

Grand Canyon Education, Inc.
Form 10-Q
November 02, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016

or

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

For the transition period from to

Commission File Number: 001-34211

GRAND CANYON EDUCATION, INC.

(Exact name of registrant as specified in its charter)

DELAWARE **20-3356009**
(State or other jurisdiction of **(I.R.S. Employer**
Incorporation or organization) **Identification No.)**
3300 W. Camelback Road
Phoenix, Arizona 85017
(Address, including zip code, of principal executive offices)
(602) 639-7500
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer

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

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

The total number of shares of common stock outstanding as of October 31, 2016, was 47,333,291.

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FORM 10-Q

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GRAND CANYON EDUCATION, INC.****Consolidated Income Statements****(Unaudited)**

(In thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net revenue	\$ 210,444	\$ 193,393	\$ 628,681	\$ 562,246
Costs and expenses:				
Instructional costs and services	91,748	83,180	271,001	237,224
Admissions advisory and related, including \$237 and \$412 for the three months ended September 30, 2016 and 2015, respectively, and \$803 and \$1,406 for the nine months ended September 30, 2016 and 2015, respectively, to related parties	28,814	27,506	87,224	83,211
Advertising	23,896	19,360	67,152	57,810
Marketing and promotional	2,127	1,827	6,477	5,309
General and administrative	13,430	12,536	32,959	31,466
Lease termination costs	3,363		3,363	
Total costs and expenses	163,378	144,409	468,176	415,020
Operating income	47,066	48,984	160,505	147,226
Interest expense	(344)	(313)	(831)	(834)
Interest and other income	(2,291)	201	50	585
Income before income taxes	44,431	48,872	159,724	146,977
Income tax expense	15,187	15,530	59,189	53,680
Net income	\$ 29,244	\$ 33,342	\$ 100,535	\$ 93,297
Earnings per share:				
Basic income per share	\$ 0.63	\$ 0.72	\$ 2.19	\$ 2.03
Diluted income per share	\$ 0.62	\$ 0.70	\$ 2.14	\$ 1.97

Basic weighted average shares outstanding	46,231	46,063	45,953	45,956
Diluted weighted average shares outstanding	47,175	47,320	47,009	47,262

The accompanying notes are an integral part of these consolidated financial statements.

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GRAND CANYON EDUCATION, INC.

Consolidated Statements of Comprehensive Income

(Unaudited)

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	\$ 29,244	\$ 33,342	\$ 100,535	\$ 93,297
Other comprehensive income, net of tax:				
Unrealized gains (losses) on available-for-sale securities, net of taxes of \$88 and \$74 for the three months ended September 30, 2016 and 2015, respectively, and \$5 and \$7 for the nine months ended September 30, 2016 and 2015, respectively	(142)	118	(6)	13
Unrealized gains (losses) on hedging derivatives, net of taxes of \$2 and \$154 for the three months ended September 30, 2016 and 2015, respectively, and \$203 and \$267 for the nine months ended September 30, 2016 and 2015, respectively	(4)	(257)	(328)	(432)
Comprehensive income	\$ 29,098	\$ 33,203	\$ 100,201	\$ 92,878

The accompanying notes are an integral part of these consolidated financial statements.

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GRAND CANYON EDUCATION, INC.

Consolidated Balance Sheets

(In thousands, except par value)	September 30, 2016 (Unaudited)	December 31, 2015
ASSETS:		
Current assets		
Cash and cash equivalents	\$ 75,143	\$ 23,036
Restricted cash, cash equivalents and investments	69,328	75,384
Investments	49,654	83,364
Accounts receivable, net	10,362	8,298
Income tax receivable	5,923	3,952
Other current assets	21,713	20,863
Total current assets	232,123	214,897
Property and equipment, net	832,665	667,483
Prepaid royalties	3,133	3,355
Goodwill	2,941	2,941
Other assets	1,404	3,306
Total assets	\$ 1,072,266	\$ 891,982
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities		
Accounts payable	\$ 28,851	\$ 34,149
Accrued compensation and benefits	22,653	17,895
Accrued liabilities	20,707	13,846
Income taxes payable	19	29
Student deposits	70,168	76,742
Deferred revenue	104,694	37,876
Due to related parties	183	675
Current portion of capital lease obligations	160	697
Current portion of notes payable	18,633	6,625
Total current liabilities	266,068	188,534
Capital lease obligations, less current portion	300	788
Other noncurrent liabilities	3,512	4,302
Deferred income taxes, noncurrent	17,321	14,855
Notes payable, less current portion	68,276	73,252
Total liabilities	355,477	281,731

Commitments and contingencies

Stockholders equity

Preferred stock, \$0.01 par value, 10,000 shares authorized; 0 shares issued and outstanding at September 30, 2016 and December 31, 2015		
Common stock, \$0.01 par value, 100,000 shares authorized; 51,275 and 50,288 shares issued and 47,328 and 46,877 shares outstanding at September 30, 2016 and December 31, 2015, respectively	513	503
Treasury stock, at cost, 3,947 and 3,411 shares of common stock at September 30, 2016 and December 31, 2015, respectively	(89,341)	(69,332)
Additional paid-in capital	203,503	177,167
Accumulated other comprehensive loss	(823)	(489)
Retained earnings	602,937	502,402
Total stockholders equity	716,789	610,251
Total liabilities and stockholders equity	\$ 1,072,266	\$ 891,982

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**GRAND CANYON EDUCATION, INC.****Consolidated Statement of Stockholders Equity****(In thousands)****(Unaudited)**

	Common Stock		Treasury Stock		Additional	Accumulated	Retained	Total
	Shares	Par Value	Shares	Cost	Paid-in	Other	Earnings	
					Capital	Loss		
Balance at December 31, 2015	50,288	\$ 503	3,411	\$(69,332)	\$ 177,167	\$ (489)	\$ 502,402	\$ 610,251
Comprehensive income						(334)	100,535	100,201
Common stock purchased for treasury			416	(15,367)				(15,367)
Restricted shares forfeited			7					
Share-based compensation	275	3	113	(4,642)	9,031			4,392
Exercise of stock options	712	7			10,009			10,016
Excess tax benefits					7,296			7,296
Balance at September 30, 2016	51,275	\$ 513	3,947	\$(89,341)	\$ 203,503	\$ (823)	\$ 602,937	\$ 716,789

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**GRAND CANYON EDUCATION, INC.****Consolidated Statements of Cash Flows****(Unaudited)**

(In thousands)	Nine Months Ended	
	2016	2015
Cash flows provided by operating activities:		
Net income	\$ 100,535	\$ 93,297
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation	9,034	8,423
Excess tax benefits from share-based compensation	(7,370)	(3,343)
Provision for bad debts	12,812	11,412
Depreciation and amortization	32,744	25,360
Deferred income taxes	2,132	(1,305)
Other, including fixed asset impairments	917	2,098
Changes in assets and liabilities:		
Restricted cash, cash equivalents and investments	6,056	3,103
Accounts receivable	(14,876)	(13,307)
Prepaid expenses and other	327	(1,549)
Due to/from related parties	(492)	(21)
Accounts payable	(3,756)	1,400
Accrued liabilities and employee related liabilities	11,619	(1,181)
Income taxes receivable/payable	5,315	(791)
Deferred rent	(790)	(824)
Deferred revenue	66,818	49,844
Student deposits	(6,574)	(3,606)
Net cash provided by operating activities	214,451	169,010
Cash flows used in investing activities:		
Capital expenditures	(157,584)	(160,223)
Purchases of land, building and golf course improvements related to off-site development	(41,876)	(9,483)
Proceeds received from note receivable	501	
Return of equity method investment	1,749	
Purchases of investments	(34,597)	(35,547)
Proceeds from sale or maturity of investments	65,807	52,315
Net cash used in investing activities	(166,000)	(152,938)
Cash flows provided by (used in) financing activities:		
Principal payments on notes payable and capital lease obligations	(18,527)	(5,117)

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Proceeds from draw on revolving line of credit	25,000	
Debt issuance costs	(194)	
Repurchase of common shares including shares withheld in lieu of income taxes	(20,009)	(4,230)
Excess tax benefits from share-based compensation	7,370	3,343
Net proceeds from exercise of stock options	10,016	2,871
Net cash provided by (used in) financing activities	3,656	(3,133)
Net increase in cash and cash equivalents	52,107	12,939
Cash and cash equivalents, beginning of period	23,036	65,238
Cash and cash equivalents, end of period	\$ 75,143	\$ 78,177
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 791	\$ 849
Cash paid for income taxes	\$ 50,826	\$ 54,408
Supplemental disclosure of non-cash investing and financing activities		
Purchases of property and equipment included in accounts payable	\$ 10,735	\$ 23,212
Purchases of equipment through capital lease obligations	\$	\$ 1,257
Tax benefit of Spirit warrant intangible	\$ 190	\$ 190
Shortfall tax expense from share-based compensation	\$ 264	\$ 18

The accompanying notes are an integral part of these consolidated financial statements.

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GRAND CANYON EDUCATION, INC.

Notes to Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

1. Nature of Business

Grand Canyon Education, Inc. (together with its subsidiaries, the University) is a comprehensive regionally accredited university that offers over 200 graduate and undergraduate degree programs and certificates across nine colleges both online and on ground at our over 250-acre campus in Phoenix, Arizona, at leased facilities and at facilities owned by third party employers. We are committed to providing an academically rigorous educational experience with a focus on professionally relevant programs that meet the objectives of our students. Our undergraduate programs are designed to be innovative and to meet the future needs of employers, while providing students with the needed critical thinking and effective communication skills developed through a Christian-oriented, liberal arts foundation. We offer master and doctoral degrees in contemporary fields that are designed to provide students with the capacity for transformational leadership in their chosen industry, emphasizing the immediate relevance of theory, application, and evaluation to promote personal and organizational change. The University is accredited by The Higher Learning Commission. The University's wholly-owned subsidiaries are primarily used to facilitate expansion of the University campus.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the University and its wholly-owned subsidiaries. Intercompany transactions have been eliminated in consolidation.

Unaudited Interim Financial Information

The accompanying unaudited interim consolidated financial statements of the University have been prepared in accordance with U.S. generally accepted accounting principles and pursuant to the rules and regulations of the United States Securities and Exchange Commission and the instructions to Form 10-Q and Article 10, consistent in all material respects with those applied in its financial statements included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2015. They do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that in the opinion of management are necessary for the fair presentation of the interim periods presented. Interim results are not necessarily indicative of results for a full year. These consolidated financial statements should be read in conjunction with the University's audited financial statements and footnotes included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2015 from which the December 31, 2015 balance sheet information was derived.

Restricted Cash, Cash Equivalents and Investments

A significant portion of the University's revenue is received from federal and state governments on behalf of students who participate in government financial aid and assistance programs. Restricted cash, cash equivalents and

investments primarily represent amounts received from the federal and state governments under various student aid grant and loan programs, such as Title IV. The University receives these funds subsequent to the completion of the authorization and disbursement process and holds them for the benefit of the student. The U.S. Department of Education (Department of Education) requires Title IV funds collected in advance of student billings to be restricted until the course begins. The University records all of these amounts as a current asset in restricted cash, cash equivalents and investments. The majority of these funds remains as restricted for an average of 60 to 90 days from the date of receipt.

Investments

The University considers its investments in municipal bonds, mutual funds and municipal securities as available-for-sale securities. Available-for-sale securities are carried at fair value, determined using Level 1 and Level 2 of the hierarchy of valuation inputs, with the use of quoted market prices and inputs other than quoted prices that are observable for the assets, with unrealized gains and losses, net of tax, reported as a separate component of other comprehensive income. Unrealized losses considered to be other-than-temporary are recognized currently in earnings. Amortization of premiums, accretion of discounts, interest and dividend income and realized gains and losses are included in interest and other income.

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GRAND CANYON EDUCATION, INC.

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(In thousands, except per share data)

(Unaudited)

Derivatives and Hedging

Derivative financial instruments are recorded on the balance sheet as assets or liabilities and re-measured at fair value at each reporting date. For derivatives designated as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

Derivative financial instruments enable the University to manage its exposure to interest rate risk. The University does not engage in any derivative instrument trading activity. Credit risk associated with the University's derivatives is limited to the risk that a derivative counterparty will not perform in accordance with the terms of the contract. Exposure to counterparty credit risk is considered low because these agreements have been entered into with institutions with strong credit ratings, and they are expected to perform fully under the terms of the agreements.

On February 27, 2013, the University entered into an interest rate corridor to manage its 30 Day LIBOR interest exposure related to its variable rate debt. The fair value of the interest rate corridor instrument as of September 30, 2016 and December 31, 2015 was \$205 and \$728, respectively, which is included in other assets. The fair value of the derivative instrument was determined using a hypothetical derivative transaction and Level 2 of the hierarchy of valuation inputs. This derivative instrument was originally designated as a cash flow hedge of variable rate debt obligations. The adjustment of \$531 and \$699 for the nine months ended September 30, 2016 and 2015, respectively, for the effective portion of the loss on the derivatives is included as a component of other comprehensive income, net of taxes.

The interest rate corridor instrument reduces variable interest rate risk starting March 1, 2013 through December 20, 2019 with a notional amount of \$75,000 as of September 30, 2016. The corridor instrument's terms permits the University to hedge its interest rate risk at several thresholds; the University pays variable interest monthly based on the 30 Day LIBOR rates until that index reaches 1.5%. If 30 Day LIBOR is equal to 1.5% through 3.0%, the University pays 1.5%. If 30 Day LIBOR exceeds 3.0%, the University pays actual 30 Day LIBOR less 1.5%.

As of September 30, 2016, no derivative ineffectiveness was identified. Any ineffectiveness in the University's derivative instrument designated as a hedge is reported in interest expense in the income statement. For the nine months ended September 30, 2016, \$8 of credit risk was recorded as a reduction in interest expense for the interest rate corridor. At September 30, 2016, the University does not expect to reclassify gains or losses on derivative instruments from accumulated other comprehensive income (loss) into earnings during the next 12 months.

Fair Value of Financial Instruments

The carrying value of cash and cash equivalents, investments, accounts receivable, accounts payable and accrued compensation and benefits and accrued liabilities expenses approximate their fair value based on the liquidity or the short-term maturities of these instruments. The carrying value of notes payable approximates fair value as it is based on variable rate index. The carrying value of capital lease obligations approximate fair value based upon market interest rates available to the University for debt of similar risk and maturities. Derivative financial instruments are carried at fair value, determined using Level 2 of the hierarchy of valuation inputs, with the use of inputs other than quoted prices that are observable for the asset or liability.

The fair value of investments, primarily municipal securities, including municipal bond portfolios and a mutual fund holding municipal securities, were determined using Level 1 and Level 2 of the hierarchy of valuation inputs, with the use of quoted market prices and inputs other than quoted prices that are observable for the assets. The unit of account used for valuation is the individual underlying security. The municipal securities are comprised of city and county bonds related to schools, water and sewer, utilities, transportation, healthcare and housing. Because these securities are held by the University as investments, assessment of non-performance risk is not applicable as such considerations are only applicable in evaluating the fair value measurements for liabilities.

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GRAND CANYON EDUCATION, INC.

Notes to Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

Revenue Recognition

Net revenues consist primarily of tuition and fees derived from courses taught by the University online, on ground at its over 250-acre campus in Phoenix, Arizona, and at facilities it leases or those of employers, as well as from related educational resources that the University provides to its students, such as access to online materials. Tuition revenue and most fees from related educational resources are recognized pro-rata over the applicable period of instruction, net of scholarships provided by the University. For the nine months ended September 30, 2016 and 2015, the University's revenue was reduced by approximately \$123,112 and \$114,660, respectively, as a result of scholarships that the University offered to students. The University maintains an institutional tuition refund policy, which provides for all or a portion of tuition to be refunded if a student withdraws during stated refund periods. Certain states in which students reside impose separate, mandatory refund policies, which override the University's policy to the extent in conflict. If a student withdraws at a time when only a portion, or none, of the tuition is refundable, then in accordance with its revenue recognition policy, the University continues to recognize the tuition that was not refunded pro-rata over the applicable period of instruction. However, for students that have taken out financial aid to pay their tuition and for which a return of such money to the Department of Education is required as a result of his or her withdrawal, the University recognizes revenue after a student withdraws only at the time of cash collection. Sales tax collected from students is excluded from net revenues. Collected but unremitted sales tax is included as an accrued liability in the consolidated balance sheets. The University also charges online students an upfront learning management fee, which is deferred and recognized over the average expected term of a student. Costs that are direct and incremental to new online students are also deferred and recognized ratably over the average expected term of a student. Deferred revenue and student deposits in any period represent the excess of tuition, fees, and other student payments received as compared to amounts recognized as revenue on the income statement and are reflected as current liabilities in the accompanying consolidated balance sheet. The University's educational programs have starting and ending dates that differ from its fiscal quarters. Therefore, at the end of each fiscal quarter, a portion of revenue from these programs is not yet earned. Other revenues may be recognized as sales occur or services are performed.

Allowance for Doubtful Accounts

The University records an allowance for doubtful accounts for estimated losses resulting from the inability, failure or refusal of its students to make required payments, which includes the recovery of financial aid funds advanced to a student for amounts in excess of the student's cost of tuition and related fees. The University determines the adequacy of its allowance for doubtful accounts based on an analysis of its historical bad debt experience, current economic trends, the aging of the accounts receivable and student status. The University applies reserves to its receivables based upon an estimate of the risk presented by the age of the receivables and student status. The University writes off accounts receivable balances at the earlier of the time the balances are deemed uncollectible, or one year after the revenue is generated. The University accelerates the write off of inactive student accounts such that the accounts are written off by day 150. The University reflects accounts receivable with an offsetting allowance as long as management believes there is a reasonable possibility of collection. Bad debt expense is recorded as an instructional

costs and services expense in the consolidated income statement.

Long-Lived Assets (other than goodwill)

The University evaluates the recoverability of our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Instructional Costs and Services

Instructional costs and services consist primarily of costs related to the administration and delivery of the University's educational programs. This expense category includes salaries, benefits and share-based compensation for full-time and adjunct faculty and administrative personnel, information technology costs, bad debt expense, curriculum and new program development costs (which are expensed as incurred) and costs associated with other support groups that provide services directly to the students. This category also includes an allocation of depreciation, amortization, rent, and occupancy costs attributable to the provision of educational services, primarily at the University's Phoenix, Arizona campus.

Admissions Advisory and Related

Admissions advisory and related expenses include salaries and benefits for admissions advisory personnel and revenue share expense as well as an allocation of depreciation, amortization, rent and occupancy costs attributable to the admissions advisory personnel.

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Notes to Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

Advertising

Advertising expenses include brand advertising, marketing leads and other branding activities. Advertising costs are expensed as incurred.

Marketing and Promotional

Marketing and promotional expenses include salaries, benefits and share-based compensation for marketing personnel, and other promotional expenses. This category also includes an allocation of depreciation, amortization, rent, and occupancy costs attributable to marketing and promotional activities. Marketing and promotional costs are expensed as incurred.

General and Administrative

General and administrative expenses include salaries, benefits and share-based compensation of employees engaged in corporate management, finance, human resources, compliance, and other corporate functions. General and administrative expenses also include an allocation of depreciation, amortization, rent, and occupancy costs attributable to the departments providing general and administrative functions.

Lease termination costs

In July 2016, the University notified a current landlord of its intent to vacate leased space by the end of the fourth quarter of 2016. As part of that notification, the University was required to pay a termination fee to its landlord of \$3,363 which was recorded as an expense in the third quarter of 2016. The new lease termination date is in July 2017. At the date the University vacates the space, it will expense the remaining amounts due under the lease net of remaining deferred rent. We estimate this amount to be \$300.

Commitments and Contingencies

The University accrues for contingent obligations when it is probable that a liability has been incurred and the amount is reasonably estimable. When the University becomes aware of a claim or potential claim, the likelihood of any loss exposure is assessed. If it is probable that a loss will result and the amount of the loss is reasonably estimable, the University records a liability for the estimated loss. If the loss is not probable or the amount of the potential loss is not reasonably estimable, the University will disclose the claim if the likelihood of a potential loss is reasonably possible and the amount of the potential loss could be material. Estimates that are particularly sensitive to future changes include tax, legal, and other regulatory matters, which are subject to change as events evolve, and as additional information becomes available during the administrative and litigation process. The University expenses legal fees as incurred.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Segment Information

The University operates as a single educational delivery operation using a core infrastructure that serves the curriculum and educational delivery needs of both its ground and online students regardless of geography. The University's Chief Executive Officer manages the University's operations as a whole and no expense or operating income information is generated or evaluated on any component level.

Accounting Pronouncements Recently Adopted

In April 2015, the Financial Accounting Standards Board (FASB) issued, *Simplifying the Presentation of Debt Issuance Costs*. The guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. As the guidance permits, the University has elected to have debt issuance costs related to lines of credit to be reported as an asset and amortized over the term of the line. The guidance is effective for the University's annual reporting period beginning January 1, 2016. The University adopted this new standard on January 1, 2016 on a retrospective basis, and the adoption of this guidance did not have a material impact on its financial condition, results of operations, or disclosures. The University did not have to restate or adjust any of our previously issued consolidated financial statements as our current accounting policy for the presentation of debt issuance costs is in compliance with the new guidance.

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Notes to Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

In April 2015, the FASB issued, *Intangibles-Goodwill and Other-Internal-Use Software, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. The guidance requires customers to determine whether a cloud computing arrangement contains a software license. If the arrangement contains a software license, customers must account for fees related to the software license element in a manner consistent with how the acquisition of other software licenses is accounted for under ASC 350-40; if the arrangement does not contain a software license, customers must account for the arrangement as a service contract. The University adopted this standard on January 1, 2016 on a prospective basis, and the adoption of this guidance did not have a material impact on its financial condition, results of operations, or disclosures. The University did not have to restate or adjust any of our previously issued consolidated financial statements as our current accounting policy for cloud computing arrangements is in compliance with the new guidance.

In November 2015, the FASB issued, *Income Taxes: Balance Sheet Classification of Deferred Taxes*. The standard requires that deferred tax assets and liabilities be classified as noncurrent on the balance sheet rather than being separated into current and noncurrent. This standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early adoption is permitted and the standard may be applied either retrospectively or on a prospective basis to all deferred tax assets and liabilities. The University early adopted this standard on January 1, 2016 on a retrospective basis. Accordingly, we reclassified the current deferred taxes to noncurrent on our December 31, 2015 consolidated balance sheet, which decreased current deferred tax assets by \$6,448 and decreased noncurrent deferred tax liabilities from \$21,303 to \$14,855.

Recent Accounting Pronouncements

In May 2014, the FASB issued *Revenue from Contracts with Customers*. The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. The accounting guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgements and changes in judgements and assets recognized from costs incurred to obtain or fulfill a contract. After the FASB amended the standard in July 2015, the standard is effective for us on January 1, 2018 using either a full retrospective or a modified retrospective approach and early adoption is permitted effective January 1, 2017. The FASB has also issued the following standards which clarify this standard and have the same effective dates: *Revenue from Contracts with Customers: Principal versus Agent Consideration (Reporting Revenue Gross versus Net)*; and *Revenue from Contracts with Customers; Narrow-Scope Improvements and Practical Expedients*. The University is currently evaluating which transition approach to use and the impact that the new revenue recognition standards will have on our consolidated financial statements.

In February 2016, the FASB issued *Leases*. The standard requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 month. This standard is effective for fiscal years, and interim

periods within those years, beginning after December 15, 2018, and early adoption is permitted. Accordingly, the standard is effective for us on January 1, 2019 using a modified retrospective approach. We are currently evaluating the impact that the standard will have on our consolidated financial statements.

In March 2016, the FASB issued *Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting*. The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. While aimed at reducing the cost and complexity of the accounting for share-based payments, the amendments are expected to significantly impact net income, earnings per share and the statement of cash flows as discussed further in Item 2 of this Form 10-Q. This standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted. Accordingly, the University will adopt this update as of January 1, 2017 using the prospective method.

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In June 2016, the FASB issued *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*. The new guidance revises the accounting requirements related to the measurement of credit losses on financial instruments and the timing of when such losses are recorded. The standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. Early adoption is permitted for fiscal years and interim periods within those years, beginning after December 15, 2018. Accordingly, the standard is effective for us on January 1, 2020 using a modified retrospective approach, and we are currently evaluating the impact that the standard will have on our consolidated financial statements.

The University has determined that no other recent accounting pronouncements apply to its operations or could otherwise have a material impact on its financial statements.

3. Investments

The following is a summary of amounts included in restricted and unrestricted investments as of September 30, 2016 and December 31, 2015. The University considered all investments as available for sale.

	As of September 30, 2016			
	Adjusted	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair Value
		Gains	(Losses)	
Municipal securities	\$ 49,749	\$ 10	\$ (105)	\$ 49,654
Municipal bond mutual fund	\$ 56,031	\$	\$ (173)	\$ 55,858
Total restricted and unrestricted investments	\$ 105,780	\$ 10	\$ (278)	\$ 105,512

	As of December 31, 2015			
	Adjusted	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair Value
		Gains	(Losses)	
Municipal securities	\$ 83,507	\$ 26	\$ (169)	\$ 83,364
Municipal bond mutual fund	\$ 55,720	\$	\$ (115)	\$ 55,605
Total restricted and unrestricted investments	\$ 139,227	\$ 26	\$ (284)	\$ 138,969

The cash flows of municipal securities are backed by the issuing municipality's credit worthiness. All municipal securities are due in one year or less as of September 30, 2016. For the nine months ended September 30, 2016, the net unrealized losses on available-for-sale securities was \$166, net of taxes.

Table of Contents**GRAND CANYON EDUCATION, INC.****Notes to Consolidated Financial Statements****(In thousands, except per share data)****(Unaudited)****4. Net Income Per Common Share**

Basic net income per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per common share reflects the assumed conversion of all potentially dilutive securities, consisting of stock options and restricted stock awards, for which the estimated fair value exceeds the exercise price, less shares which could have been purchased with the related proceeds, unless anti-dilutive. For employee equity awards, repurchased shares are also included for any unearned compensation adjusted for tax. The table below reflects the calculation of the weighted average number of common shares outstanding, on an as if converted basis, used in computing basic and diluted earnings per common share.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Denominator:				
Basic weighted average shares outstanding	46,231	46,063	45,953	45,956
Effect of dilutive stock options and restricted stock	944	1,257	1,056	1,306
Diluted weighted average shares outstanding	47,175	47,320	47,009	47,262

Diluted weighted average shares outstanding exclude the incremental effect of shares that would be issued upon the assumed exercise of stock options and vesting of restricted stock. For the nine months ended September 30, 2016 and 2015, approximately 458 and 373, respectively, of the University's stock options outstanding were excluded from the calculation of diluted earnings per share as their inclusion would have been anti-dilutive. These options and restricted stock awards could be dilutive in the future.

5. Allowance for Doubtful Accounts

	Balance at Beginning of Period	Charged to Expense	Deductions⁽¹⁾	Balance at End of Period
Nine months ended September 30, 2016	\$ 5,137	12,812	(11,766)	\$ 6,183
Nine months ended September 30, 2015	\$ 6,472	11,412	(12,089)	\$ 5,795

(1) Deductions represent accounts written off, net of recoveries.

6. Property and Equipment

Property and equipment consist of the following:

	September 30, 2016	December 31, 2015
Land	\$ 126,046	\$ 103,280
Land improvements	21,573	13,389
Buildings	501,208	392,754
Buildings and leasehold improvements	94,300	72,494
Equipment under capital leases	5,943	6,467
Computer equipment	101,409	91,225
Furniture, fixtures and equipment	56,021	51,352
Internally developed software	28,826	25,996
Other	1,176	1,099
Construction in progress	70,720	54,506
	1,007,222	812,562
Less accumulated depreciation and amortization	(174,557)	(145,079)
Property and equipment, net	\$ 832,665	\$ 667,483

7. Commitments and Contingencies***Leases***

The University leases certain land, buildings and equipment under non-cancelable operating leases expiring at various dates through 2022. Future minimum lease payments under operating leases due each year are as follows at September 30, 2016:

2016 (remaining three months)	\$ 1,209
2017	3,007
2018	884
2019	422
2020	413
Thereafter	460
Total minimum payments	\$ 6,395

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GRAND CANYON EDUCATION, INC.

Notes to Consolidated Financial Statements

(In thousands, except per share data)

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Total rent expense and related taxes and operating expenses under operating leases for the nine months ended September 30, 2016 and 2015 were \$5,282 and \$5,837, respectively.

Legal Matters

From time to time, the University is a party to various lawsuits, claims, and other legal proceedings that arise in the ordinary course of business, some of which are covered by insurance. When the University is aware of a claim or potential claim, it assesses the likelihood of any loss or exposure. If it is probable that a loss will result and the amount of the loss is reasonably estimable, the University records a liability for the loss. If the loss is not probable or the amount of the loss is not reasonably estimable, the University discloses the nature of the specific claim if the likelihood of a potential loss is reasonably possible and the amount involved could be material. With respect to the majority of pending litigation matters, the University's ultimate legal and financial responsibility, if any, cannot be estimated with certainty and, in most cases, any potential losses related to those matters are not considered probable.

Upon resolution of any pending legal matters, the University may incur charges in excess of presently established reserves. Management does not believe that any such charges would, individually or in the aggregate, have a material adverse effect on the University's financial condition, results of operations or cash flows.

Tax Reserves, Non-Income Tax Related

From time to time the University has exposure to various non-income tax related matters that arise in the ordinary course of business. The University reserve is not material for tax matters where its ultimate exposure is considered probable and the potential loss can be reasonably estimated.

8. Share-Based Compensation

Incentive Plan

Restricted Stock

During the nine months ended September 30, 2016, the University granted 264 shares of common stock with a service vesting condition to certain of its executives, officers, faculty and employees. The restricted shares have voting rights and vest in five annual installments of 20%, with this first installment vesting in March of the calendar year following the date of grant (the first vesting date) and on each of the four anniversaries of the first vesting date. Upon vesting, shares will be held in lieu of taxes equivalent to the minimum statutory tax withholding required to be paid when the restricted stock vests. During the nine months ended September 30, 2016, the University withheld 113 shares of common stock in lieu of taxes at a cost of \$4,642 on the restricted stock vesting dates. In June 2016, the University granted 11 shares of common stock to certain of the non-employee members of the University's board of directors. The

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restricted shares granted to these directors have voting rights and vest on the earlier of (a) the one year anniversary of the date of grant or (b) immediately prior to the following year's annual stockholders' meeting.

A summary of the activity related to restricted stock granted under the University's 2008 Equity Incentive Plan (Incentive Plan) since December 31, 2015 is as follows:

	Total Shares	Weighted Average Grant Date Fair Value per Share
Outstanding as of December 31, 2015	1,056	\$ 34.30
Granted	275	\$ 44.46
Vested	(325)	\$ 30.44
Forfeited, canceled or expired	(7)	\$ 38.09
Outstanding as of September 30, 2016	999	\$ 38.33

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GRAND CANYON EDUCATION, INC.

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Stock Options

During the nine months ended September 30, 2016, no options were granted. A summary of the activity related to stock options granted under the University's Incentive Plan since December 31, 2015 is as follows:

	Summary of Stock Options Outstanding			
	Total Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (\$)(1)
Outstanding as of December 31, 2015	2,220	\$ 14.71		
Granted		\$		
Exercised	(712)	\$ 14.07		
Forfeited, canceled or expired	(2)	\$ 19.23		
Outstanding as of September 30, 2016	1,506	\$ 15.01	3.18	\$ 38,215
Exercisable as of September 30, 2016	1,499	\$ 14.97	3.16	\$ 38,117
Available for issuance as of September 30, 2016	1,802			

- (1) Aggregate intrinsic value represents the value of the University's closing stock price on September 30, 2016 (\$40.39) in excess of the exercise price multiplied by the number of shares underlying options outstanding or exercisable, as applicable.

Share-based Compensation Expense

The table below outlines share-based compensation expense for the nine months ended September 30, 2016 and 2015 related to restricted stock and stock options granted:

	2016	2015
Instructional costs and services	\$ 5,462	\$ 5,054