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

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2023.

☐ 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 001-37468

AppFolio, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**26-0359894**
(State of incorporation or organization)	***(I.R.S. Employer Identification No.)***
70 Castilian Drive **Santa Barbara, California**	**93117**
(Address of principal executive offices)	***(Zip Code)***

(805) 364-6093

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Class A common stock, $0.0001 par value	APPF	NASDAQ Global Market

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 and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

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

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

As of July 20, 2023, the number of shares of the registrant's Class A common stock outstanding was 20,925,280 and the number of shares of the registrant's Class B common stock outstanding was 14,719,225.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2023 (this "Quarterly Report"), contains forward-looking statements within the meaning of federal securities laws, which statements involve substantial risks and uncertainties. The forward-looking statements made in this Quarterly Report are based primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, operating results, and prospects and relate only to events as of the date on which the statements are made. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “should,” “might,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential,” or “continue,” or the negative of these words or other similar terms or expressions that concern our expectations, strategy, plans, or intentions. We cannot assure you that the results, events, and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events, or circumstances could differ materially from those described in the forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures, or investments we may make. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties, and other factors described in the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Quarterly Report and "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2022 (our "Annual Report"), as well as in the other reports we file with the Securities and Exchange Commission (the "SEC"). You should read this Quarterly Report, and the other documents we file with the SEC, with the understanding that our actual future results may be materially different from the results expressed or implied by these forward-looking statements. As such, you should not rely upon forward-looking statements as predictions of future events. Examples of forward-looking statements include, among others, statements made regarding changes in the competitive environment, responding to customer needs, research and product development plans, future products and services, growth in the size of our business and number of customers, strategic plans and objectives, business forecasts and plans, our future or assumed financial condition, results of operations and liquidity, trends affecting our business and industry, capital needs and financing plans, capital resource allocation plans, share repurchase plans, and commitments and contingencies, including with respect to the outcome of legal proceedings or regulatory matters. Any forward-looking statement made by us in this Quarterly Report is based only on information currently available to us and speaks only as of the date on which it is made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report to reflect events or circumstances after the date of this Quarterly Report or to reflect new information or the occurrence of unanticipated events, except as required by law.

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

APPFOLIO, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands)

	June 30, 2023	December 31, 2022
Assets		
Current assets		
Cash and cash equivalents	$ 24,698	$ 70,769
Investment securities—current	139,273	89,297
Accounts receivable, net	20,033	16,503
Prepaid expenses and other current assets	25,478	24,899
Total current assets	209,482	201,468
Investment securities—noncurrent	—	25,161
Property and equipment, net	26,635	26,110
Operating lease right-of-use assets	20,308	23,485
Capitalized software development costs, net	26,857	35,315
Goodwill	56,060	56,060
Intangible assets, net	3,593	4,833
Other long-term assets	8,424	8,785
Total assets	$ 351,359	$ 381,217
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 1,532	$ 2,473
Accrued employee expenses	31,447	34,376
Accrued expenses	18,560	15,601
Income tax payable	13,485	—
Other current liabilities	9,687	8,893
Total current liabilities	74,711	61,343
Operating lease liabilities	39,554	50,237
Other liabilities	11,141	4,091
Total liabilities	125,406	115,671
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Class A common stock	2	2
Class B common stock	2	2
Additional paid-in capital	223,025	209,704
Accumulated other comprehensive loss	(587)	(1,684)
Treasury stock	(25,756)	(25,756)
Retained earnings	29,267	83,278
Total stockholders' equity	225,953	265,546
Total liabilities and stockholders' equity	$ 351,359	$ 381,217

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

APPFOLIO, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Revenue	$ 147,075	$ 117,450	$ 283,175	$ 222,746
Costs and operating expenses:				
Cost of revenue (exclusive of depreciation and amortization)[1]	57,854	47,430	114,062	90,777
Sales and marketing[1]	27,002	26,995	56,400	51,914
Research and product development[1]	37,263	26,687	74,925	51,007
General and administrative[1]	18,819	37,947	50,510	56,911
Depreciation and amortization	6,816	8,321	14,487	16,736
Total costs and operating expenses	147,754	147,380	310,384	267,345
Loss from operations	(679)	(29,930)	(27,209)	(44,599)
Other (loss) income, net	(54)	45	(34)	35
Interest income, net	1,478	151	2,839	258
Income (loss) before provision for income taxes	745	(29,734)	(24,404)	(44,306)
Provision for (benefit from) income taxes	19,646	236	29,607	(49)
Net loss	$ (18,901)	$ (29,970)	$ (54,011)	$ (44,257)
Net loss per common share, basic and diluted	$ (0.53)	$ (0.86)	$ (1.52)	$ (1.27)
Weighted average common shares outstanding, basic and diluted	35,565	34,927	35,505	34,881

[1] Includes stock-based compensation expense as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Stock-based compensation expense included in costs and operating expenses:				
Cost of revenue (exclusive of depreciation and amortization)	$ 988	$ 726	$ 1,756	$ 1,084
Sales and marketing	444	2,013	2,861	3,473
Research and product development	4,348	4,024	9,787	6,830
General and administrative	4,992	3,198	10,271	5,992
Total stock-based compensation expense	$ 10,772	$ 9,961	$ 24,675	$ 17,379

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

APPFOLIO, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(UNAUDITED)
(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Net loss	$ (18,901)	$ (29,970)	$ (54,011)	$ (44,257)
Other comprehensive income (loss):				
Changes in unrealized gains (losses) on investment securities	334	(400)	1,097	(1,745)
Comprehensive loss	$ (18,567)	$ (30,370)	$ (52,914)	$ (46,002)

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

APPFOLIO, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)
(in thousands)

	Common Stock Class A		Common Stock Class B		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Treasury Stock	Retained Earnings	Total
	Shares	Amount	Shares	Amount					
Balance at December 31, 2022	20,569	$ 2	14,746	$ 2	$ 209,704	$ (1,684)	$ (25,756)	$ 83,278	$ 265,546
Exercise of stock options	64	—	—	—	834	—	—	—	834
Stock based compensation	—	—	—	—	14,075	—	—	—	14,075
Vesting of restricted stock units, net of shares withheld for taxes	79	—	—	—	(5,539)	—	—	—	(5,539)
Conversion of Class B common stock to Class A common stock	27	—	(27)	—	—	—	—	—	—
Issuance of restricted stock awards	2	—	—	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	—	763	—	—	763
Net loss	—	—	—	—	—	—	—	(35,110)	(35,110)
Balance at March 31, 2023	20,741	$ 2	14,719	$ 2	$ 219,074	$ (921)	$ (25,756)	$ 48,168	$ 240,569
Exercise of stock options	95	—	—	—	668	—	—	—	668
Stock based compensation	—	—	—	—	11,000	—	—	—	11,000
Vesting of restricted stock units, net of shares withheld for taxes	82	—	—	—	(7,717)	—	—	—	(7,717)
Issuance of restricted stock awards	4	—	—	—	—	—	—	—	—
Other comprehensive income	—	—	—	—	—	334	—	—	334
Net loss	—	—	—	—	—	—	—	(18,901)	(18,901)
Balance at June 30, 2023	20,922	$ 2	14,719	$ 2	$ 223,025	$ (587)	$ (25,756)	$ 29,267	$ 225,953

	Common Stock Class A		Common Stock Class B		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Treasury Stock	Retained Earnings	Total
	Shares	Amount	Shares	Amount					
Balance at December 31, 2021	19,417	$ 2	15,408	$ 2	$ 171,930	$ (194)	$ (25,756)	$ 151,397	$ 297,381
Exercise of stock options	17	—	—	—	100	—	—	—	100
Stock-based compensation	—	—	—	—	7,967	—	—	—	7,967
Vesting of restricted stock units, net of shares withheld for taxes	17	—	—	—	(1,073)	—	—	—	(1,073)
Conversion of Class B common stock to Class A common stock	572	—	(572)	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	—	(1,345)	—	—	(1,345)
Net loss	—	—	—	—	—	—	—	(14,287)	(14,287)
Balance at March 31, 2022	20,023	$ 2	14,836	$ 2	$ 178,924	$ (1,539)	$ (25,756)	$ 137,110	$ 288,743
Exercise of stock options	41	—	27	—	503	—	—	—	503
Stock-based compensation	—	—	—	—	10,639	—	—	—	10,639
Vesting of restricted stock units, net of shares withheld for taxes	66	—	—	—	(4,524)	—	—	—	(4,524)
Conversion of Class B stock to Class A stock	37	—	(37)	—	—	—	—	—	—
Issuance of restricted stock awards	6	—	—	—	—	—	—	—	—
Other comprehensive loss	—	—	—	—	—	(400)	—	—	(400)
Net income	—	—	—	—	—	—	—	(29,970)	(29,970)
Balance at June 30, 2022	20,173	$ 2	14,826	$ 2	$ 185,542	$ (1,939)	$ (25,756)	$ 107,140	$ 264,991

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

APPFOLIO, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)

	Six Months Ended June 30, 2023	Six Months Ended June 30, 2022
Cash from operating activities		
Net loss	$ (54,011)	$ (44,257)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	13,135	15,637
Amortization of operating lease right-of-use assets	1,109	1,809
Impairment, net	—	19,792
Gain on lease modification	(4,281)	—
Deferred income taxes	9	(1,550)
Stock-based compensation, including as amortized	26,027	18,478
Other	(717)	6
Changes in operating assets and liabilities:		
Accounts receivable	(3,530)	(2,924)
Prepaid expenses and other current assets	(2,429)	(2,652)
Other assets	363	(1,308)
Accounts payable	(989)	17
Accrued employee expenses	(2,719)	(3,217)
Accrued expenses	2,170	3,182
Taxes payable	25,152	52
Operating lease liabilities	(4,638)	(1,311)
Other liabilities	(2,308)	1,527
Net cash (used in) provided by operating activities	(7,657)	3,281
Cash from investing activities		
Purchases of available-for-sale investments	(73,597)	(44,900)
Proceeds from sales of available-for-sale investments	1,013	—
Proceeds from maturities of available-for-sale investments	49,617	43,498
Purchases of property and equipment	(2,171)	(5,099)
Capitalization of software development costs	(2,151)	(7,193)
Proceeds from sale of equity-method investment	629	—
Net cash used in investing activities	(26,660)	(13,694)
Cash from financing activities		
Proceeds from stock option exercises	1,502	603
Tax withholding for net share settlement	(13,256)	(5,597)
Net cash used in financing activities	(11,754)	(4,994)
Net decrease in cash, cash equivalents and restricted cash	(46,071)	(15,407)
Cash, cash equivalents and restricted cash		
Beginning of period	71,019	58,283
End of period	$ 24,948	$ 42,876

The following table presents a reconciliation of cash, cash equivalents and restricted cash reported within our Condensed Consolidated Balance Sheets to the total of the same such amounts shown above (in thousands):

	June 30, 2023	June 30, 2022
Cash and cash equivalents	$ 24,698	$ 42,626
Restricted cash included in other assets	250	250
Total cash, cash equivalents and restricted cash	$ 24,948	$ 42,876

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

APPFOLIO, INC.

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

1. Nature of Business

AppFolio, Inc. ("we," "us" or "our") is a leading provider of cloud business management solutions for the real estate industry. Our solutions are designed to enable our customers to digitally transform their businesses, address critical business operations and deliver a better customer experience. Digital transformation is effectively a requirement for business success in the modern world, and the way we work and live requires powerful software solutions.

2. Summary of Significant Accounting Policies

Basis of Presentation and Significant Accounting Policies

The accompanying unaudited Condensed Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information. Certain information and disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted. Accordingly, these Condensed Consolidated Financial Statements should be read in conjunction with our audited consolidated financial statements and the related notes included in our Annual Report, which was filed with the SEC on February 9, 2023. The year-end condensed balance sheet was derived from our audited consolidated financial statements. Our unaudited interim Condensed Consolidated Financial Statements include, in the opinion of management, all adjustments, consisting of normal and recurring items, necessary for the fair statement of our Condensed Consolidated Financial Statements. The operating results for the six months ended June 30, 2023 are not necessarily indicative of the results expected for the full year ending December 31, 2023.

Reclassification

We reclassified certain amounts in our Condensed Consolidated Statements of Cash Flows within the cash flows from operating activities section in the prior year to conform to the current year's presentation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue, expenses, other income, and provision for income taxes during the reporting period. Assets and liabilities which are subject to judgment and use of estimates include the fair value of financial instruments, capitalized software development costs, period of benefit associated with deferred costs, incremental borrowing rate used to measure operating lease liabilities, the recoverability of goodwill and long-lived assets, income taxes, useful lives associated with property and equipment and intangible assets, contingencies, assumptions underlying performance-based compensation (whether cash or stock-based), and assumptions underlying stock-based compensation. Actual results could differ from those estimates and any such differences may have a material impact on our Condensed Consolidated Financial Statements.

Net Loss per Common Share

Net loss per common share was the same for shares of our Class A and Class B common stock because they are entitled to the same liquidation and dividend rights and are therefore combined in the table below. The following table presents a reconciliation of the weighted average number of shares of our Class A and Class B common stock used to compute net loss per common share (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Weighted average common shares outstanding	35,573	34,931	35,512	34,885
Less: Weighted average unvested restricted shares subject to repurchase	8	4	7	4
Weighted average common shares outstanding; basic and diluted	35,565	34,927	35,505	34,881

Because we reported a net loss for all periods presented, all potentially dilutive common shares are anti-dilutive for these periods and have been excluded from the calculation of net loss per share.

Recent Accounting Pronouncements Adopted

In October 2021, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2021-08, "*Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*," which requires contract assets and contract liabilities acquired in a business combination to be recognized and measured by the acquirer on the acquisition date in accordance with ASC 606, "*Revenue from Contracts with Customers*," as if the acquirer had originated the contracts. ASU 2021-08 is effective for fiscal years beginning after December 15, 2022, with early adoption permitted. We adopted ASU 2021-08 on January 1, 2023. Adoption did not have an impact on our condensed consolidated financial statements.

3. Investment Securities and Fair Value Measurements

Investment Securities

Investment securities classified as available-for-sale consisted of the following as of June 30, 2023 and December 31, 2022 (in thousands):

	June 30, 2023			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	$ 5,484	$ —	$ (32)	$ 5,452
Agency securities	11,261	—	(233)	11,028
Treasury securities	123,582	8	(797)	122,793
Total available-for-sale investment securities	$ 140,327	$ 8	$ (1,062)	$ 139,273

	December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate bonds	$ 17,497	$ 2	$ (112)	$ 17,387
Agency securities	17,507	—	(484)	17,023
Treasury securities	81,605	—	(1,557)	80,048
Total available-for-sale investment securities	$ 116,609	$ 2	$ (2,153)	$ 114,458

As of June 30, 2023, the decline in fair value below amortized cost basis was not considered other than temporary as it is more likely than not we will hold the securities until maturity or recovery of the cost basis. No allowance for credit losses for available-for-sale investment securities was recorded as of June 30, 2023 or December 31, 2022.

The fair values of available-for-sale investment securities, by remaining contractual maturity, are as follows (in thousands):

	June 30, 2023		December 31, 2022	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 140,327	$ 139,273	$ 90,822	$ 89,297
Due after one year through three years	—	—	25,787	25,161
Total available-for-sale investment securities	$ 140,327	$ 139,273	$ 116,609	$ 114,458

During the six months ended June 30, 2023 and 2022, we had sales and maturities of investment securities, as follows (in thousands):

	Six Months Ended June 30, 2023			
	Gross Realized Gains	Gross Realized Losses	Gross Proceeds from Sales	Gross Proceeds from Maturities
Corporate bonds	$ 3	$ —	$ 1,013	$ 11,012
Agency securities	—	—	—	6,250
Treasury securities	—	—	—	32,355
Total	$ 3	$ —	$ 1,013	$ 49,617

	Six Months Ended June 30, 2022			
	Gross Realized Gains	Gross Realized Losses	Gross Proceeds from Sales	Gross Proceeds from Maturities
Corporate bonds	$ —	$ —	$ —	$ 23,998
Treasury securities	—	—	—	19,500
Total	$ —	$ —	$ —	$ 43,498

Fair Value Measurements

Recurring Fair Value Measurements

The following tables present our financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2023 and December 31, 2022 by level within the fair value hierarchy (in thousands):

	June 30, 2023		
	Level 1	Level 2	Total Fair Value
Cash equivalents:			
Money market funds	$ 5,226	$ —	$ 5,226
Treasury securities	797	—	797
Available-for-sale investment securities:			
Corporate bonds	—	5,452	5,452
Agency securities	—	11,028	11,028
Treasury securities	122,793	—	122,793
Total	$ 128,816	$ 16,480	$ 145,296

	December 31, 2022		
	Level 1	Level 2	Total Fair Value
Cash equivalents:			
Money market funds	$ 41,973	$ —	$ 41,973
Treasury securities	1,287	—	1,287
Available-for-sale investment securities:			
Corporate bonds	—	17,387	17,387
Agency securities	—	17,023	17,023
Treasury securities	80,048	—	80,048
Total	$ 123,308	$ 34,410	$ 157,718

The carrying amounts of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities approximate their fair value because of the short maturity of these items.

Fair value for our Level 1 investment securities is based on market prices for identical assets. Our Level 2 securities were priced by a pricing vendor. The pricing vendor utilizes the most recent observable market information in pricing these securities or, if specific prices are not available for these securities, other observable inputs like market transactions involving comparable securities are used.

4. Capitalized Software Development Costs, net

Capitalized software development costs were as follows (in thousands):

	June 30, 2023	December 31, 2022
Capitalized software development costs, gross	$ 128,142	$ 129,749
Less: Accumulated amortization	(101,285)	(94,434)
Capitalized software development costs, net	$ 26,857	$ 35,315

Capitalized software development costs were $1.3 million and $4.2 million for the three months ended June 30, 2023 and 2022, respectively, and $2.3 million and $8.3 million for the six months ended June 30, 2023 and 2022, respectively. Amortization expense with respect to capitalized software development costs totaled $4.9 million and $6.0 million for the three months ended June 30, 2023 and 2022, respectively, and $10.8 million and $12.0 million for the six months ended June 30, 2023 and 2022, respectively. During the three and six months ended June 30, 2023, we disposed of $1.3 million and $3.5 million, respectively, of fully amortized capitalized software development costs.

Future amortization expense with respect to capitalized software development costs as of June 30, 2023 is estimated as follows (in thousands):

Years Ending December 31,	
2023	$ 8,580
2024	12,042
2025	5,012
2026	1,223
Total amortization expense	$ 26,857

5. Intangible Assets, net

Intangible assets consisted of the following (in thousands, except years):

	June 30, 2023			
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life in Years
Customer relationships	$ 1,670	$ (1,559)	$ 111	5.0
Database	4,710	(2,120)	2,590	10.0
Technology	6,539	(6,539)	—	4.0
Trademarks and trade names	1,520	(1,367)	153	5.0
Partner relationships	680	(680)	—	3.0
Non-compete agreements	7,340	(6,606)	734	5.0
Domain names	90	(85)	5	5.0
Patents	252	(252)	—	5.0
Total intangible assets, net	$ 22,801	$ (19,208)	$ 3,593	5.8

	December 31, 2022			
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Weighted Average Useful Life in Years
Customer relationships	$ 1,670	$ (1,448)	$ 222	5.0
Database	4,710	(1,884)	2,826	10.0
Technology	6,539	(6,539)	—	4.0
Trademarks and trade names	1,520	(1,211)	309	5.0
Partner relationships	680	(680)	—	3.0
Non-compete agreements	7,340	(5,872)	1,468	5.0
Domain names	90	(82)	8	5.0
Patents	252	(252)	—	5.0
Total intangible assets, net	$ 22,801	$ (17,968)	$ 4,833	4.7

Amortization expense with respect to intangible assets totaled $0.6 million and $1.2 million for the three months ended June 30, 2023 and 2022, respectively, and $1.2 million and $2.3 million for the six months ended June 30, 2023 and 2022, respectively. Future amortization expense with respect to intangible assets as of June 30, 2023 is estimated as follows (in thousands):

Years Ending December 31,	
2023	$ 1,236
2024	473
2025	471
2026	471
2027	471
Thereafter	471
Total amortization expense	$ 3,593

6. Accrued Employee Expenses

Accrued employee expenses consisted of the following (in thousands):

	June 30, 2023	December 31, 2022
Accrued vacation	$ 13,523	$ 12,067
Accrued bonuses	10,028	13,806
Accrued severance	515	496
Accrued payroll and other	7,381	8,007
Total accrued employee expenses	$ 31,447	$ 34,376

In the first quarter of 2023, we accrued $14.9 million of severance related to separation costs associated with our former Chief Executive Officer's Transition and Separation Agreement, dated March 1, 2023 ("Separation Agreement"). The $14.9 million was fully paid in the second quarter of 2023.

7. Leases

Operating leases for our corporate offices have remaining lease terms ranging from one to ten years, some of which include options to extend the leases for up to ten years. These options to extend have not been recognized as part of our operating lease right-of-use assets and lease liabilities as it is not reasonably certain that we will exercise these options. Our lease agreements do not contain any residual value guarantees or material restrictive covenants. Certain leases contain provisions for property-related costs that are variable in nature for which we are responsible, including common area maintenance, which are expensed as incurred.

The components of lease expense recognized in the Condensed Consolidated Statements of Operations were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Operating lease cost	$ 1,131	$ 1,468	$ 2,276	$ 2,915
Variable lease cost	448	252	1,021	375
Total lease cost	$ 1,579	$ 1,720	$ 3,297	$ 3,290

Lease-related assets and liabilities were as follows (in thousands):

	June 30, 2023	December 31, 2022
Assets		
Operating lease right-of-use assets	$ 20,308	$ 23,485
Liabilities		
Other current liabilities	$ 3,052	$ 3,357
Operating lease liabilities	39,554	50,237
Total lease liabilities	$ 42,606	$ 53,594

During the second quarter of 2022, we decided to exit and make available for sublease certain leased office spaces. As a result, we recorded an impairment of $19.4 million consisting of $15.7 million related to ROU assets and $3.7 million related to property and equipment associated with our leased office spaces. These charges were recorded within General and administrative expenses in our Condensed Consolidated Statements of Operations.

In January 2023, we entered into an amendment to the lease agreement for our San Diego facility (the "San Diego Lease"). We remeasured the lease liability and recorded a reduction to the lease liability and right-of-use asset using the discount rate at the modification date, which resulted in a gain of $2.4 million in the Condensed Consolidated Statements of Operations.

In June 2023, we entered into a second amendment to reduce the rentable square footage and our future rental payment obligations under the San Diego Lease pursuant to which we made a one-time payment of $2.9 million. We again remeasured the lease liability and recorded a reduction to the lease liability using the discount rate at the modification date. As a result, we recorded a gain of $1.9 million in the Condensed Consolidated Statements of Operations.

In July 2023, we entered into an agreement to sublet one of our office spaces in Santa Barbara through December 31, 2031.

Future minimum lease payments under non-cancellable leases as of June 30, 2023 were as follows (in thousands):

Years ending December 31,		
2023[(1)]	$	(793)
2024[(1)]		5,063
2025		6,168
2026		6,345
2027		6,528
Thereafter		31,090
Total future minimum lease payments		54,401
Less: imputed interest		(11,795)
Total	$	42,606

(1) Future minimum lease payments for the years ending December 31, 2023 and 2024 are presented net of tenant improvement allowances of $3.7 million and $0.7 million respectively.

8. Commitments and Contingencies

Legal Liability to Landlord Insurance

We have a wholly owned subsidiary, Terra Mar Insurance Company, Inc., which was established in connection with reinsuring liability to landlord insurance policies offered to our customers by our third-party service provider. Each policy has a limit of $100 thousand per incident. We assume a 100% quota share of the liability to landlord insurance policies placed with our customers by our third-party service provider. We accrue for reported claims, and include an estimate of losses incurred but not reported by our property manager customers, in cost of revenue because we bear the risk related to all such claims. Our estimated liability for reported claims and incurred but not reported claims as of June 30, 2023 and December 31, 2022 was $3.2 million and $2.7 million, respectively, and is included in *Other current liabilities* on our Condensed Consolidated Balance Sheets.

Included in *Prepaid expenses and other current assets* as of June 30, 2023 and December 31, 2022 are $2.8 million and $4.5 million, respectively, of deposits held with a third party related to requirements to maintain collateral for this insurance service.

Legal Proceedings

From time to time we may become involved in various legal proceedings, investigative inquiries, and other disputes arising from or related to matters incident to the ordinary course of our business activities. We are not currently a party to any matters, nor are we aware of any pending or threatened matters, that we believe would have a material adverse effect on our business, operating results, cash flows or financial condition should such proceedings be resolved unfavorably.

Indemnification

In the ordinary course of business, we may provide indemnification of varying scope and terms to customers, business partners, investors, directors, officers, and other parties with respect to certain matters, including, but not limited to, losses arising out of our breach of any applicable agreements, intellectual property infringement claims made by third parties, and other liabilities relating to or arising from our services or our acts or omissions. These indemnification provisions may survive termination of the underlying agreement and the maximum potential amount of future payments we could be required to make under these indemnification provisions may not be subject to maximum loss clauses and is indeterminable. We have not incurred any costs as a result of such indemnification obligations and have not recorded any liabilities related to such obligations in the Condensed Consolidated Financial Statements.

9. Stock-Based Compensation

Stock Options

A summary of activity in connection with our stock options for the six months ended June 30, 2023, is as follows (number of shares in thousands):

	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life in Years
Options outstanding as of December 31, 2022	516	$ 12.90	2.7
Options granted	120	129.74	
Options exercised	(159)	9.44	
Options outstanding as of June 30, 2023	477	$ 43.44	3.4

During the six months ended June 30, 2023, we granted our Chief Executive Officer 120,000 stock options of our Class A common stock. These stock options vest based on service conditions with one-third vesting at the end of each of the years ending December 31, 2025, 2026 and 2027. No stock options were granted during the six months ended June 30, 2022.

Our stock-based compensation expense for stock options was $0.4 million and $0.6 million for the three and six months ended June 30, 2023, respectively. There was no stock-based compensation expense for stock options in the same periods in the prior year.

The fair value of stock options granted is estimated on the date of grant using the Black-Scholes option-pricing model. The following table summarizes information relating to our stock options granted during six months ended June 30, 2023:

Weighted average grant-date fair value per share	$ 67.23
Weighted average Black-Scholes model assumptions:	
Risk-free interest rate	4.06 %
Expected term (in years)	6.92
Expected volatility	44 %
Expected dividend yield	—

As of June 30, 2023, the total estimated remaining stock-based compensation expense for the aforementioned stock options was $7.5 million, which is expected to be recognized over a weighted average period of 4.5 years.

Restricted Stock Units

A summary of activity in connection with our RSUs for the six months ended June 30, 2023, is as follows (number of shares in thousands):

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested as of December 31, 2022	1,162	$ 116.88
Granted	630	122.37
Vested	(261)	116.18
Forfeited	(196)	115.28
Unvested as of June 30, 2023	1,335	$ 119.84

Unvested RSUs as of June 30, 2023 were composed of 1.1 million RSUs with only service conditions and 0.2 million PSUs with both service conditions and performance conditions. RSUs granted with only service conditions generally vest over a four-year period. The number of PSUs granted, as included in the above table, assumes achievement of the performance metric at 100% of the performance target. Of the unvested PSUs as of June 30, 2023, 0.1 million are subject to vesting based on the achievement of pre-established performance metrics for the year ending December 31, 2023 and will vest over a three year period, assuming continued employment through each vesting date. The actual number of shares to be issued at the end of the performance period will range from 0% to 142% of the target number of shares depending on achievement relative to the performance metric over the applicable period. The remaining 0.1 million PSUs unvested as of June 30, 2023 are subject to vesting based on the achievement of pre-established performance metrics for three year measurement periods ending December 31, 2023, assuming continued employment throughout the performance period. The actual number of shares to be issued at the end of the performance period will range from 0% to 100% of the initial target awards. Achievement of the performance metric between 100% and 150% of the performance target will result in a performance-based cash bonus payment between 0% and 65% of the initial target awards.

We recognized stock-based compensation expense for the RSUs and PSUs of $10.4 million and $10.5 million for the three months ended June 30, 2023 and 2022, respectively, and $24.1 million and $18.3 million for the six months ended June 30, 2023 and 2022, respectively. Excluded from stock-based compensation expense is capitalized software development costs of $0.2 million and $0.7 million for the three months ended June 30, 2023 and 2022, respectively, and $0.4 million and $1.2 million for the six months ended June 30, 2023 and 2022, respectively. As of June 30, 2023, the total estimated remaining stock-based compensation expense for the aforementioned RSUs and PSUs was $126.2 million, which is expected to be recognized over a weighted average period of 2.7 years.

Restricted Stock Awards

A summary of activity in connection with our restricted stock awards ("RSAs") for the six months ended June 30, 2023 is as follows (number of shares in thousands):

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Unvested as of December 31, 2022	6	$ 96.33
Granted	6	151.83
Vested	(6)	96.33
Unvested as of June 30, 2023	6	$ 151.83

We have the right to repurchase any unvested RSAs subject to certain conditions. RSAs vest over a one-year period. Our stock-based compensation expense for RSAs was not material for the periods presented.

As of June 30, 2023, the total estimated remaining stock-based compensation expense for unvested RSAs with a repurchase right was $0.9 million, which is expected to be recognized over a weighted average period of 0.9 years.

10. Income Taxes

We calculate our provision for (benefit from) income taxes on a quarterly basis by applying an estimated annual effective tax rate to income/loss from operations and by calculating the tax effect of discrete items recognized during the quarter.

For the three and six months ended June 30, 2023, we recorded income tax expense of $19.6 million and $29.6 million representing an effective tax rate of 2,637% and (121)%. The effective tax rate as compared to the U.S. federal statutory rate of 21% differs primarily due to the change in valuation allowance against deferred tax assets, non-deductible officers' compensation and state income taxes, partially offset by tax benefits from research and development tax credits.

We assess our ability to realize our deferred tax assets on a quarterly basis and we establish a valuation allowance if it is more-likely-than-not that some portion of the deferred tax assets will not be realized. We weigh all available positive and negative evidence, including our earnings history and results of recent operations, scheduled reversals of deferred tax liabilities, projected future taxable income and tax planning strategies.

There were no material changes to our unrecognized tax benefits during the six months ended June 30, 2023.

11. Revenue and Other Information

The following table presents our revenue categories for the three and six months ended June 30, 2023 and 2022 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	**2022**	**2023**	**2022**
Core solutions	$ 38,515	$ 32,414	$ 75,684	$ 63,223
Value Added Services	106,085	81,450	202,920	152,950
Other	2,475	3,586	4,571	6,573
Total revenue	$ 147,075	$ 117,450	$ 283,175	$ 222,746

Our revenue is generated primarily from customers in the United States. All of our property and equipment is located in the United States.

Deferred Revenue

Deferred revenue as of June 30, 2023 and December 31, 2022 was $1.1 million and $0.9 million, respectively, and is included in *Other current liabilities* on our Condensed Consolidated Balance Sheets. During the six months ended June 30, 2023 and 2022, we recognized $0.7 million and $2.1 million of revenue, respectively, which were included in the deferred revenue balances as of December 31, 2022 and 2021, respectively.

Remaining Performance Obligations

As of June 30, 2023, the total non-cancelable remaining performance obligations ("RPO") under our contracts with customers was $24 million, and we expect to recognize revenue on approximately 50% of these RPO over the following 12 months, with the balance to be recognized thereafter.

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

The following discussion and analysis of our financial condition and results of operations should be read together with our Condensed Consolidated Financial Statements and the related notes included elsewhere in this Quarterly Report and in our Annual Report. This discussion and analysis contains forward-looking statements that are based on our current expectations and reflect our plans, estimates and anticipated future financial performance. These statements involve numerous risks and uncertainties. Our actual results may differ materially from those expressed or implied by these forward-looking statements as a result of many factors, including those set forth in the section entitled “Risk Factors” in our Annual Report, as well as our other public filings with the SEC. Please also refer to the section of this Quarterly Report entitled "Forward-Looking Statements" for additional information.

Overview

We are a leading provider of cloud business management solutions for the real estate industry. Our solutions are designed to enable our property manager customers to digitally transform their businesses, address critical business operations and deliver a better customer experience. Our products assist our customers with an interconnected and growing network of stakeholders in their business ecosystems, including property owners, real estate investment managers, rental prospects, residents, and service providers, and provide key functionality related to critical transactions across the real estate lifecycle, including screening potential tenants, sending and receiving payments and risk mitigation services. AppFolio’s intuitive interface, coupled with streamlined and automated workflows, make it easier for our customers to eliminate redundant and manual processes so they can deliver a great experience for their network of stakeholders while improving financial and operational performance.

We rely heavily on our talented team of employees to execute our growth plans and achieve our long-term strategic objectives. We believe our people are at the heart of our success and our customers' success, and we have worked hard not only to attract and retain talented individuals, but also to provide a challenging and rewarding work environment to motivate and develop our valuable human capital. As we navigate the challenges of increased competition for talent, we continue to evolve our compensation and employee reward practices.

Property management units under management. We believe that our ability to increase our number of property management units under management is an indicator of our market penetration, growth, and potential future business opportunities. We define property management units under management as active or committed units under management at the period end date. We had 7.7 million and 6.8 million property management units under management as of June 30, 2023 and 2022, respectively.

Key Components of Results of Operations

Revenue

Our core solutions and certain of our Value Added Services are offered on a subscription basis. Our core solutions subscription fees vary by property type and are designed to scale with the size of our customers’ businesses. We recognize revenue for subscription-based services on a straight-line basis over the contract term beginning on the date that our service is made available. We generally invoice monthly or, to a lesser extent, annually in advance of the subscription period.

We also offer certain Value Added Services, which are not covered by our subscription fees, on a per-use basis. Usage-based fees are charged either as a percentage of the transaction amount (e.g., for certain of our payment services) or on a flat fee per transaction basis with no minimum usage commitments (e.g., for our tenant screening and risk mitigation services). We recognize revenue for usage-based services in the period the service is rendered. Our payments services fees are recorded gross of the interchange and payment processing related fees. We generally invoice our usage-based services on a monthly basis or collect the fee at the time of service. A significant majority of our Value Added Services revenue comes from the use of our payment services, tenant screening services, and risk mitigation services.

We charge our customers for assistance onboarding onto our core solutions and for certain other non-recurring services. We generally invoice for these other services in advance of the services being completed and recognize revenue in the period the service is rendered. We generate revenue from the legacy customers of previously acquired businesses by providing services outside of our property management core solution platform. Revenue derived from these services is recorded in *Other revenue*. As of June 30, 2023 and 2022, we had 19,145 and 17,878 property management customers, respectively.

Costs and Operating Expenses

Cost of Revenue (Exclusive of Depreciation and Amortization). Many of our Value Added Services are facilitated by third-party service providers. Cost of revenue paid to these third-party service providers includes the cost of electronic interchange and payment processing-related services to support our payments services, the cost of credit reporting services for our tenant screening services, and various costs associated with our risk mitigation service providers. These third-party costs vary both in amount and as a percent of revenue for each Value Added Service offering. Cost of revenue also consists of personnel-related costs for our employees focused on customer service and the support of our operations (including salaries, performance-based compensation, benefits, and stock-based compensation), platform infrastructure costs (such as data center operations and hosting-related costs), and allocated shared and other costs. Cost of revenue excludes depreciation of property and equipment, amortization of capitalized software development costs and amortization of intangible assets.

Sales and Marketing. Sales and marketing expense consists of personnel-related costs for our employees focused on sales and marketing (including salaries, sales commissions, performance-based compensation, benefits, and stock-based compensation), costs associated with sales and marketing activities, and allocated shared and other costs. Marketing activities include advertising, online lead generation, lead nurturing, customer and industry events, and the creation of industry-related content and collateral. We focus our sales and marketing efforts on generating awareness of our software solutions, creating sales leads, establishing and promoting our brands, and cultivating an educated community of successful and vocal customers.

Research and Product Development. Research and product development expense consists of personnel-related costs for our employees focused on research and product development (including salaries, performance-based compensation, benefits, and stock-based compensation), fees for third-party development resources, and allocated shared and other costs. Our research and product development efforts are focused on expanding functionality and the ease of use of our existing software solutions by adding new core functionality, Value Added Services and other improvements, as well as developing new products and services. We capitalize our software development costs that meet the criteria for capitalization. Amortization of capitalized software development costs is included in depreciation and amortization expense.

General and Administrative. General and administrative expense consists of personnel-related costs for employees in our executive, finance, information technology, human resources, legal, compliance, corporate development and administrative organizations (including salaries, performance-based cash compensation, benefits, and stock-based compensation). In addition, general and administrative expense includes fees for third-party professional services (including audit, legal, compliance, and tax services), transaction costs related to sales of subsidiary businesses, regulatory fees, other corporate expenses, impairment of long-lived assets, gains on lease modifications, and allocated shared and other costs.

Depreciation and Amortization. Depreciation and amortization expense includes depreciation of property and equipment, amortization of capitalized software development costs, and amortization of intangible assets. We depreciate or amortize property and equipment, software development costs, and intangible assets over their expected useful lives on a straight-line basis, which approximates the pattern in which the economic benefits of the assets are consumed.

Other Income (Loss), Net. Other income (loss), net includes gains and losses associated with the sale of businesses and property and equipment.

Interest Income, Net. Interest income, net includes interest earned on investment securities, amortization and accretion of the premium and discounts paid from the purchase of investment securities, and interest earned on cash deposited in our bank accounts.

Provision for (Benefit from) Income Taxes. Provision for income taxes consists of federal and state income taxes in the United States.

Results of Operations

Revenue

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
	(dollars in thousands)							
Core solutions	$ 38,515	$ 32,414	$ 6,101	19 %	$ 75,684	$ 63,223	$ 12,461	20 %
Value Added Services	106,085	81,450	24,635	30 %	202,920	152,950	49,970	33 %
Other	2,475	3,586	(1,111)	(31)%	4,571	6,573	(2,002)	(30)%
Total revenue	$ 147,075	$ 117,450	$ 29,625	25 %	$ 283,175	$ 222,746	$ 60,429	27 %

The increase in revenue for the three and six months ended June 30, 2023, compared to the same periods in the prior year, was primarily attributable to an increase in the usage of our payment, tenant screening and risk mitigation services. During the three and six month period ended June 30, 2023, we also experienced growth of 13% in the number of property management units under management compared to the same periods in the prior year, which drove growth in users of our subscription and usage-based services.

We expect our payment services, including the eCheck (ACH) transaction fee, which we will no longer waive beginning in the third quarter of 2023, to increase for the remainder of the year ended December 31, 2023.

Cost of Revenue (Exclusive of Depreciation and Amortization)

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
	(dollars in thousands)							
Cost of revenue (exclusive of depreciation and amortization)	$ 57,854	$ 47,430	$ 10,424	22 %	$ 114,062	$ 90,777	$ 23,285	26 %
Percentage of revenue	39.3 %	40.4 %			40.3 %	40.8 %		
Stock-based compensation, included above	$ 988	$ 726	$ 262	36 %	$ 1,756	$ 1,084	$ 672	62 %
Percentage of revenue	0.7 %	0.6 %			0.6 %	0.5 %		

For the three and six months ended June 30, 2023, expenditures to third-party service providers related to the delivery of our Value Added Services increased $7.0 million and $15.2 million, respectively, compared to the same periods in the prior year. This increase was directly associated with the increased adoption and utilization of our Value Added Services. Personnel-related costs, including stock-based and performance-based compensation, necessary to support growth and key investments, increased $2.4 million and $6.1 million for the three and six months ended June 30, 2023, respectively, compared to the same periods in the prior year. Allocated shared and other costs increased by $1.0 million and $1.9 million for the three and six months ended June 30, 2023, respectively, compared to the same periods in the prior year, primarily related to platform infrastructure, software and other costs incurred in support of our overall growth.

As a percentage of revenue, cost of revenue (exclusive of depreciation and amortization) fluctuates primarily based on the mix of Value Added Services revenue in the period, given the varying percentage of revenue we pay to third-party service providers. We expect cost of revenue (exclusive of depreciation and amortization) for the year ending December 31, 2023, to decrease as a percentage of revenue compared to the year ended December 31, 2022, primarily due to increased revenue from our enhanced revenue mix.

Sales and Marketing

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
	(dollars in thousands)							
Sales and marketing	$ 27,002	$ 26,995	$ 7	— %	$ 56,400	$ 51,914	$ 4,486	9 %
Percentage of revenue	18.4 %	23.0 %			19.9 %	23.3 %		
Stock-based compensation, included above	$ 444	$ 2,013	$ (1,569)	(78)%	$ 2,861	$ 3,473	$ (612)	(18)%
Percentage of revenue	0.3 %	1.7 %			1.0 %	1.6 %		

Sales and marketing expense for the three months ended June 30, 2023 stayed flat compared to the same period in the prior year. Sales and marketing expense for the six months ended June 30, 2023 increased primarily due to increases in personnel-related costs, including stock-based and performance-based compensation, necessary to support growth in the business of $3.4 million compared to the same period in the prior year. Advertising costs increased by $0.9 million for the six months ended June 30, 2023 compared to the same period in the prior year, due to increased promotional activities.

The decrease in stock-based compensation for the three and six months ended June 30, 2023 was primarily due to the reversal of expense for unvested equity awards as a result of changes in our leadership team.

We expect sales and marketing expense for the year ending December 31, 2023 to decrease as a percentage of revenue compared to the year ended December 31, 2022, as we continue to leverage headcount efficiencies.

Research and Product Development

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
				(dollars in thousands)				
Research and product development	$ 37,263	$ 26,687	$ 10,576	40 %	$ 74,925	$ 51,007	$ 23,918	47 %
Percentage of revenue	25.3 %	22.7 %			26.5 %	22.9 %		
Stock-based compensation, included above	$ 4,348	$ 4,024	$ 324	8 %	$ 9,787	$ 6,830	$ 2,957	43 %
Percentage of revenue	3.0 %	3.4 %			3.5 %	3.1 %		

Research and product development expense for the three and six months ended June 30, 2023 increased primarily due to an increase in personnel-related costs, including stock-based and performance-based compensation, net of capitalized software development costs, of $10.2 million and $23.0 million, respectively, compared to the same periods in the prior year. The increase in personnel-related costs was primarily due to headcount growth within our research and product development organization.

We expect research and product development expenses for the year ending December 31, 2023 to increase as a percentage of revenue compared to the year ended December 31, 2022, as we continue to invest in our research and product development organization to support our strategy to expand the use cases of our product capabilities to the larger customer segment.

General and Administrative

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
				(dollars in thousands)				
General and administrative	$ 18,819	$ 37,947	$ (19,128)	(50)%	$ 50,510	$ 56,911	$ (6,401)	(11)%
Percentage of revenue	12.8 %	32.3 %			17.8 %	25.5 %		
Stock-based compensation, included above	$ 4,992	$ 3,198	$ 1,794	56 %	$ 10,271	$ 5,992	$ 4,279	71 %
Percentage of revenue	3.4 %	2.7 %			3.6 %	2.7 %		

General and administrative expense for the three and six months ended June 30, 2023 decreased compared to the same periods in the prior year primarily due to lease-related asset impairment charges of $19.4 million and $19.8 million recognized in the three and six months ended June 30, 2022, respectively, that did not recur in 2023. In addition, allocated shared and other costs decreased $1.9 million and $4.3 million for the three and six months ended June 30, 2023, compared to the same periods in the prior year, due to gains related to lease modifications. This was partially offset by an increase in personnel-related costs, including stock-based and performance-based compensation, in the three and six months ended June 30, 2023 of $1.9 million and $17.5 million, respectively, compared to the same periods in the prior year. The increase in personnel-related costs for the six months ended June 30, 2023 was driven primarily by the separation costs associated with our former Chief Executive Officer's Separation Agreement. For further information see Note 6, Accrued Employee Expenses, of the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this report.

For the three and six months ended June 30, 2023, stock-based compensation increased due to additional grants to current and new employees.

We expect general and administrative expenses for the year ending December 31, 2023 to decrease as a percentage of revenue compared to the year ended December 31, 2022, as we continue to leverage headcount efficiencies.

Depreciation and Amortization

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
	(dollars in thousands)							
Depreciation and amortization	$ 6,816	$ 8,321	$ (1,505)	(18)%	$ 14,487	$ 16,736	$ (2,249)	(13)%
Percentage of revenue	4.6 %	7.1 %			5.1 %	7.5 %		

Depreciation and amortization expense for the three and six months ended June 30, 2023 decreased, compared to the same periods in the prior year, primarily due to decreased amortization expense associated with capitalized software development and intangible balances.

We expect depreciation and amortization expenses for the year ending December 31, 2023 to decrease as a percentage of revenue compared to the year ended December 31, 2022 due to a decrease in amortization of accumulated capitalized software development balances.

Interest Income, Net

	Three Months Ended June 30, 2023		Change		Six Months Ended June 30, 2023		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
	(dollars in thousands)							
Interest income, net	$ 1,478	$ 151	$ 1,327	879 %	$ 2,839	$ 258	$ 2,581	1,000 %
Percentage of revenue	1.0 %	— %			1.0 %	0.1 %		

Interest income for the three and six months ended June 30, 2023 increased, compared to the same periods in the prior year, primarily due to higher interest rates.

Provision for (Benefit from) Income Taxes

	Three Months Ended June 30,		Change		Six Months Ended June 30,		Change	
	2023	2022	Amount	%	2023	2022	Amount	%
	(dollars in thousands)							
Income (loss) before provision for income taxes	$ 745	$ (29,734)	$ 30,479	(103)%	$ (24,404)	$ (44,306)	$ 19,902	(45)%
Provision for (benefit from) income taxes	$ 19,646	$ 236	$ 19,410	*	$ 29,607	$ (49)	$ 29,656	*
Effective tax rate	2,637 %	(1)%			(121)%	— %		

*Percentage not meaningful

Our effective tax rates for the three and six months ended June 30, 2023 differ from the U.S. federal statutory rate of 21% primarily due to the change in valuation allowance against deferred tax assets, non-deductible officers' compensation and state income taxes, partially offset by tax benefits from stock-based compensation and research and development tax credits. Our effective tax rates for the three and six months ended June 30, 2022 differ from the U.S. federal statutory rate of 21% primarily due to the change in valuation allowance against deferred tax assets and tax benefits from research and development credits.

The increase in our effective tax rate for the three months ended June 30, 2023, as compared to the same period in 2022, is primarily due to the significant increase in our pre-tax income and increase in tax expense attributable to the change in valuation allowance against deferred tax assets, higher non-deductible officers’ compensation, state income taxes, and capitalized research and development expenses as required by a change in U.S. tax law effective January 1, 2022. The decrease in our effective tax rate for the six months ended June 30, 2023 as compared to the same period in 2022 is primarily attributable to the decrease in our pre-tax losses and increase in tax expense for similar reasons aforementioned.

Liquidity and Capital Resources

Our principal sources of liquidity continue to be cash, cash equivalents, and investment securities totaling $164.0 million, as well as cash flows generated from our operations. We have financed our operations primarily through cash generated from operations. We believe that our existing cash and cash equivalents, investment securities, and cash generated from operating activities will be sufficient to meet our working capital and capital expenditure requirements for at least the next twelve months.

Capital Requirements

Our future capital requirements will depend on many factors, including continued market acceptance of our software solutions, changes in the number of our customers, adoption and utilization of our Value Added Services by new and existing customers, the timing and extent of the introduction of new core functionality, products and Value Added Services, and the timing and extent of our investments across our organization. In addition, we have in the past entered into, and may in the future enter into, arrangements to acquire or invest in new technologies or markets adjacent to those we serve today. Furthermore, our Board of Directors has authorized the repurchase of up to $100.0 million of shares of our Class A common stock from time to time. To date, we have repurchased $4.2 million of our Class A common stock under the share repurchase program.

Cash Flows

The following table summarizes our cash flows for the periods indicated (in thousands):

	Six Months Ended June 30,	
	2023	**2022**
Net cash (used in) provided by operating activities	$ (7,657)	$ 3,281
Net cash used in investing activities	(26,660)	(13,694)
Net cash used in financing activities	(11,754)	(4,994)
Net decrease in cash, cash equivalents and restricted cash	$ (46,071)	$ (15,407)

Operating Activities

Our primary source of operating cash inflows is cash collected from our customers in connection with their use of our core solutions and Value Added Services. Our primary uses of cash from operating activities are for personnel-related expenditures and third-party costs incurred to support the delivery of our software solutions.

The net decrease in cash provided by operating activities for the six months ended June 30, 2023, compared to the same period in the prior year, was primarily due to the payment of separation costs in the second quarter of 2023 related to our former Chief Executive Officer's Separation Agreement, partially offset by changes in working capital levels.

Investing Activities

Cash used in investing activities is generally composed of purchases of investment securities, maturities and sales of investment securities, purchases of property and equipment, and additions to capitalized software development.

The net increase in cash used in investing activities for the six months ended June 30, 2023, compared to the same period in the prior year, was primarily due to higher purchases of available-for-sale investment securities.

Financing Activities

Cash used in financing activities is generally composed of net share settlements for employee tax withholdings associated with the vesting of equity awards offset by proceeds from the exercise of stock options.

The net increase in cash used in financing activities for the six months ended June 30, 2023, compared to the same period in the prior year, was primarily due to an increase in net share settlements for employee tax withholdings associated with the vesting of equity awards.

Critical Accounting Policies and Estimates

Our Condensed Consolidated Financial Statements and the related notes are prepared in accordance with accounting principles generally accepted in the United States. The preparation of our Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting period.

There have been no changes to our critical accounting policies and estimates described in our Annual Report that have had a material impact on our Condensed Consolidated Financial Statements and related notes.

Item 3. Qualitative and Quantitative Disclosure about Market Risk

Interest Rate Risk

Investment Securities

As of June 30, 2023, we had $139.3 million of investment securities consisting of United States government agency securities, corporate bonds, and treasury securities. The primary objective of investing in securities is to support our liquidity and capital needs. We did not purchase these investments for trading or speculative purposes and have not used any derivative financial instruments to manage our interest rate risk exposure.

Our investment securities are exposed to market risk due to interest rate fluctuations. While fluctuations in interest rates do not impact our interest income from our investment securities as all of these securities have fixed interest rates, changes in interest rates may impact the fair value of the investment securities. Since our investment securities are held as available for sale, all changes in fair value impact our other comprehensive (loss) income unless an investment security is considered impaired in which case changes in fair value are reported in other expense. As of June 30, 2023, a hypothetical 100 basis point decrease in interest rates would have resulted in an increase in the fair value of our investment securities of approximately $0.6 million and a hypothetical 100 basis point increase in interest rates would have resulted in a decrease in the fair value of our investment securities of approximately $0.6 million. This estimate is based on a sensitivity model which measures an instant change in interest rates by 100 basis points at June 30, 2023.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the supervision and participation of our principal executive officer and principal financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and other procedures designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Based on our management's evaluation, our principal executive officer and principal financial officer concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various investigative inquiries, legal proceedings and other disputes arising from or related to matters incident to the ordinary course of our business activities, including actions with respect to intellectual property, employment, labor, regulatory and contractual matters. Although the results of such investigative inquiries, legal proceedings and other disputes cannot be predicted with certainty, we believe that we are not currently a party to any matters which, if determined adversely to us, would, individually or taken together, have a material adverse effect on our business, operating results, financial condition or cash flows. However, regardless of the merit of any matters raised or the ultimate outcome, investigative inquiries, legal proceedings and other disputes may generally have an adverse impact on us as a result of defense and settlement costs, diversion of management resources, and other factors.

Item 1A. Risk Factors

An investment in our Class A common stock involves risks. Before making an investment decision, you should carefully consider all of the information in this Quarterly Report, including in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Condensed Consolidated Financial Statements and related notes. In addition, you should carefully consider the risks and uncertainties described in the section entitled “Risk Factors” in our Annual Report, which was filed with the SEC on February 9, 2023, as well as in our other public filings with the SEC. If any of the identified risks are realized, our business, financial condition, operating results and prospects could be materially and adversely affected. In that case, the trading price of our Class A common stock may decline, and you could lose all or part of your investment. In addition, other risks of which we are currently unaware, or which we do not currently view as material, could have a material adverse effect on our business, financial condition, operating results and prospects. As of the date of this report, there have been no material changes to the risk factors previously disclosed in the Annual Report. We may, however, disclose changes to such factors or disclose additional factors from time to time in our future filings with the SEC.

Item 5. Other Information

On May 5, 2023, Janet Kerr, a member of our Board of Directors, entered into a prearranged stock selling plan for the sale of up to 1,000 shares of the Company's Class A common stock between August 4, 2023 and December 31, 2023 (the "Sale Period"). Ms. Kerr's trading plan was entered into during an open insider trading window and is intended to satisfy the affirmative defense of Rule 10b5-1(c) under the Exchange Act of 1934, as amended, and the Company's policies regarding insider transactions.

Item 6. Exhibits

Exhibit Number	Description of Document
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.
32.1*	Certifications of Chief Executive Officer and Principal Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	Inline XBRL Instance Document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document.
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

* The certifications attached as Exhibit 32.1 accompany this Quarterly Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed “filed” by the registrant for purposes of Section 18 of the Exchange Act, and are not to be incorporated by reference into any of the registrant’s filings under the Securities Act or the Exchange Act, whether made before or after the date of this Quarterly Report, irrespective of any general incorporation language contained in any such filing.

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SIGNATURES

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

AppFolio, Inc.

Date:	July 27, 2023	By:	/s/ Shane Trigg
			Shane Trigg Chief Executive Officer (Principal Executive Officer)
Date:	July 27, 2023	By:	/s/ Fay Sien Goon
			Fay Sien Goon Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Shane Trigg, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of AppFolio, 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 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 Rules13a-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 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.

Date: July 27, 2023

/s/ Shane Trigg
Shane Trigg
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Fay Sien Goon, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of AppFolio, 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 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 Rules13a-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 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.

Date: July 27, 2023

/s/ Fay Sien Goon
Fay Sien Goon
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The following certifications are hereby made in connection with the Quarterly Report on Form 10-Q of AppFolio, Inc. (the "Company") for the period ended June 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the "Report"):

I, Shane Trigg, President and Chief Executive Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge, (i) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods presented.

Date:	July 27, 2023	By:	/s/ Shane Trigg
			Shane Trigg
			President and Chief Executive Officer

I, Fay Sien Goon, Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge, (i) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods presented.

Date:	July 27, 2023	By:	/s/ Fay Sien Goon
			Fay Sien Goon
			Chief Financial Officer