year 2020, the Company granted a target level of \$12.3 million under the TRIP that was driven by certain revenue and EBITDA targets related to the performance of Galvanize. Seventy percent of the earned award is based on the performance of Galvanize for the calendar year 2021 (“Tranche #1”) and thirty percent of the earned award is based on the performance of Galvanize for the calendar year 2022 (“Tranche 2”), both of which are expected to vest in January following each of the calendar year ends. The revenue and EBITDA targets are split sixty percent and forty percent, respectively for both tranches. In all cases, vesting is dependent upon continuing service by the grantee as an employee of the Company. The Company determined the achievement of the performance conditions associated with all tranches are not able to be determined at this time.

Fiscal Year 2019 LTIP

During fiscal year 2019, the Company granted 263,936 PSUs at target under a LTIP that was driven by certain revenue targets and enrollment levels, as well as students’ academic progress. These PSUs had a grant date fair value of

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

\$7.9 million, or a weighted average grant-date fair value of \$30.05 per share. During fiscal year 2020, the Company granted an additional 14,199 PSUs at target with a grant date fair value of \$0.4 million, or \$28.17 per share. Forty-five percent of the earned award is based on students' academic progress ("Tranche #1") and twenty-five percent of the earned award is based on certain enrollment levels ("Tranche 2"), both of which will vest on October 15, 2021. The remaining thirty percent of the earned award is based on certain revenue targets ("Tranche #3") and will vest on August 15, 2022. In all cases, vesting is dependent upon continuing service by the grantee as an employee of the Company. The Company determined the achievement of the performance conditions associated with all three tranches were not probable and therefore no expense was recorded during the year ended June 30, 2020.

Fiscal Year 2019 SPP

During fiscal year 2019, the Company adopted a new long-term shareholder performance plan ("2019 SPP") that provides for incentive award opportunities to its key senior executives. The awards were granted in the form of PSUs and will be earned based on the Company's market capitalization growth over a completed three-year performance period. The 2019 SPP was designed to provide the executives with a percentage of shareholder value growth. No amounts will be earned if total stock price growth over the three-year period is below 25% (7.6% annualized). An amount of 6% of total value growth will be earned based on achieving total stock price growth of 33% (10% annualized) and a maximum of 7.5% of total value growth will be earned if total stock price growth equals or exceeds 95% (25% annualized).

During fiscal year 2019, the Company granted 2,108,305 PSUs at a weighted-average grant-date fair value of \$8.18 per share, based on the highest level of performance. During the fourth quarter of fiscal year 2020, the Company granted an additional 66,934 PSUs at a weighted average grant-date fair value of \$12.56 per share, based on the highest level of performance. The final amount of PSUs will be determined (and vesting will occur) based on the 30-day average price of the Company's stock subsequent to seven days after the release of fiscal year 2021 results. The fair value was determined using a Monte Carlo simulation model and will be amortized on a straight-line basis over the vesting period.

Summary of All Performance Share Units

As of June 30, 2020, there was \$7.9 million of total unrecognized compensation expense related to nonvested PSUs. The cost is expected to be recognized over a weighted average period of 1.2 years. During the years ended June 30, 2020, 2019 and 2018, the Company recognized \$6.3 million, \$3.9 million and \$5.9 million, respectively, of stock-based compensation expense related to PSUs.

Performance share unit activity (excluding the fiscal year 2020 TRIP) during the years ended June 30, 2020, 2019 and 2018 was as follows:

| | Shares | Weighted Average Grant-Date Fair Value |
|--------------------------|---------------|---|
| Nonvested, June 30, 2017 | 1,043,602 | \$ 13.16 |
| Granted | 138,241 | 12.81 |
| Vested | (320,340) | 12.62 |
| Canceled | (152,524) | 14.00 |
| Nonvested, June 30, 2018 | 708,979 | \$ 13.15 |
| Granted | 2,372,241 | 10.61 |
| Vested | (427,954) | 13.24 |
| Canceled | (281,025) | 13.02 |
| Nonvested, June 30, 2019 | 2,372,241 | \$ 10.61 |
| Granted | 81,133 | 15.30 |
| Vested | — | — |
| Canceled | (8,352) | 29.93 |

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

| | | |
|--------------------------|-----------|----------|
| Nonvested, June 30, 2020 | 2,445,022 | \$ 10.70 |
|--------------------------|-----------|----------|

Deferred Stock Units (“DSU”)

The DSUs vest on the grant-date anniversary and are settled in the form of shares of common stock issued to the holder upon separation from the Company.

Deferred stock unit activity during the years ended June 30, 2020 and 2019 was as follows:

| | Shares | Weighted Average Grant-Date Fair Value |
|--------------------------|--------|---|
| Nonvested, June 30, 2018 | — | \$ — |
| Granted | 18,258 | 25.41 |
| Vested | — | — |
| Canceled | — | — |
| Nonvested, June 30, 2019 | 18,258 | \$ 25.41 |
| Granted | 23,844 | 20.13 |
| Vested | — | — |
| Canceled | — | — |
| Nonvested, June 30, 2020 | 42,102 | \$ 22.42 |

Summary of All Deferred Stock Units

As of June 30, 2020, there was \$0.2 million of total unrecognized compensation expense related to nonvested DSUs. The cost is expected to be recognized over a weighted average period of 0.5 years. During the years ended June 30, 2020, 2019 and 2018, the Company recognized \$0.5 million, \$0.5 million and zero, respectively, of stock-based compensation expense related to DSUs.

10. Redeemable Noncontrolling Interest

Investment in LearnBop, Inc.

On July 31, 2014, the Company acquired a majority interest in LearnBop, Inc. (“LearnBop”), for \$6.5 million in 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 minority shareholders have a non-transferable put right, which was exercisable between July 31, 2018 and December 31, 2018 for the remaining minority interest. In January 2018, prior to the commencement of the exercise period, the Company and the minority shareholders entered into a stock purchase agreement to purchase the remaining 49% interest for \$0.5 million. As a result, LearnBop became a wholly owned subsidiary of the Company.

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 vigorously defends these claims; however, no assurances can be given as to the outcome of any pending legal proceedings. The Company believes, based on currently available

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

information, that the outcome of any existing or known threatened proceedings, even if determined adversely, should not have a material adverse effect on its business, financial condition, liquidity or results of operations.

On May 10, 2019, K12 Virtual Schools LLC filed a demand for arbitration with the American Arbitration Association (“AAA”), Case No. 01-19-001-4778, naming Georgia Cyber Academy, Inc. (“GCA”) as the respondent. The demand asserted claims for GCA’s breach and anticipatory breach of the Educational Products and Services Agreement between GCA and K12 Virtual Schools LLC, as amended on January 4, 2019, based on GCA’s engagement of other educational products and service providers for the school year 2019-2020. On May 29, 2019, GCA filed counterclaims against K12 Virtual Schools, LLC for breach of contract, fraud, breach of the duty of good faith and fair dealing, and negligent misrepresentation. The AAA appointed an arbitrator on June 12, 2019, and the parties presented evidence in support of their respective claims during merits hearings in March and June 2020. On July 8, 2020, the parties executed an agreement, effective June 30, 2020, to resolve all of their claims. Under the terms of the settlement agreement, GCA will pay the Company \$19 million over a period of two years, of which \$10 million was paid in July 2020. The Company recorded revenues of \$4.6 million for services provided by the Company during fiscal year 2020 and the remaining \$14.4 million reflected a prior year receivable, as part of a comprehensive settlement agreement.

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 agreement with the Company’s Chairman and Chief Executive Officer with an amended extended term to September 30, 2022, all other agreements provide for employment on an “at-will” basis. If the employee resigns for “good reason” or is terminated 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

As of June 30, 2020, the Company provided guarantees of approximately \$1.0 million related to lease commitments on the buildings for certain of the Company’s schools.

In addition, 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.

Risks and Uncertainties

Impact of COVID-19 to K12’s Business

The impact of the global emergence of COVID-19 on the Company’s business is currently not estimable or determinable. The Company is conducting business as usual with some modifications to employee travel, employee work locations, and cancellation of certain events. The Company will continue to actively monitor the situation and may take further actions that alter its business operations as may be required by federal, state or local authorities or that it determines is in the best interests of its employees, customers, partners, suppliers and stockholders. It is not clear what the potential effects any such alterations or modifications may have on the Company’s business, including the effects on its customers and prospects, or on its financial results for fiscal year 2021.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security (“CARES”) Act was enacted and signed into law. The Company has evaluated the business provisions in the CARES Act and adopted the deferral of the employer

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

portion of the social security payroll tax (6.2%) outlined within. The deferral is effective from the enactment date through December 31, 2020. The deferred amount will be paid in two installments, 50% of the deferred amount by December 31, 2021 and the remainder by December 31, 2022. The deferred payroll taxes are recorded within other long-term liabilities on the consolidated balance sheets.

12. Restructuring

In the third quarter of fiscal year 2017, the Company exited three facilities that were no longer being utilized, which were subject to operating leases. In aggregate, during fiscal year 2017, the Company recorded an impairment of \$5.4 million for the three leases. As part of the adoption of ASC 842, the lease impairment liability of \$1.8 million as of June 30, 2019 was offset against the right-of-use asset.

13. Severance

During the years ended June 30, 2020, 2019 and 2018, the Company reduced its workforce, as well as provided severance to its former CEO pursuant to his employment agreement in the form of compensation and an acceleration of certain equity awards (fiscal year 2018 only), resulting in severance of \$1.5 million, \$1.0 million and \$6.3 million, respectively. Included in severance expense for the years ended June 30, 2020, 2019 and 2018 is \$0.1 million, \$0.1 million and \$2.4 million, respectively, associated with accelerated vesting of equity awards to former executives and other employees.

14. Acquisitions and Investments

Acquisition of Galvanize, Inc.

On January 27, 2020, the Company acquired 100% of Galvanize in exchange for \$165.0 million, plus working capital of \$12.2 million. Galvanize provides talent development for individuals and enterprises in information technology fields. The acquisition of Galvanize expands the Company's offerings to include post-secondary skills training in data science and software engineering, technology staffing and developing talent and capabilities for companies. The Company also plans to use Galvanize's curriculum to create appropriate content to offer high school students.

The acquisition has been accounted for as a business combination under the acquisition method of accounting, which results in acquired assets and assumed liabilities being measured at their estimated fair values as of January 27, 2020, the acquisition date. As of the acquisition date, goodwill is measured as the excess of consideration transferred and the fair values of the assets acquired and liabilities assumed.

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Notes to Consolidated Financial Statements (Continued)

Based on management's preliminary valuation of the fair value of tangible and intangible assets acquired and liabilities assumed, which are based on estimates and assumptions that are subject to change, the preliminary estimated purchase price is allocated as follows (in thousands):

Allocation of Purchase Price

| | | |
|--|----|----------------|
| Cash | \$ | 9,232 |
| Current assets, excluding cash | | 8,888 |
| Property and equipment, net | | 11,270 |
| Operating lease right-of-use assets, net | | 99,676 |
| Intangible assets, net | | 68,483 |
| Goodwill | | 84,741 |
| Other assets | | 1,802 |
| Current liabilities | | (4,370) |
| Deferred revenue | | (3,374) |
| Deferred tax asset (liability) | | 2,412 |
| Current operating lease liability | | (11,620) |
| Long-term operating lease liability | | (89,782) |
| Other long-term liabilities | | (130) |
| Total consideration | \$ | <u>177,228</u> |

The final purchase price allocation will be completed within one year of the acquisition date ("measurement period"). If information becomes available which would indicate material adjustments are required to the purchase price allocation, such adjustments will be included in the purchase price allocation retrospectively.

The Company made several adjustments to its third quarter allocation of the preliminary purchase price during the fourth quarter of fiscal year 2020.

- The value of the trade names increased from \$24.0 million to \$60.3 million and the estimated useful life decreased from 18 years to 15 years. Amortization expense during the fourth quarter of fiscal year 2020 included an adjustment of \$0.4 million to reflect the updated balance and estimated useful life as of the acquisition date.
- The value of the operating lease right-of-use assets, net increased from \$90.7 million to \$99.7 million. Lease expense during the fourth quarter of fiscal year 2020 included an adjustment of \$0.1 million to reflect the updated balance as of the acquisition date.
- The deferred tax liability decreased from \$17.4 million to \$2.4 million, mostly as a result of the change to the trade names and changes to the preliminary Section 382 analysis.
- Goodwill decreased from \$107.6 million to \$84.7 million, mostly as a result of the transactions above.

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Notes to Consolidated Financial Statements (Continued)

Section 382 of the Internal Revenue Code could limit the Company's ability to utilize Galvanize's net operating losses and the Company believes the analysis of Section 382 has been substantially completed. The Company has made a preliminary assessment of its unfavorable/favorable leases as it relates to the value assigned to its operating lease right-of-use assets. The Section 382 and unfavorable/favorable leases analyses are still under review. The Company expects to complete these analyses within the measurement period.

The fair value of the identified intangible assets was determined primarily using an income-based approach of either the multi-period excess earnings method or relief from royalty method, as well as the replacement cost approach, as appropriate. Intangible assets are amortized on a straight-line basis over the amortization periods noted below.

Intangible Assets

| Intangible Assets | Amount | Estimated Useful Life |
|--------------------------|-----------------------|------------------------------|
| | (In thousands) | (In years) |
| Customer relationships | \$ 4,785 | 4.22 |
| Developed technology | 3,357 | 4.00 |
| Trade names | 60,341 | 15.00 |
| | \$ 68,483 | |

Goodwill represents the excess of the purchase price of an acquired business over the fair value of the tangible and intangible assets acquired and liabilities assumed. Goodwill will not be amortized, but instead will be tested for impairment at least annually (or more frequently if indicators of impairment arise). In the event that management determines that the goodwill has become impaired, the Company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made. Goodwill is not deductible for tax purposes.

Included in the Company's consolidated results of operations are revenues of \$11.0 million and loss from operations of \$18.1 million, related to Galvanize. The following unaudited pro forma combined results of operations give effect to the acquisition of Galvanize as if it had occurred on July 1, 2018. The unaudited pro forma combined results of operations are provided for informational purposes only and do not purport to represent the Company's actual consolidated results of operations had the acquisition occurred on the dates assumed, nor are these financial statements necessarily indicative of the Company's future consolidated results of operations. The unaudited pro forma combined results of operations do not reflect the costs of any integration activities or any benefits that may result from operating efficiencies or revenue synergies. Pro forma results include non-recurring transaction costs of \$1.0 million, which are included in selling, general and administrative expenses.

| (In thousands) | Year Ended June 30, | |
|-------------------------------|----------------------------|--------------|
| | 2020 | 2019 |
| Revenues | \$ 1,066,547 | \$ 1,066,304 |
| Income (loss) from operations | 6,574 | 23,148 |
| Net income (loss) | (1,519) | 13,729 |

Investments in Limited Partnerships

During fiscal year 2019, the Company invested in two early stage funds focused on career education with a total commitment of \$13.0 million. The Company invested in Rethink Education III, LP ("Rethink") and New Markets Education Partners II, L.P. ("New Markets") to support the development of new technologies that will advance online learning, to find early opportunities to adopt those new technologies at K12, and to simultaneously achieve a reasonable return on investment. As of June 30, 2020, the Company has contributed an aggregate \$4.2 million to these funds: \$1.7 million is an investment in New Markets and is recorded at cost and will be adjusted, as necessary, for impairment; and \$2.5 million is an investment in Rethink and is recorded under the equity method of accounting. The Company's investments in these funds are included in deposits and other assets on the consolidated balance sheet.

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Notes to Consolidated Financial Statements (Continued)

Investment in Tallo, Inc.

In August 2018, the Company invested \$6.7 million for a 39.5% minority interest in Tallo, Inc. (“Tallo”). This investment in preferred stock that contains additional rights over common stock and has no readily determinable fair value, was recorded at cost and will be adjusted, as necessary, for impairment. In the event Tallo issues equity at a materially different price than what the Company paid, the Company would also assess changing the carrying value. Tallo also issued a convertible note to the Company for \$5.0 million that will be accounted for as an available-for-sale debt security and adjusted to fair value quarterly. The note bears interest at the mid-term Applicable Federal Rate plus 25 bps per annum with a maturity of 48 months. The note is convertible at the Company’s option into 3.67 million Series D Preferred Shares that would give the Company an effective ownership of 56% if exercised. The Company’s investment in Tallo is included in deposits and other assets on the consolidated balance sheets.

15. Related Party Transactions

The Company contributed to Future of School, a charity focused on access to quality education. Future of School is a related party as an executive officer of the Company serves on its Board of Directors. During the years ended June 30, 2020, 2019 and 2018, contributions made by the Company to Future of School were \$1.2 million, \$1.4 million, and \$0.3 million, respectively. In fiscal year 2019, the Company accrued \$2.5 million for contributions to be made in subsequent years. The amounts shown for fiscal year 2020 reduced that obligation and as of June 30, 2020, \$1.3 million remains outstanding.

16. 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 401(k) 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. The Company expensed \$1.8 million, \$1.6 million and \$1.4 million during the years ended June 30, 2020, 2019 and 2018, respectively, under the 401(k) Plan.

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Notes to Consolidated Financial Statements (Continued)

17. Supplemental Disclosure of Cash Flow Information

| | Year Ended June 30, | | |
|--|---------------------|----------|----------|
| | 2020 | 2019 | 2018 |
| Cash paid for interest | \$ 1,287 | \$ 1,108 | \$ 778 |
| Cash paid for taxes | 3,384 | 4,453 | 12,210 |
| Supplemental disclosure of non-cash financing activities: | | | |
| Right-of-use assets obtained as a result of the adoption of ASC 842 (1) | \$ 117,328 | \$ — | \$ — |
| Right-of-use assets obtained in exchange for new finance lease liabilities (2) | 17,160 | 19,664 | 17,414 |
| Supplemental disclosure of non-cash investing activities: | | | |
| Stock-based compensation expense capitalized on software development | \$ 229 | \$ 167 | \$ 1,083 |
| Stock-based compensation expense capitalized on curriculum development | 184 | 170 | 969 |
| Business combinations: | | | |
| Acquired assets | \$ 130,868 | \$ — | \$ 209 |
| Intangible assets | 68,483 | — | 695 |
| Goodwill | 84,741 | — | 2,983 |
| Assumed liabilities | (103,490) | — | (734) |
| Deferred revenue | (3,374) | — | (361) |

(1) Includes right-of-use assets obtained as a result of the acquisition of Galvanize.

(2) Previously referred to as property and equipment financed by capital lease obligations, including student peripherals.

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

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

| | Fiscal Year 2020 | | | |
|--|------------------|-----------------|-----------------|-----------------|
| | Jun 30, 2020 | Mar 31, 2020 | Dec 31, 2019 | Sep 30, 2019 |
| (In thousands) | | | | |
| Consolidated Quarterly Statements of Operations | | | | |
| Revenues | \$ 268,931 | \$ 257,154 | \$ 257,559 | \$ 257,121 |
| Instructional costs and services | 177,436 | 178,968 | 167,470 | 169,358 |
| Gross margin | 91,495 | 78,186 | 90,089 | 87,763 |
| Selling, general, and administrative expenses | 84,454 | 63,687 | 59,784 | 107,151 |
| Income (loss) from operations | 7,041 | 14,499 | 30,305 | (19,388) |
| Interest income (expense), net | (577) | (76) | 441 | 910 |
| Other income (expense), net | 1,008 | (1,093) | 365 | (8) |
| Income (loss) before income taxes and loss from equity method investments | 7,472 | 13,330 | 31,111 | (18,486) |
| Income tax (expense) benefit | (2,548) | (4,419) | (10,392) | 8,818 |
| Loss from equity method investments | (36) | (157) | (125) | (62) |
| Net income (loss) attributable to common stockholders | \$ 4,888 | \$ 8,754 | \$ 20,594 | \$ (9,730) |
| Net income (loss) attributable to common stockholders per share: | | | | |
| Basic | \$ 0.12 | \$ 0.22 | \$ 0.52 | \$ (0.25) |
| Diluted | \$ 0.12 | \$ 0.22 | \$ 0.52 | \$ (0.25) |
| Weighted average shares used in computing per share amounts: | | | | |
| Basic | 39,637,347 | 39,539,791 | 39,450,017 | 39,288,557 |
| Diluted | 41,166,794 | 39,938,898 | 39,973,933 | 39,288,557 |

K12 Inc.

Notes to Consolidated Financial Statements (Continued)

| | Fiscal Year 2019 | | | |
|--|------------------|-----------------|-----------------|-----------------|
| | Jun 30, 2019 | Mar 31, 2019 | Dec 31, 2018 | Sep 30, 2018 |
| (In thousands) | | | | |
| Consolidated Quarterly Statements of Operations | | | | |
| Revenues | \$ 256,314 | \$ 253,252 | \$ 254,872 | \$ 251,314 |
| Instructional costs and services | 175,863 | 168,260 | 160,329 | 158,985 |
| Gross margin | 80,451 | 84,992 | 94,543 | 92,329 |
| Selling, general, and administrative expenses | 77,770 | 61,725 | 61,253 | 106,081 |
| Income (loss) from operations | 2,681 | 23,267 | 33,290 | (13,752) |
| Interest income, net | 1,214 | 754 | 477 | 316 |
| Other income (expense), net | 154 | 556 | (789) | 193 |
| Income (loss) before income taxes and loss from equity method investments | 4,049 | 24,577 | 32,978 | (13,243) |
| Income tax (expense) benefit | (662) | (5,842) | (9,074) | 5,058 |
| Loss from equity method investments | (70) | (273) | (192) | (97) |
| Net income (loss) attributable to common stockholders | \$ 3,317 | \$ 18,462 | \$ 23,712 | \$ (8,282) |
| Net income attributable to common stockholders per share: | | | | |
| Basic | \$ 0.08 | \$ 0.47 | \$ 0.61 | \$ (0.22) |
| Diluted | \$ 0.08 | \$ 0.44 | \$ 0.59 | \$ (0.22) |
| Weighted average shares used in computing per share amounts: | | | | |
| Basic | 39,135,413 | 39,008,990 | 38,816,669 | 38,434,049 |
| Diluted | 41,667,000 | 41,753,323 | 40,325,260 | 38,434,049 |

SCHEDULE II

**K12 INC.
VALUATION AND QUALIFYING ACCOUNTS
Years Ending June 30, 2020, 2019 and 2018**

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, 2020 | \$ 11,765,869 | 2,882,067 | 7,840,262 | \$ 6,807,674 |
| June 30, 2019 | \$ 12,384,279 | 6,325,188 | 6,943,598 | \$ 11,765,869 |
| June 30, 2018 | \$ 14,791,171 | 4,088,592 | 6,495,484 | \$ 12,384,279 |

2. INVENTORY RESERVES

| | Balance at Beginning of Period | Charged to Cost and Expenses | Deductions, Shrinkage and Obsolescence | Balance at End of Period |
|---------------|--------------------------------------|------------------------------------|--|-----------------------------|
| June 30, 2020 | \$ 4,131,386 | 877,357 | 191,443 | \$ 4,817,300 |
| June 30, 2019 | \$ 3,491,655 | 1,359,595 | 719,864 | \$ 4,131,386 |
| June 30, 2018 | \$ 2,310,309 | 1,314,225 | 132,879 | \$ 3,491,655 |

3. COMPUTER RESERVE (1)

| | Balance at Beginning of Period | Additions Charged to Cost and Expenses | Deductions, Shrinkage and Obsolescence | Balance at End of Period |
|---------------|--------------------------------------|---|--|-----------------------------|
| June 30, 2020 | \$ 788,230 | 835,488 | 812,036 | \$ 811,682 |
| June 30, 2019 | \$ 899,654 | 383,770 | 495,194 | \$ 788,230 |
| June 30, 2018 | \$ 819,042 | 550,142 | 469,530 | \$ 899,654 |

(1) A reserve account is maintained against potential obsolescence of, and damage beyond economic repair to, 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 2020, 2019 and 2018, 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, 2020 | \$ 4,548,900 | 441,868 | — | \$ 4,990,768 |
| June 30, 2019 | \$ 4,458,517 | 90,383 | — | \$ 4,548,900 |
| June 30, 2018 | \$ 7,152,860 | 22,388 | 2,716,731 | \$ 4,458,517 |

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 Rule 13a-15(d) under 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, 2020, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at a reasonable assurance level.

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 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.

We acquired Galvanize on January 27, 2020, which represented approximately 1% of our revenues during the fiscal year ended June 30, 2020. Excluding goodwill, intangible assets and operating lease right-of-use assets recorded from the transaction, Galvanize represented approximately 2% of our total assets as of June 30, 2020. As the Galvanize acquisition was completed during the third quarter of fiscal year 2020, the scope of management's assessment of the

effectiveness of its internal control over financial reporting does not include the Galvanize business. This exclusion is pursuant to the SEC's general guidance that an assessment of a recently acquired business' internal control over financial reporting may be omitted from the scope of management's assessment of its internal control over financial reporting for one year following the date of acquisition.

Management evaluated the effectiveness of our internal control over financial reporting as of June 30, 2020 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, 2020, our internal control over financial reporting was effective. The effectiveness of our internal control over financial reporting as of June 30, 2020 has been audited by BDO USA, LLP, an independent registered public accounting firm, as stated in its report which appears on the subsequent page 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 quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. We are in the process of incorporating Galvanize's operations into our internal control over financial reporting and intend to complete this within one year of the acquisition date.

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
K12 Inc.
Herndon, Virginia

Opinion on Internal Control over Financial Reporting

We have audited K12 Inc.'s (the "Company's") internal control over financial reporting as of June 30, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2020, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of the Company as of June 30, 2020 and 2019, 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, 2020, and the related notes and financial statement schedule listed in the accompanying index and our report dated August 12, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's 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 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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. 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.

As indicated in the accompanying "Item 9A, Management's Report on Internal Control over Financial Reporting", management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Galvanize, which was acquired on January 27, 2020, and which is included in the consolidated balance sheets of the Company as of June 30, 2020, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the year then ended. As of June 30, 2020, Galvanize constituted 2% of total assets and 2% of net assets, excluding the goodwill, intangible assets and operating right-of-use assets and related lease liabilities recorded for Galvanize. For the year ended June 30, 2020, Galvanize recorded a net loss of \$18.1 million and constituted 1% of consolidated revenues. Management did not assess the effectiveness of internal control over financial reporting of Galvanize because of the timing of the acquisition which was completed on January 27, 2020. Our audit of internal control over financial reporting of the Company also did not include an evaluation of the internal control over financial reporting of Galvanize.

Definition and Limitations of Internal Control over Financial Reporting

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.

/s/ BDO USA, LLP

Potomac, Maryland
August 12, 2020

ITEM 9B. OTHER INFORMATION

None.

PART III

We will file a definitive Proxy Statement for our 2020 Annual Meeting of Stockholders (the 2020 Proxy Statement") with the SEC, pursuant to Regulation 14A of the Exchange Act, 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 2020 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 2020 Proxy Statement under the captions "Proposal 1: Election of Directors," "Corporate Governance and Board Matters" and, if applicable, "Delinquent Section 16(a) Reports."

We have adopted a Code of Business Conduct and Ethics that applies to all directors, officers and employees. The Code of Business Conduct and Ethics is available on our website at www.k12.com under the Investor Relations – Governance section. We intend to satisfy the disclosure requirements under the Exchange Act regarding any amendment to, or waiver from a material provision of our Code of Business Conduct and Ethics involving our principal executive, financial or accounting officer or controller by posting such information on our website.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is hereby incorporated by reference to our 2020 Proxy Statement under the captions "Compensation Discussion and Analysis," "Compensation Tables," "Compensation Committee Report," "Compensation Committee Interlocks and Insider Participation" and "Director Compensation for Fiscal 2020."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND, MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 is hereby incorporated by reference to our 2020 Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management."

Stock-based Incentive Plan Information

The following table provides certain information as of June 30, 2020, with respect to our equity compensation plans under which common stock is authorized for issuance:

Equity Compensation Plan Information
As of June 30, 2020

| | 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 | 1,021,517 (1) | \$ 19.73 | 1,260,352 (2) |

- (1) Includes shares under the 2016 Incentive Award Plan (“2016 Plan”) and the 2007 Equity Incentive Award Plan (“2007 Plan”).
- (2) The 2016 Plan, which became effective upon its approval by the stockholders on December 15, 2016, authorizes the issuance of up to 9,768,550 shares as of the effective date.

Issuer Purchases of Equity Securities

On May 16, 2018, the Company entered into a stock repurchase agreement pursuant to which the Company repurchased 1,832,145 shares of its common stock in a single transaction at a purchase price of \$15.00 per share, representing aggregate consideration of \$27.5 million.

ITEM 13. CERTAIN RELATIONSHIPS AND, RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is hereby incorporated by reference to our 2020 Proxy Statement under the captions “Certain Relationships and Related-Party Transactions” and “Director Independence.”

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is hereby incorporated by reference to our 2020 Proxy Statement under the caption “Fees Paid to Independent Registered Public Accounting Firm.”

PART IV

ITEM 15. *EXHIBIT 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.*

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

ITEM 16. *10-K SUMMARY*

None.

Exhibit Index

| <u>Exhibit No.</u> | <u>Description of Exhibit</u> |
|--------------------|--|
| 2.1 | Agreement and Plan of Merger, dated January 21, 2020, by and among K12 Management Inc. and KAcquisitionCo Inc., on the one hand, and Galvanize Inc. and Fortis Advisors LLC, as Securityholders' Representative (solely with respect to Article XIII), on the other hand (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed with the SEC on January 27, 2020, File No. 001-33883). |
| 3.1 | Fourth 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, 2016, filed with the SEC on January 27, 2017, File No. 001-33883). |
| 3.2 | Second Amended and Restated Bylaws of K12 Inc. (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K, filed with the SEC on February 9, 2016, 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* | Form of Stock Option Agreement under the 2016 Incentive Award Plan (incorporated by reference to Exhibit 4.2 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2017, filed with the SEC on August 9, 2017, File No. 001-33883). |
| 4.3* | Form of Restricted Stock Award Agreement under the 2016 Incentive Award Plan (incorporated by reference to Exhibit 4.3 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2017, filed with the SEC on August 9, 2017, File No. 001-33883). |
| 4.4* | K12 Inc. 2016 Incentive Award Plan (incorporated by reference to Exhibit 4.2 to the Registrant's Post-Effective Amendment to Form S-8, filed on March 22, 2017, File No. 333-213033). |
| 4.5* | K12 Inc. 2007 Equity Incentive Award Plan, as amended (incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Schedule 14A, filed on October 28, 2015, 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). |
| 4.9 | Description of Common Stock (incorporated by reference to Exhibit 4.9 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2019, filed with the SEC on August 7, 2019, File No. 001-33883). |
| 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* | Second Amended and Restated Employment Agreement of Nathaniel A. Davis, dated January 27, 2016. (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2015, filed with the SEC on January 28, 2016, File No. 001-33883). |
| 10.3* | Form of Performance Share Unit Agreement under the 2016 Incentive Award Plan (incorporated by reference to Exhibit 10.8 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2017, filed with the SEC on August 9, 2017, File No. 001-33883). |
| 10.4* | Form of Performance Share Unit Agreement under the 2007 Equity Incentive Award Plan, as amended (incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, filed with the SEC on October 27, 2015, File No. 001-33883). |
| 10.5* | 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). |
| 10.6* | Form of Executive Change in Control Severance Agreement (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the SEC on June 11, 2020, File No. 001-33883). |
| 10.7 | 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). |

| Exhibit No. | Description of Exhibit |
|-------------|--|
| 10.8 | 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). |
| 10.9 | 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). |
| 10.10* | Form of Stock Option Agreement under the 2007 Equity Incentive Award Plan, as amended (incorporated by reference to Exhibit 10.18 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2015, filed with the SEC on August 4, 2015, File No. 001-33883). |
| 10.11* | Form of Restricted Stock Award Agreement under the 2007 Equity Incentive Award Plan, as amended (incorporated by reference to Exhibit 10.19 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2015, filed with the SEC on August 4, 2015, File No. 001-33883). |
| 10.12* | First Amendment to the Second Amended and Restated Employment Agreement of Nathaniel A. Davis, dated April 20, 2018. (incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2018, filed with the SEC on April 25, 2018, File No. 001-33883). |
| 10.13* | Second Amendment to Second Amended and Restated Employment Agreement of Nathaniel A. Davis, dated August 29, 2019 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the SEC on September 3, 2019, File No. 001-33883). |
| 10.14 | Credit Agreement, dated January 27, 2020, by and among K12 Inc., the guarantors party thereto, the lenders party thereto, PNC Bank, National Association, as administrative agent (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the SEC on January 27, 2020, File No. 001-33883). |
| 10.15* | Employment Agreement of Timothy J. Medina, dated April 6, 2020 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed with the SEC on April 8, 2020, File No. 001-33883). |
| 10.16* | Third Amendment to Second Amended and Restated Employment Agreement of Nathaniel A. Davis, dated June 10, 2020 (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed with the SEC on June 11, 2020, File No. 001-33883). |
| 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. |
| 99.1† | Third Amended and Restated Educational Products and Administrative, and Technology Services Agreement between the Ohio Virtual Academy and K12 Virtual Schools L.L.C., dated July 1, 2017 (incorporated by reference to Exhibit 99.1 to the Registrant's Annual Report on Form 10-K for the year ended June 30, 2017, filed with the SEC on August 9, 2017, File No. 001-33883). |
| 101.INS | Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document |
| 101.SCH | Inline XBRL Taxonomy Extension Schema |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation |
| 101.LAB | Inline XBRL Taxonomy Extension Labels |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation |
| 101.DEF | Inline XBRL Taxonomy Extension Definition |
| 104 | The cover page from this Annual Report on Form 10-K, formatted in Inline XBRL (contained in Exhibit 101) |

* Denotes management compensation plan or arrangement.

† Confidential treatment requested with the Securities and Exchange Commission as to certain portions. Confidential materials omitted and filed separately with the Securities and Exchange Commission.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

August 12, 2020

K12 INC.

By: /s/ NATHANIEL A. DAVIS

Name: Nathaniel A. Davis

Title: *Chairman and Chief Executive Officer*

POWER OF ATTORNEY

Know all persons by these presents, that each person whose signature appears below constitutes and appoints Nathaniel A. Davis, Timothy J. Medina and Vincent W. Mathis, 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 this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|---|-----------------|
| <u>/s/ NATHANIEL A. DAVIS</u> Nathaniel A. Davis | Chairman and Chief Executive Officer (Principal Executive Officer) | August 12, 2020 |
| <u>/s/ TIMOTHY J. MEDINA</u> Timothy J. Medina | Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer) | August 12, 2020 |
| <u>/s/ AIDA M. ALVAREZ</u> Aida M. Alvarez | Director | August 12, 2020 |
| <u>/s/ CRAIG R. BARRETT</u> Craig R. Barrett | Director | August 12, 2020 |
| <u>/s/ GUILLERMO BRON</u> Guillermo Bron | Director | August 12, 2020 |
| <u>/s/ ROBERT L. COHEN</u> Robert L. Cohen | Director | August 12, 2020 |
| <u>/s/ JOHN M. ENGLER</u> John M. Engler | Director | August 12, 2020 |
| <u>/s/ STEVEN B. FINK</u> Steven B. Fink | Director | August 12, 2020 |
| <u>/s/ VICTORIA D. HARKER</u> Victoria D. Harker | Director | August 12, 2020 |
| <u>/s/ ROBERT E. KNOWLING, JR.</u> Robert E. Knowling, Jr. | Director | August 12, 2020 |
| <u>/s/ LIZA McFADDEN</u> Liza McFadden | Director | August 12, 2020 |

Subsidiaries of Registrant

| Name | Jurisdiction |
|---------------------------------|---------------------|
| K12 Management Inc. | Delaware |
| K12 Services Inc. | Delaware |
| K12 International Holdings B.V. | Netherlands |
| LearnBop, Inc. | Delaware |

Subsidiaries of K12 Management Inc.

| Name | Jurisdiction |
|--------------------------------------|---------------------|
| Disguise the Learning, Inc. | Tennessee |
| K12 Virtual Schools L.L.C. | Delaware |
| K12 Classroom L.L.C. | Delaware |
| K12 California L.L.C. | Delaware |
| K12 Florida L.L.C. | Delaware |
| K12 Washington L.L.C. | Delaware |
| Big Universe, Inc. | Virginia |
| Middlebury Interactive Languages LLC | Delaware |
| Onsite Technology Solutions, LLC | Delaware |
| Galvanize Inc. | Delaware |
| Fuel Education LLC | Delaware |

Subsidiaries of K12 International Holdings B.V.

| Name | Jurisdiction |
|-------------------------|---------------------|
| K12 International Ltd. | Cayman Islands |
| K12 International GmbH | Switzerland |
| K12 Education (UK) Ltd. | United Kingdom |

Subsidiaries of Galvanize Inc.

| Name | Jurisdiction |
|--------------------|---------------------|
| Gather Denver, LLC | Colorado |
| Hack Reactor, LLC | Delaware |
| Makersquare, LLC | Delaware |

Consent of Independent Registered Public Accounting Firm

K12 Inc.
Herndon, Virginia

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-213033, No. 333-148436, No. 333-198608 and No. 333-206083) of K12 Inc. of our reports dated August 12, 2020, relating to the consolidated financial statements and financial statement schedule, and the effectiveness of K12 Inc.'s internal control over financial reporting, which appear in this Annual Report on Form 10-K.

/s/ BDO USA, LLP

Potomac, Maryland
August 12, 2020

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICERS

I, Nathaniel A. Davis, certify that:

- (1) I have reviewed this Annual Report on Form 10-K of K12 Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 12, 2020

/s/ NATHANIEL A. DAVIS

Nathaniel A. Davis

Chairman and Chief Executive Officer

(Principal Executive Officer)

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Timothy J. Medina, certify that:

- (1) I have reviewed this Annual Report on Form 10-K of K12 Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 12, 2020

/s/ TIMOTHY J. MEDINA

Timothy J. Medina

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)

Exhibit 32.1

The following certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350 and in accordance with SEC Release No. 33-8238. This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall it be incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Section 906 Certification

Pursuant to 18 U.S.C. Section 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of K12 Inc., a Delaware corporation (the “Company”), hereby certifies, to such officer’s knowledge, that:

- (1) the accompanying Annual Report of the Company on Form 10-K for the fiscal year ended June 30, 2020 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 12, 2020

/s/ NATHANIEL A. DAVIS

Nathaniel A. Davis

Chairman and Chief Executive Officer

(Principal Executive Officer)

The following certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350 and in accordance with SEC Release No. 33-8238. This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall it be incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

Section 906 Certification

Pursuant to 18 U.S.C. Section 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of K12 Inc., a Delaware corporation (the “Company”), hereby certifies, to such officer’s knowledge, that:

- (1) the accompanying Annual Report of the Company on Form 10-K for the fiscal year ended June 30, 2020 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 12, 2020

/s/ TIMOTHY J. MEDINA

Timothy J. Medina

Executive Vice President and Chief Financial Officer

(Principal Financial Officer)

ADJUSTED OPERATING INCOME AND ADJUSTED EBITDA

Adjusted Operating Income and Adjusted EBITDA for fiscal 2018–2020 are shown excluding these charges, where applicable, to the calculation. A reconciliation of GAAP Net Income to the Adjusted Operating Income, and Adjusted EBITDA presented on page XXI inclusive of the aforementioned charges, are as follows:

| <i>(\$ million)</i> | 2018 | 2019 | 2020 |
|---|--------------|--------------|--------------|
| Net Income | 27.4 | 37.2 | 24.5 |
| Loss from equity method investments | - | 0.6 | 0.4 |
| Tax expense / (benefit) | (0.9) | 10.5 | 8.5 |
| Net interest expense / (income) | (1.0) | (2.7) | (0.7) |
| Other income / (expense), net | - | (0.1) | (0.2) |
| Income from operations | 25.5 | 45.5 | 32.5 |
| Stock-based compensation expense | 20.8 | 16.7 | 23.6 |
| Impact to Adjusted Operating Income of aforementioned charges | 2.9 | - | - |
| Adjusted Operating Income (as presented) | 49.2 | 62.2 | 56.1 |
| Depreciation and amortization | 75.3 | 71.4 | 72.1 |
| Adjusted EBITDA (as presented) | 124.5 | 133.6 | 128.2 |

Executive Management

Nathaniel A. Davis
Chief Executive Officer
and Chairman

Kevin P. Chavous
President of Academics,
Policy, and Schools

James J. Rhyu
President, Corporate Strategy,
Marketing, and Technology

Dr. Shaun E. McAlmont
President,
Career Learning Solutions

Timothy J. Medina
Chief Financial Officer

Vincent W. Mathis
Executive Vice President,
General Counsel and Secretary

Valerie A. Maddy
Senior Vice President,
Human Resources

Board of Directors

Nathaniel A. Davis
Chief Executive Officer
and Chairman

Honorable Aida M. Alvarez
Former Clinton Cabinet Member,
Small Business Administration

Dr. Craig R. Barrett
Retired Chairman and CEO,
Intel Corporation

Guillermo Bron
Former Managing Director,
Pine Brook Road Partners, LLC

Robert L. Cohen
Founding Chief Financial Officer,
2U, Inc.

John M. Engler
Former Governor of Michigan

Steven B. Fink
Co-Chairman,
Heron International

Victoria D. Harker
Executive Vice President and
Chief Financial Officer, TEGNA Inc.

Robert E. Knowling, Jr.
Chairman,
Eagles Landing Partners

Liza McFadden
President,
Liza & Partners LLC

Company Directory

Transfer Agent
Computershare
P.O. Box 30170
College Station, TX 77842
800.368.5948
Corporate website:
us.computershare.com

Independent Auditor
BDO USA, LLP
Bethesda, MD

Legal Counsel
Latham & Watkins LLP
Washington, DC

Stock Exchange Listing
Listed on the New York Stock
Exchange under the symbol LRN

Annual Meeting
The annual meeting of K12 Inc.
stockholders will be held
virtually on December 15, 2020,
at 10 AM (ET).

Investor Inquiries
Mike Kraft
Senior Vice President,
Corporate Communications
571.353.7778
mkraft@K12.com

Online Information
For corporate reports and
company news, visit K12.com.





K12.com
866.968.7512

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