

Grand Canyon Education, Inc.
Form 10-Q
November 01, 2017
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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, 2017

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 (State or other jurisdiction of Incorporation or organization)	20-3356009 (I.R.S. Employer 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, a smaller reporting company, or an emerging growth company. See definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth 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
	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

The total number of shares of common stock outstanding as of October 27, 2017, was 48,120,857.

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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		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2017	2016	2017	2016
Net revenue	\$ 236,209	\$ 210,444	\$ 702,716	\$ 628,681
Costs and expenses:				
Instructional costs and services	104,303	91,748	301,907	271,001
Admissions advisory and related	31,426	28,814	94,483	87,224
Advertising	25,523	23,896	74,930	67,152
Marketing and promotional	2,350	2,127	7,074	6,477
General and administrative	12,915	13,430	32,914	32,959
Lease termination costs		3,363		3,363
Total costs and expenses	176,517	163,378	511,308	468,176
Operating income	59,692	47,066	191,408	160,505
Interest expense	(567)	(344)	(1,642)	(831)
Interest and other income	1,445	(2,291)	2,186	50
Income before income taxes	60,570	44,431	191,952	159,724
Income tax expense	21,266	15,187	56,889	59,189
Net income	\$ 39,304	\$ 29,244	\$ 135,063	\$ 100,535
Earnings per share:				
Basic income per share	\$ 0.83	\$ 0.63	\$ 2.87	\$ 2.19
Diluted income per share	\$ 0.81	\$ 0.62	\$ 2.80	\$ 2.14
Basic weighted average shares outstanding	47,316	46,231	47,083	45,953
Diluted weighted average shares outstanding	48,292	47,175	48,197	47,009

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

Table of Contents**GRAND CANYON EDUCATION, INC.****Consolidated Statements of Comprehensive Income****(Unaudited)**

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	\$ 39,304	\$ 29,244	\$ 135,063	\$ 100,535
Other comprehensive income, net of tax:				
Unrealized gains (losses) on available-for-sale securities, net of taxes of \$25 and \$88 for the three months ended September 30, 2017 and 2016, respectively, and \$257 and \$5 for the nine months ended September 30, 2017 and 2016, respectively	40	(142)	416	(6)
Unrealized losses on hedging derivatives, net of taxes of \$20 and \$2 for the three months ended September 30, 2017 and 2016, respectively, and \$65 and \$203 for the nine months ended September 30, 2017 and 2016, respectively	(30)	(4)	(104)	(328)
Comprehensive income	\$ 39,314	\$ 29,098	\$ 135,375	\$ 100,201

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

Table of Contents**GRAND CANYON EDUCATION, INC.****Consolidated Balance Sheets**

(In thousands, except par value)	September 30, 2017 (Unaudited)	December 31, 2016
ASSETS:		
Current assets		
Cash and cash equivalents	\$ 180,142	\$ 45,976
Restricted cash and cash equivalents	75,604	84,931
Investments	89,609	62,596
Accounts receivable, net	12,243	9,999
Income tax receivable	4,546	4,686
Other current assets	24,702	21,880
Total current assets	386,846	230,068
Property and equipment, net	897,540	855,528
Prepaid royalties	2,837	3,059
Goodwill	2,941	2,941
Other assets	766	897
Total assets	\$ 1,290,930	\$ 1,092,493
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities		
Accounts payable	\$ 27,523	\$ 24,824
Accrued compensation and benefits	24,377	19,697
Accrued liabilities	23,184	21,283
Income taxes payable	10,750	2,734
Student deposits	76,111	85,881
Deferred revenue	116,438	40,739
Current portion of notes payable	6,680	31,636
Total current liabilities	285,063	226,794
Other noncurrent liabilities	1,341	1,689
Deferred income taxes, noncurrent	27,209	23,708
Notes payable, less current portion	61,596	66,616
Total liabilities	375,209	318,807
Commitments and contingencies		
Stockholders equity		
Preferred stock, \$0.01 par value, 10,000 shares authorized; 0 shares issued and outstanding at September 30, 2017 and December 31, 2016	522	515

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Common stock, \$0.01 par value, 100,000 shares authorized; 52,238 and 51,509 shares issued and 48,120 and 47,559 shares outstanding at September 30, 2017 and December 31, 2016, respectively

Treasury stock, at cost, 4,118 and 3,950 shares of common stock at September 30, 2017 and December 31, 2016, respectively	(99,051)	(89,394)
Additional paid-in capital	228,928	212,559
Accumulated other comprehensive loss	(598)	(910)
Retained earnings	785,920	650,916

Total stockholders equity	915,721	773,686
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Total liabilities and stockholders equity	\$ 1,290,930	\$ 1,092,493
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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	Other	Retained	
	Shares	Par Value	Shares	Cost	Paid-in	Comprehensive	Loss	Earnings	Total
Balance at December 31, 2016	51,509	\$ 515	3,950	\$ (89,394)	\$ 212,559	\$	(910)	\$ 650,916	\$ 773,686
Cumulative effect from the adoption of accounting pronouncements, net of taxes					59			(59)	
Comprehensive income							312	135,063	135,375
Restricted shares forfeited			19						
Share-based compensation	192	2	149	(9,657)	9,560				(95)
Exercise of stock options	537	5			6,750				6,755
Balance at September 30, 2017	52,238	\$ 522	4,118	\$ (99,051)	\$ 228,928	\$	(598)	\$ 785,920	\$ 915,721

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)**

	Nine Months Ended September 30,	
(In thousands)	2017	2016
Cash flows provided by operating activities:		
Net income	\$ 135,063	\$ 100,535
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation	9,562	9,034
Provision for bad debts	13,351	12,812
Depreciation and amortization	40,467	32,744
Deferred income taxes	3,813	2,132
Other	1,751	917
Changes in assets and liabilities:		
Accounts receivable	(15,595)	(14,876)
Prepaid expenses and other	(3,016)	(2,173)
Accounts payable	4,007	(3,756)
Accrued liabilities and employee related liabilities	6,710	11,127
Income taxes receivable/payable	8,156	5,315
Deferred rent	(271)	(790)
Deferred revenue	75,699	66,818
Student deposits	(9,770)	(6,574)
Net cash provided by operating activities	269,927	213,265
Cash flows used in investing activities:		
Capital expenditures	(75,604)	(157,584)
Purchases of land, building and golf course improvements related to off-site development	(10,152)	(41,876)
Proceeds received from note receivable		501
Return of equity method investment	685	1,749
Purchases of investments	(76,630)	(32,097)
Proceeds from sale or maturity of investments	49,617	65,807
Net cash used in investing activities	(112,084)	(163,500)
Cash flows used in financing activities:		
Principal payments on notes payable and capital lease obligations	(5,102)	(5,527)
Debt issuance costs		(194)
Net borrowings from revolving line of credit	(25,000)	12,000
Repurchase of common shares including shares withheld in lieu of income taxes	(9,657)	(20,009)
Net proceeds from exercise of stock options	6,755	10,016

Net cash used in financing activities	(33,004)	(3,714)
Net increase in cash and cash equivalents and restricted cash	124,839	46,051
Cash and cash equivalents and restricted cash, beginning of period	130,907	98,420
Cash and cash equivalents and restricted cash, end of period	\$ 255,746	\$ 144,471
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 1,633	\$ 791
Cash paid for income taxes	\$ 45,413	\$ 50,826
Supplemental disclosure of non-cash investing and financing activities		
Purchases of property and equipment included in accounts payable	\$ 6,437	\$ 10,735
Tax benefit of Spirit warrant intangible	\$	\$ 190
Shortfall tax expense from share-based compensation	\$	\$ 264

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 220 graduate and undergraduate degree programs, emphases and certificates across nine colleges both online and on ground at our over 270 acre campus in Phoenix, Arizona, at leased facilities and at facilities owned by third party employers. 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's 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. 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, 2016 from which the December 31, 2016 balance sheet information was derived.

Restricted Cash and Cash Equivalents

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

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.

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GRAND CANYON EDUCATION, INC.

Notes to Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

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, 2017 and December 31, 2016 was \$322 and \$490, 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 \$169 and \$531 for the nine months ended September 30, 2017 and 2016, respectively, for the effective portion of the losses 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 \$68,333 as of September 30, 2017. 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, 2017, 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. At September 30, 2017, 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, 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. 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, were determined using Level 2 of the hierarchy of valuation inputs, with the use of 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.

Revenue Recognition

Net revenues consist primarily of tuition and fees derived from courses taught by the University online, on ground at its over 270 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, 2017 and 2016, the University's revenue was reduced by approximately \$135,630 and \$123,112, 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 under Title IV 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

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GRAND CANYON EDUCATION, INC.

Notes to Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

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 were 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 as well as an allocation of depreciation, amortization, rent and occupancy costs attributable to the admissions advisory personnel.

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.

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GRAND CANYON EDUCATION, INC.

Notes to Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

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 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 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 Adopted in 2017

In March 2016, the FASB issued Compensation Stock Compensation: Improvement to Employee Share-Based Payment Accounting, to simplify certain aspects of the accounting for share-based payment transactions to employees. The new standard requires excess tax benefits and tax deficiencies to be recorded in the consolidated statements of income as a component of the provision for income taxes when stock awards vest or options are exercised. In addition, it eliminates the requirement to reclassify cash flows related to excess tax benefits from operating activities to financing activities on the consolidated statements of cash flows. The standard also provides an accounting policy election to account for forfeitures as they occur, allows us to withhold more of an employee's vesting shares for tax withholding purposes without triggering liability accounting, and clarifies that all cash payments made to tax authorities on an employee's behalf for withheld shares should be presented as a financing activity on our consolidated cash flows statement.

The University adopted the new guidance in the first quarter of 2017 which required us to reflect any adjustments as of January 1, 2017. Upon adoption, excess tax benefits or deficiencies from share-based awards or options are now reflected in the consolidated statement of income as a component of the provision for income taxes, whereas previously they were recognized in equity. The University elected to account for forfeitures as they occur, rather than estimate expected forfeitures. The net cumulative effect of this change increased additional paid-in capital and decreased retained earnings as of January 1, 2017 by \$59, net of tax. The University did not have any previously unrecognized excess tax effects that had not been recorded as a reduction to tax liability.

The University adopted the provisions of the standard impacting the cash flow presentation retrospectively, and accordingly, to conform to the current period presentation, we reclassified \$7,370 of excess tax benefits which had been included as a financing activity to an operating activity for the nine months ended September 30, 2016 in our consolidated statement of cash flows. The presentation requirement for cash flows related to employee taxes paid for withheld shares had no impact on our consolidated statement of cash flows since such cash flows have historically been presented as a financing activity.

Adoption of the provision of the new standard related to income taxes was adopted prospectively and resulted in a reduction to our provision for income taxes of \$15,374 for the nine months ended September 30, 2017, due to the recognition of excess tax benefits from restricted stock awards that vested or stock options that were exercised in 2017. Our restricted stock awards vest in March each year so the excess tax benefits and deficiencies is greatest in the first quarter each year. The inclusion of excess tax benefits and deficiencies as a component of our income tax expense will increase volatility within our provision for income taxes as the amount of excess tax benefits or deficiencies from share-based compensation awards are dependent on our stock price at the date the restricted awards vest, our stock price on the date an option is exercised, and the quantity of options exercised.

Table of Contents**GRAND CANYON EDUCATION, INC.****Notes to Consolidated Financial Statements**

(In thousands, except per share data)

(Unaudited)

In August 2016, the FASB issued a new standard that clarifies how certain cash receipts and cash payments are presented and classified in the consolidated statement of cash flows. The University elected to early adopt this guidance in the first quarter of 2017 on a retrospective basis. There was no reclassification impact of the adoption on our consolidated statement of cash flows for the nine months ended September 30, 2017 and 2016, as our historical statements have been presented in accordance with this new guidance.

In November 2016, the FASB issued a new standard that requires restricted cash and cash equivalents to be included with the amount of cash and cash equivalents that are reconciled on the consolidated statement of cash flows. The University elected to early adopt this guidance in the first quarter of 2017 on a retrospective basis, and accordingly, to conform to the current period presentation, we reclassified our restricted cash and cash equivalents to be included in the total of cash and cash equivalents presented at the bottom of our consolidated statement of cash flows for both the beginning and ending periods for our nine months ended September 30, 2017 and 2016. As a result, the amount of the change in our net cash provided by operating activities no longer includes the impact of the change in restricted cash and cash equivalents for either period.

The following table summarizes the effects related to the adoption of both accounting standards (share-based compensation and restricted cash and cash equivalents) for the nine months ended September 30, 2016:

Consolidated Statement of Cash Flows Data:

	September 30, 2016	
	As reported	As adjusted
Net cash provided by operating activities	\$ 214,451	\$ 213,265
Net cash used in investing activities	\$ (166,000)	\$ (163,500)
Net cash provided by (used in) financing activities	\$ 3,656	\$ (3,714)
Net increase in cash and cash equivalents and restricted cash	\$ 52,107	\$ 46,051
Cash and cash equivalents and restricted cash, beginning of period	\$ 23,036	\$ 98,420
Cash and cash equivalents and restricted cash, end of period	\$ 75,143	\$ 144,471

Recent Accounting Pronouncements

In May 2014, the FASB issued Revenue from Contracts with Customers, as amended. 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. In July 2015, the FASB approved a one-year delay in the effective date. The University will adopt this new standard January 1, 2018 using the modified retrospective method and providing certain additional disclosure as defined within the standard. The University has elected to apply this guidance retrospectively to all contracts at the date of initial application. Management has undertaken a review of contracts and revenue streams for all of our net revenues. The majority of our revenues are related to tuition, net of scholarships, due from our students. Tuition revenues, net of scholarships, are currently recognized pro-rata over the applicable period of instruction which the University believes is consistent with the revenue recognition method required by the new standard. The University will provide expanded disclosures pertaining to revenue recognition in our quarterly filings beginning in the period of adoption. The University will clarify further its receivables and contract liabilities reported in its consolidated balance sheets. The University does not expect to have any contract assets. The University will elect the short-term contract exemption with respect to its performance obligations as all performance obligations as of the end of any reporting period are completed within less than a year. We anticipate the adoption of this standard will not have a material impact on our consolidated financial statements, cash flows or results of operations. The University is continuing to evaluate the impact the adoption of this standard will have on our accounting systems and system of internal controls and does not anticipate significant changes to our accounting systems and expects that there may be some enhancements in internal controls as a result of implementing the new standard.

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In January 2016, the FASB issued *Financial Instruments – Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. The standard addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most prominent among the amendments is the requirement for changes in the fair value of equity investments, with certain exceptions, to be recognized through net income rather than other comprehensive income (OCI). This standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and early adoption is not permitted. Accordingly, the standard is effective for us on January 1, 2018. We are currently evaluating the impact that the standard will have on our consolidated financial statements.

In February 2016, the FASB issued *Leases*. The standard establishes a right-of-use (ROU) model that requires a lessee to recognize a ROU asset and a lease liability on the balance sheet for all leases with lease terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. 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 transition approach. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The University has begun evaluating the impact that the future adoption of this standard will have on our consolidated financial statements and we believe the adoption will slightly increase our assets and liabilities, and will increase our financial statement disclosures.

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 consolidated financial statements.

3. Investments

The following is a summary of investments as of September 30, 2017 and December 31, 2016. The University considers all investments as available for sale.

	As of September 30, 2017			
	Adjusted	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	(Losses)	Value
Municipal securities	\$ 89,631	\$ 57	\$ (79)	\$ 89,609

	As of December 31, 2016			
	Adjusted	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	(Losses)	Value
Municipal securities	\$ 62,769	\$ 12	\$ (185)	\$ 62,596

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, 2017. For the nine months ended September 30, 2017, the net unrealized losses on available-for-sale securities was \$14, net of taxes.

4. Net Income Per Common Share

Basic earnings 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

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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		Nine Months Ended	
	September 30,		September 30,	
	2017	2016	2017	2016
Denominator:				
Basic weighted average shares outstanding	47,316	46,231	47,083	45,953
Effect of dilutive stock options and restricted stock	976	944	1,114	1,056
Diluted weighted average shares outstanding	48,292	47,175	48,197	47,009

Diluted weighted average shares outstanding exclude the incremental effect of unvested restricted stock and shares that would be issued upon the assumed exercise of stock options in accordance with the treasury stock method. For the nine months ended September 30, 2017 and 2016, approximately 3 and 458, respectively, of the University's stock options and restricted stock awards 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	Charged to	Deductions⁽¹⁾	Balance at
	Beginning of	Expense		End of
	Period			Period
Nine months ended September 30, 2017	\$ 5,918	13,351	(12,978)	\$ 6,291
Nine months ended September 30, 2016	\$ 5,137	12,812	(11,766)	\$ 6,183

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

6. Property and Equipment

Property and equipment consist of the following:

	September 30, 2017	December 31, 2016
Land	\$ 142,013	\$ 127,769
Land improvements	25,119	23,158
Buildings	593,913	559,791
Buildings and leasehold improvements	116,935	105,168
Equipment under capital leases	5,937	5,943
Computer equipment	116,650	108,551
Furniture, fixtures and equipment	62,651	59,300
Internally developed software	34,729	30,407
Other	1,176	1,176
Construction in progress	18,898	19,112
	1,118,021	1,040,375
Less accumulated depreciation and amortization	(220,481)	(184,847)
Property and equipment, net	\$ 897,540	\$ 855,528

7. Commitments and Contingencies

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 can be reasonably estimated, the University records a liability for the loss. If the loss is not probable or the amount of the loss cannot be reasonably estimated, 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.

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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 Plans

The University has made grants of restricted stock and stock options under its 2008 Equity Incentive Plan (the 2008 Plan). In January 2017, the Board of Directors of the University approved, and at the University's 2017 annual meeting of stockholders held on June 14, 2017, the University's stockholders adopted, a 2017 Equity Incentive Plan (the 2017 Plan). All future grants of equity incentives will be made from the 2017 Plan.

Restricted Stock

During the nine months ended September 30, 2017, the University granted 188 shares of common stock under the 2008 Plan 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, 2017, the University withheld 149 shares of common stock in lieu of taxes at a cost of \$9,657 on the restricted stock vesting dates. In June 2017, following the annual stockholders meeting, the University granted 4 shares of common stock under the 2017 Plan to the non-employee members of the University's board of directors. The 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 2008 Plan and the 2017 Plan since December 31, 2016 is as follows:

	Total Shares	Weighted Average Grant Date Fair Value per Share
Outstanding as of December 31, 2016	993	\$ 38.32
Granted	192	\$ 70.44
Vested	(371)	\$ 32.38
Forfeited, canceled or expired	(19)	\$ 41.77
Outstanding as of September 30, 2017	795	\$ 48.79

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Stock Options

During the nine months ended September 30, 2017, no options were granted. A summary of the activity since December 31, 2016 related to stock options granted under the 2008 Plan 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, 2016	1,272	\$ 15.26		
Granted		\$		
Exercised	(537)	\$ 12.57		
Forfeited, canceled or expired	(2)	\$ 16.35		
Outstanding as of September 30, 2017	733	\$ 17.23	2.92	\$ 53,939
Exercisable as of September 30, 2017	733	\$ 17.23	2.92	\$ 53,939

- (1) Aggregate intrinsic value represents the value of the University's closing stock price on September 29, 2017 (\$90.82) 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, 2017 and 2016 related to restricted stock and stock options granted:

	2017	2016
Instructional costs and services	\$ 5,992	\$ 5,462
Admissions advisory and related expenses	144	169
Marketing and promotional	123	92

General and administrative	3,303	3,311
Share-based compensation expense included in operating expenses	9,562	9,034
Tax effect of share-based compensation	(3,825)	(3,614)
Share-based compensation expense, net of tax	\$ 5,737	\$ 5,420

9. Regulatory

The University is subject to extensive regulation by federal and state governmental agencies and accrediting bodies. In particular, the Higher Education Act of 1965, as amended (the Higher Education Act), and the regulations promulgated thereunder by the Department of Education, subject the University to significant regulatory scrutiny on the basis of numerous standards that schools must satisfy in order to participate in the various federal student financial assistance programs under Title IV of the Higher Education Act.

To participate in the Title IV programs, an institution must be authorized to offer its programs of instruction by the relevant agency of the state in which it is located, accredited by an accrediting agency recognized by the Department of Education and certified as eligible by the Department of Education. The Department of Education will certify an institution to participate in the Title IV programs only after the institution has demonstrated compliance with the Higher Education Act and the Department of Education's extensive regulations regarding institutional eligibility. An institution must also demonstrate its compliance to the Department of Education on an ongoing basis. The University's accreditation has been reaffirmed by the Higher Learning Commission (HLC) after a comprehensive review of the institution's academic offerings, governance and administration, mission, finances and resources during an on-site visit in November 2016. The accreditation was reaffirmed by the HLC's Institutional Actions council at its meeting on February 28, 2017 with no requirements for any monitoring or interim reports. The comprehensive review occurs every 10 years, along with a mid-term report in year four. As of September 30, 2017, management believes the University is in compliance with the applicable regulations in all material respects. The University has a program participation agreement with full certification from the Department of Education, which gives the University the ability to participate in the Title IV programs through December 31, 2020.

Because the University operates in a highly regulated industry, it, like other industry participants, may be subject from time to time to investigations, claims of non-compliance, or lawsuits by governmental agencies or third parties, which allege statutory violations, regulatory infractions, or common law causes of action. While there can be no assurance that regulatory agencies or third parties will not undertake investigations or make claims against the University, or that such claims, if made, will not have a material adverse effect on the University's business, results of operations or financial condition, management believes the University is in compliance with applicable regulations in all material respects.

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Item 2. Management's Di