

STRAYER EDUCATION INC  
Form 10-Q  
October 27, 2016  
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the  
Securities Exchange Act of 1934

For the quarterly period ended September 30, 2016

Commission File No. 0-21039

Strayer Education, Inc.

(Exact name of registrant as specified in this charter)

Maryland  
(State or other jurisdiction of  
incorporation or organization)

52-1975978  
(I.R.S. Employer  
Identification No.)

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2303 Dulles Station Boulevard

Herndon, VA 20171  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (703) 561-1600

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

As of October 21, 2016, there were outstanding 11,093,958 shares of Common Stock, par value \$0.01 per share, of the Registrant.

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STRAYER EDUCATION, INC.

## UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	December 31, 2015	September 30, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 106,889	\$ 120,502
Tuition receivable, net	18,519	18,925
Income taxes receivable	—	2,437
Other current assets	6,944	10,838
Total current assets	132,352	152,702
Property and equipment, net	77,139	71,725
Deferred income taxes	26,449	27,894
Goodwill	6,800	20,793
Other assets	5,694	13,390
Total assets	\$ 248,434	\$ 286,504
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 42,253	\$ 44,818
Income taxes payable	2,684	—
Deferred revenue	12,373	16,633
Other current liabilities	281	203
Total current liabilities	57,591	61,654
Other long-term liabilities	47,987	51,631
Total liabilities	105,578	113,285
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value \$0.01; 20,000,000 shares authorized; 11,027,177 and 11,093,958 shares issued and outstanding at December 31, 2015 and September 30, 2016, respectively	110	111
Additional paid-in capital	24,738	32,016
Retained earnings	118,008	141,092
Total stockholders' equity	142,856	173,219
Total liabilities and stockholders' equity	\$ 248,434	\$ 286,504

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



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STRAYER EDUCATION, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2015	2016	2015	2016
Revenues	\$ 99,142	\$ 102,156	\$ 320,777	\$ 321,809
Costs and expenses:				
Instruction and educational support	55,281	56,295	174,223	176,175
Marketing	21,593	25,388	52,944	61,434
Admissions advisory	4,089	4,691	12,144	13,171
General and administration	10,925	10,952	33,424	33,211
Total costs and expenses	91,888	97,326	272,735	283,991
Income from operations	7,254	4,830	48,042	37,818
Investment income	44	115	222	327
Interest expense	1,144	161	3,689	481
Income before income taxes	6,154	4,784	44,575	37,664
Provision for income taxes	2,431	1,906	17,593	14,580
Net income	\$ 3,723	\$ 2,878	\$ 26,982	\$ 23,084
Earnings per share:				
Basic	\$ 0.35	\$ 0.27	\$ 2.55	\$ 2.18
Diluted	\$ 0.35	\$ 0.27	\$ 2.52	\$ 2.14
Weighted average shares outstanding:				
Basic	10,593	10,616	10,586	10,608
Diluted	10,736	10,828	10,726	10,803

STRAYER EDUCATION, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

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	For the three months ended September 30,		For the nine months ended September 30,	
	2015	2016	2015	2016
Net income	\$ 3,723	\$ 2,878	\$ 26,982	\$ 23,084
Other comprehensive income:				
Change in fair value of derivative instrument, net of income tax	145	—	(88)	—
Comprehensive income	\$ 3,868	\$ 2,878	\$ 26,894	\$ 23,084

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

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STRAYER EDUCATION, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands, except share data)

	Common Stock Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2014	10,903,341	\$ 109	\$ 14,550	\$ 77,985	\$ 88	\$ 92,732
Tax shortfall associated with stock-based compensation arrangements	—	—	(25)	—	—	(25)
Restricted stock grants, net of forfeitures and conversions	124,924	1	(1)	—	—	—
Stock-based compensation	—	—	7,576	—	—	7,576
Change in fair value of derivative instrument, net of income tax	—	—	—	—	(88)	(88)
Net income	—	—	—	26,982	—	26,982
Balance at September 30, 2015	11,028,265	\$ 110	\$ 22,100	\$ 104,967	\$ —	\$ 127,177
	Common Stock Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2015	11,027,177	\$ 110	\$ 24,738	\$ 118,008	\$ —	\$ 142,856
Tax shortfall associated with stock-based compensation arrangements	—	—	(51)	—	—	(51)
Restricted stock grants, net of forfeitures	66,781	1	(1)	—	—	—
Stock-based compensation	—	—	7,330	—	—	7,330
Net income	—	—	—	23,084	—	23,084
Balance at September 30, 2016	11,093,958	\$ 111	\$ 32,016	\$ 141,092	\$ —	\$ 173,219

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



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STRAYER EDUCATION, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Nine Months Ended September 30,	
	2015	2016
Cash flows from operating activities:		
Net income	\$ 26,982	\$ 23,084
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of gain on sale of assets	(210)	(211)
Amortization of deferred rent	(417)	(919)
Amortization of deferred financing costs	1,163	197
Depreciation and amortization	13,711	13,276
Deferred income taxes	(3,358)	(5,543)
Stock-based compensation	7,576	7,330
Changes in assets and liabilities:		
Tuition receivable, net	(435)	425
Other current assets	1,402	(3,895)
Other assets	2	(2,264)
Accounts payable and accrued expenses	1,023	2,825
Income taxes payable and income taxes receivable	205	(4,854)
Deferred revenue	8,126	5,940
Other long-term liabilities	(1,299)	(5,284)
Net cash provided by operating activities	54,471	30,107
Cash flows from investing activities:		
Purchases of property and equipment	(9,587)	(7,501)
Cash used in acquisition, net of cash acquired	—	(7,635)
Net cash used in investing activities	(9,587)	(15,136)
Cash flows from financing activities:		
Payments on term loan	(118,750)	—
Payments of contingent consideration	(650)	(1,358)
Payment of deferred financing costs	(850)	—
Net cash used in financing activities	(120,250)	(1,358)
Net increase in cash and cash equivalents	(75,366)	13,613
Cash and cash equivalents — beginning of period	162,283	106,889
Cash and cash equivalents — end of period	\$ 86,917	\$ 120,502
Non-cash transactions:		
Purchases of property and equipment included in accounts payable	\$ 633	\$ 112

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Contingent consideration recorded in connection with an acquisition	\$ —	\$ 8,000
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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STRAYER EDUCATION, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Nature of Operations

Strayer Education, Inc. (the “Company”), a Maryland corporation, conducts its operations through its wholly-owned subsidiaries, Strayer University (the “University”) and New York Code and Design Academy (“NYCDA”). The University is an accredited institution of higher education that provides undergraduate and graduate degrees in various fields of study through physical campuses, predominantly located in the eastern United States, and online. NYCDA is a New York City-based provider of non-degree web and mobile app development courses. NYCDA courses are delivered primarily on-ground to students seeking to further their career in software application development. The Company has only one reporting segment.

2. Significant Accounting Policies

Financial Statement Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. On January 13, 2016, the Company acquired all of the outstanding stock of NYCDA, and the results of NYCDA are included with the Company from the acquisition date. All intercompany accounts and transactions have been eliminated in the consolidated financial statements.

All information as of December 31, 2015 and September 30, 2015 and 2016, and for the three and nine months ended September 30, 2015 and 2016 is unaudited but, in the opinion of management, contains all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the condensed consolidated financial position, results of operations, and cash flows of the Company. Certain amounts in the prior period financial statements have been reclassified to conform to the current period’s presentation. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full fiscal year.

## Revenue Recognition

The Company's educational programs typically are offered on a quarterly basis and such periods coincide with the Company's quarterly financial reporting periods. Approximately 95% of the Company's revenues during the nine months ended September 30, 2016 consisted of tuition revenue, which is recognized in the quarter of instruction. Tuition revenue is assessed for collectibility on a student-by-student basis throughout the quarter of instruction, and is shown net of any refunds, withdrawals, corporate discounts, scholarships and employee tuition discounts. This collectibility assessment considers available sources of funds for the student including Federal Financial Student Aid programs. The Company reassesses the collectibility of tuition revenue that it may earn based on new information and changes in the facts and circumstances relevant to a student's ability to pay, including the timing of a student's withdrawal from a program of study.

At the start of each academic term or program, a liability (deferred revenue) is recorded for academic services to be provided and a tuition receivable is recorded for the portion of the tuition not paid in advance. Any cash received prior to the start of an academic term or program is recorded as deferred revenue. Some students may be eligible for scholarship awards, the estimated value of which will be realized in the future and is deducted from revenue when earned, based on historical student attendance and completion behavior. Deferred revenue is recorded as a current or long-term liability in the consolidated balance sheets based on when the benefit is expected to be realized. Revenues also include textbook-related income, certificate revenue, certain academic fees, licensing revenue, and other income, which are recognized when earned.

The Company's refund policy typically permits students who complete less than half of a course to receive a partial refund of tuition for that course. Refunds reduce the tuition revenue that would have otherwise been recognized for that student. Since the University's academic terms coincide with the Company's financial reporting periods, nearly all refunds are processed and recorded within the same quarter as the corresponding revenue. The amount of tuition revenue refundable to students may vary based on the student's state of residence. Unused books and related academic materials may be returned for a full refund within

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21 days of the start of class; however, purchases of electronic content are not refundable if downloaded. Revenues derived from fees are not eligible for a refund.

## Graduation Fund

In the third quarter of 2013, the Company introduced the Graduation Fund, which allows new undergraduate students to earn tuition credits that are redeemable in the final year of a student's course of study if he or she successfully remains in the program. New students registering in credit-bearing courses in any undergraduate program receive one free course for every three courses that are successfully completed. Students must meet all of the University's admission requirements, and must be enrolled in a bachelor's degree program. The Company's employees and their dependents are not eligible for the program. Students who have more than one consecutive term of non-attendance lose any Graduation Fund credits earned to date, but may earn and accumulate new credits if the student is reinstated or readmitted by the University in the future.

Revenue from students participating in the Graduation Fund is recorded in accordance with the Revenue Recognition Topic, ASC 605-50. The Company defers the value of benefits estimated to be redeemed in the future based on the underlying revenue transactions that result in progress by the student toward earning the benefit. The Company's estimate of the benefits that will be redeemed in the future is based on its historical experience of student persistence toward completion of a course of study within this program and similar programs. Each quarter, the Company assesses its methodologies and assumptions underlying these estimates and, to date, any adjustments to the estimates have not been material. The amount estimated to be redeemed in the next twelve months is \$12.7 million and is included in deferred revenue as a current liability in the unaudited condensed consolidated balance sheets.

The table below presents activity in the Graduation Fund for the nine months ended September 30, 2015 and 2016 (in thousands):

	September 30, 2015	September 30, 2016
Balance at beginning of period	\$ 9,706	\$ 20,937
Revenue deferred	12,423	17,799
Benefit redeemed	(3,974)	(12,185)
Balance at end of period	\$ 18,155	\$ 26,551

## Restricted Cash

A significant portion of the Company's revenues are funded by various federal and state government programs. The Company generally does not receive funds from these programs prior to the start of the corresponding academic term. The Company may be required to return certain funds for students who withdraw from the University during the academic term. There were no amounts payable for these obligations at September 30, 2016 or December 31, 2015.

As part of commencing operations in Pennsylvania in 2003, the Company was required to maintain a "minimum protective endowment" of at least \$0.5 million in an interest-bearing account. These funds are required as long as the Company operates its campuses in the state. The Company holds these funds in an interest-bearing account which is included in other assets.

#### Tuition Receivable and Allowance for Doubtful Accounts

The Company records tuition receivable and deferred revenue for its students upon the start of the academic term or program. Therefore, at the end of the quarter (and academic term), tuition receivable represents amounts due from students for educational services already provided and deferred revenue generally represents advance payments from students for academic services to be provided in the future. Tuition receivables are not collateralized; however, credit risk is minimized as a result of the diverse nature of the University's student base. An allowance for doubtful accounts is established primarily based upon historical collection rates by age of receivable, net of estimated recoveries. These collection rates incorporate historical performance based on a student's current enrollment status and likelihood of future enrollment. The Company periodically assesses its methodologies for estimating bad debts in consideration of actual experience.



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The Company's tuition receivable and allowance for doubtful accounts were as follows as of December 31, 2015 and September 30, 2016 (in thousands):

	December 31, 2015	September 30, 2016
Tuition receivable	\$ 28,543	\$ 28,719
Allowance for doubtful accounts	(10,024)	(9,794)
Tuition receivable, net	\$ 18,519	\$ 18,925

Approximately \$2.0 million of tuition receivable is included in other assets as of both December 31, 2015 and September 30, 2016, because these amounts are expected to be collected after 12 months.

The following table illustrates changes in the Company's allowance for doubtful accounts for the three and nine months ended September 30, 2015 and 2016 (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2015	2016	2015	2016
Allowance for doubtful accounts, beginning of period	\$ 8,733	\$ 9,981	\$ 8,835	\$ 10,024
Additions charged to expense	2,293	3,865	9,315	11,069
Write-offs, net of recoveries	(1,250)	(4,052)	(8,374)	(11,299)
Allowance for doubtful accounts, end of period	\$ 9,776	\$ 9,794	\$ 9,776	\$ 9,794

## Fair Value

The Fair Value Measurement Topic, ASC 820-10 ("ASC 820-10"), establishes a framework for measuring fair value, establishes a fair value hierarchy based upon the observability of inputs used to measure fair value, and expands disclosures about fair value measurements. Assets and liabilities are classified in their entirety within the fair value hierarchy based on the lowest level input that is significant to the fair value measurement. Under ASC 820-10, fair value of an investment is the price that would be received to sell an asset or to transfer a liability to an entity in an orderly transaction between market participants at the measurement date. The hierarchy gives the highest priority to assets and liabilities with readily available quoted prices in an active market and lowest priority to unobservable inputs which require a higher degree of judgment when measuring fair value, as follows:

- Level 1 assets or liabilities use quoted prices in active markets for identical assets or liabilities as of the measurement date;
- Level 2 assets or liabilities use observable inputs, other than quoted market prices, that are either directly or indirectly observable in the marketplace for identical or similar assets and liabilities; and
- Level 3 assets or liabilities use unobservable inputs that are supported by little or no market activity.

The Company's assets and liabilities that are subject to fair value measurement are categorized in one of the three levels above. Fair values are based on the inputs available at the measurement dates, and may rely on certain assumptions that may affect the valuation of fair value for certain assets or liabilities.

#### Goodwill and Indefinite-Lived Intangible Assets

Goodwill represents the excess of the purchase price of an acquired business over the amount assigned to the assets acquired and liabilities assumed. Indefinite-lived intangible assets, which include trade names, are recorded at fair market value on their acquisition date. An indefinite life was assigned to the trade names because they have the continued ability to generate cash flows indefinitely.

Goodwill and the indefinite-lived intangible assets are assessed at least annually for impairment during the three-month period ending September 30, or more frequently if events occur or circumstances change between annual tests that would more likely than not reduce the fair value of the respective reporting unit below its carrying amount. Under Accounting Standards Update No. 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment, the Company is permitted, but not required, to first assess qualitative factors to determine whether it is necessary to perform the more thorough quantitative goodwill

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impairment test. Following its qualitative assessment, the Company determined it was not more likely than not that the fair value of its goodwill was less than the carrying amount and, accordingly, no impairment existed at September 30, 2016.

### Accounting for Derivative Instruments and Hedging Activities

On the date that the Company enters into a derivative contract, it designates the derivative as a hedge of (a) a forecasted transaction or (b) the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). All derivatives are recognized in the balance sheet at their fair value.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded, net of income tax, in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction (e.g., until periodic settlements of a variable-rate asset or liability are recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) is recorded in current-period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. The Company also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, the Company discontinues hedge accounting prospectively.

### Authorized Stock

The Company has authorized 20,000,000 shares of common stock, par value \$.01, of which 11,027,177 and 11,093,958 shares were issued and outstanding as of December 31, 2015 and September 30, 2016, respectively. The Company also has authorized 8,000,000 shares of preferred stock, none of which has been issued or outstanding since 2004. Before any preferred stock may be issued in the future, the Board of Directors would need to establish the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, and the terms or conditions of the redemption of the preferred stock.

### Stock-Based Compensation

As required by the Stock Compensation Topic, ASC 718, the Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors, including employee stock options, restricted stock, restricted stock units, and employee stock purchases related to the Company's Employee Stock Purchase Plan, based on estimated fair values. Stock-based compensation expense recognized in the unaudited consolidated statements of income for each of the three and nine months ended September 30, 2015 and 2016 is based on awards ultimately expected to vest and, therefore, has been adjusted for estimated forfeitures. The Company estimates forfeitures at the time of grant and revises the estimate, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The forfeiture rate used is based on historical experience. The Company also assesses the likelihood that performance criteria associated with performance-based awards will be met. If it is determined that it is more likely than not that performance criteria will not be achieved, the Company revises its estimate of the number of shares it believes will ultimately vest.

#### Net Income Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the periods. Diluted earnings per share reflects the potential dilution that could occur assuming conversion or exercise of all dilutive unexercised stock options, restricted stock and restricted stock units. The dilutive effect of stock awards was determined using the treasury stock method. Under the treasury stock method, all of the following are assumed to be used to repurchase shares of the Company's common stock: (1) the proceeds received from the exercise of stock options, (2) the amount of compensation cost associated with the stock awards for future service not yet recognized by the Company, and (3) the amount of tax benefits that would be recorded in additional paid-in capital when the stock awards become deductible for income tax purposes. Stock options are not included in the computation of diluted earnings per share when the stock option exercise price of an individual grant exceeds the average market price for the period.

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Set forth below is a reconciliation of shares used to calculate basic and diluted earnings per share for the three and nine months ended September 30, 2015 and 2016 (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2015	2016	2015	2016
Weighted average shares outstanding used to compute basic earnings per share	10,593	10,616	10,586	10,608
Incremental shares issuable upon the assumed exercise of stock options	—	—	—	—
Unvested restricted stock	143	212	140	195
Shares used to compute diluted earnings per share	10,736	10,828	10,726	10,803

## Income Taxes

The Company provides for deferred income taxes based on temporary differences between financial statement and income tax bases of assets and liabilities using enacted tax rates in effect in the year in which the differences are expected to reverse.

The Income Taxes Topic, ASC 740, requires the company to determine whether uncertain tax positions should be recognized within the Company's financial statements. The Company recognizes interest and penalties, if any, related to uncertain tax positions in income tax expense. Uncertain tax positions are recognized when a tax position, based solely on its technical merits, is determined to be more likely than not to be sustained upon examination. Upon determination, uncertain tax positions are measured to determine the amount of benefit that is greater than 50% likely to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. A tax position is derecognized if it no longer meets the more likely than not threshold of being sustained.

The tax years 2013-2015 remain open for Federal tax examination and the tax years 2012-2015 remain open to examination by state and local taxing jurisdictions in which the Company is subject.

## Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the period reported.

The most significant management estimates included allowances for doubtful accounts, the useful lives of property and equipment, fair value of future contractual operating lease obligations, potential sublease income and vacancy periods, accrued expenses, forfeiture rates and the likelihood of achieving performance criteria for stock-based awards, value of free courses earned by students that will be redeemed in the future, valuation of goodwill, intangible assets and the interest rate swap arrangement, fair value of contingent consideration, and the provision for income taxes. Actual results could differ from those estimates.

#### Recent Accounting Pronouncements

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes (“ASU 2015-17”). The new guidance requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The Company adopted ASU 2015-17 effective January 1, 2016 and reclassified approximately \$6.4 million of its deferred tax asset from current to non-current assets in the condensed consolidated balance sheet as of December 31, 2015, to conform to the current period presentation.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”). The new guidance requires the recognition of right-of-use assets and lease liabilities on the balance sheet for most leases. Under current guidance, operating leases are off-balance sheet. ASU 2016-02 also requires more extensive quantitative and qualitative disclosures about leasing arrangements. ASU 2016-02 applies to fiscal periods beginning after December 15, 2018, using the modified retrospective method, with early adoption permitted. The Company anticipates that the impact of ASU 2016-02 on its consolidated balance sheet will be material as the Company will record significant asset and liability balances in connection with its leased properties.

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”). ASU 2016-09 impacts several aspects of the accounting for share-based payment transactions, including classification of certain items on the consolidated statement of cash flows and accounting for income taxes. Specifically, ASU 2016-09 requires excess tax benefits and tax deficiencies to be recognized as

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income tax expense or benefit in earnings, which could introduce significant volatility to the Company's provision for income taxes. In addition, ASU 2016-09 allows companies to recognize the impact of stock award forfeitures at the time of forfeiture, rather than as an estimate ratably over the life of awards. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The transition method varies for each of the areas in ASU 2016-09. The Company does not plan to early adopt and is currently evaluating the impact of ASU 2016-09 on its Consolidated Financial Statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). The standard establishes a new 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. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU 2014-09 by one year to fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted for fiscal years, and interim periods within those years, beginning after December 15, 2016. Accordingly, the new revenue recognition standard is effective for the Company on January 1, 2018 using either a full retrospective or a modified retrospective approach. The Company is currently evaluating which transition approach to use and the impact that the new revenue recognition standard will have on our Consolidated Financial Statements.

There have been three new ASUs issued amending certain aspects of ASU 2014-09. ASU No. 2016-08 Principal versus Agent Considerations (Reporting Revenue Gross Versus Net), was issued in March, 2016 to clarify certain aspects of the principal versus agent guidance in ASU 2014-09. In addition, ASU No. 2016-10, Identifying Performance Obligations and Licensing, issued in April 2016, amends other sections of ASU 2014-09 including clarifying guidance related to identifying performance obligations and licensing implementation. ASU No. 2016-12, Revenue from Contracts with Customers – Narrow Scope Improvements and Practical Expedients, was issued in May 2016 and provides amendments and practical expedients to the guidance in ASU 2014-09 in the areas of assessing collectibility, presentation of sales taxes received from customers, noncash consideration, contract modification and clarification of using the full retrospective approach to adopt ASU 2014-09. With its evaluation of the impact of ASU 2014-09, the Company will also consider the impact related to the updated guidance provided by these three new ASUs.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses, which is included in ASC Topic 326, Measurement of Credit Losses on Financial Instruments. The new guidance revises the accounting requirements related to the measurement of credit losses and will require organizations to measure all expected credit losses for financial assets based on historical experience, current conditions and reasonable and supportable forecasts about collectibility. Assets must be presented in the financial statements at the net amount expected to be collected. The guidance will be effective for the Company's annual and interim reporting periods beginning January 1, 2020, with early adoption permitted. The Company is evaluating the impact this standard will have on its financial condition, results of operations, and disclosures.

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, which is included in FASB Accounting

Standards Codification (ASC) Topic 230, Statement of Cash Flows. The new guidance clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows, including contingent consideration payments made after a business acquisition. Specifically, cash payments to settle a contingent consideration liability which are not made soon after the acquisition date should be classified as cash used in financing activities up to the initial amount of contingent consideration recognized with the remaining amount classified as cash flows from operating activities. The guidance will be effective for the Company's annual and interim reporting periods beginning January 1, 2018, and early adoption is permitted. The Company does not expect adoption of this guidance to have a material impact on its financial condition, results of operations, or disclosures.

Other ASUs issued by the FASB but not yet effective are not expected to have a material effect on the Company's Consolidated Financial Statements.

### 3. Acquisition of New York Code and Design Academy

On January 13, 2016, the Company acquired all of the outstanding stock of New York Code and Design Academy, Inc. ("NYCDA"), a provider of non-degree information technology curriculum primarily based in the New York City area (the "Acquisition"). The Acquisition supports the Company's strategy to complement its traditional degree offerings with a broader platform of educational services. The Company incurred transaction costs of approximately \$0.2 million, and these costs are included in general and administrative costs in the unaudited consolidated statements of income. The acquisition is accounted for as a business combination.



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The purchase price includes \$2.4 million paid up front in cash, plus contingent cash payments of (a) up to \$12.5 million payable based on NYCDA's results of operations over a five-year period (the "Earnout"), and (b) \$5.5 million payable based on NYCDA's receipt of state regulatory permits. Pursuant to the Acquisition, \$1.0 million of the Earnout may be accelerated upon receipt of one of the state regulatory permits. In April 2016 and August 2016, NYCDA received the state regulatory permits and the Company paid \$6.0 and \$0.5 million of contingent consideration to the sellers, respectively.

In addition, the Company paid a total of \$4.6 million to two of NYCDA's founders who are required to remain employed for at least three years from the acquisition date. If either of them terminates employment voluntarily, or is terminated for cause (as defined), he is required to reimburse the Company his respective portion of the retention amount. This amount is classified as prepaid compensation and is amortized to compensation expense over three years.

Total potential cash payments for the acquisition and the Earnout could total \$25.0 million.

The Company determined the preliminary fair values of the assets acquired and liabilities assumed at the date of the Acquisition. The allocation of the purchase price is based on preliminary estimates and assumptions, and is subject to revision based on final analyses that support the underlying estimates, which will be completed within the measurement period of up to 12 months from the date of the Acquisition. Accordingly, the allocation is subject to change and the impact of such changes could be material. During the second quarter of 2016, there was a measurement period adjustment to goodwill and deferred tax liabilities of \$0.2 million.

The allocation of the purchase price, including the measurement period adjustment recorded in the second quarter of 2016, is as follows:

	Purchase Price Allocation	Useful Life
Cash	\$ 790	
Other assets	1,265	
Intangibles:		
Trade name	5,660	Indefinite
Goodwill	13,993	
Liabilities assumed	(4,783)	
Total assets acquired and liabilities assumed, net	16,925	
Less: contingent consideration	(14,500)	

Less: cash acquired	(790)
Cash paid for acquisition, net of cash acquired	\$ 1,635

The fair value of the contingent consideration was measured by applying a probability weighted discounted cash flow model based on significant inputs not observable in the market (Level 3 inputs). Key assumptions include a discount rate of 4.5% and expected future value of payments of \$12.5 million, based on management's assessment that NYCDA will achieve its performance targets after the five-year measurement period. The fair value of assets acquired and liabilities assumed was determined based on assumptions that reasonable market participants would use while employing the concept of highest and best use of the respective items. The following assumptions were used, the majority of which include significant unobservable inputs (Level 3), and valuation methodologies to determine fair value:

- Intangibles – Income approaches were used to value the substantial majority of the acquired intangibles. The trade name was valued using the relief from-royalty method, which represents the benefit of owning these intangible assets rather than paying royalties for their use.
- Other assets and liabilities – The carrying value of all other assets and liabilities approximated fair value at the time of acquisition.

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## 4. Restructuring and Related Charges

In October 2013, the Company implemented a restructuring to better align the Company's resources with student enrollments at the time. This restructuring included the closing of 20 physical locations and reductions in the number of campus-based and corporate employees. A liability for lease obligations, some of which continue through 2022, was recorded and is measured at fair value using a discounted cash flow approach encompassing significant unobservable inputs (Level 3). The estimation of future cash flows includes non-cancelable contractual lease costs over the remaining terms of the leases discounted at the Company's marginal borrowing rate of 4.5%, partially offset by estimated future sublease rental income discounted at credit-adjusted rates. The Company's estimates, which involve significant judgment, also consider the amount and timing of sublease rental income based on subleases that have been executed and subleases expected to be executed based on current commercial real estate market data and conditions, and other qualitative factors specific to the facilities. The estimates are subject to adjustment as market conditions change or as new information becomes available, including the execution of additional sublease agreements.

The following details the changes in the Company's restructuring liability for lease and related costs during the nine months ended September 30, 2015 and 2016 (in thousands):

	September 30, 2015	September 30, 2016
Balance at beginning of period(1)	\$ 27,283	\$ 20,055
Adjustments(2)	265	(1,695)
Payments	(5,040)	(4,434)
Balance at end of period(1)	\$ 22,508	\$ 13,926

(1) The current portion of restructuring liabilities was \$4.8 million and \$5.0 million as of December 31, 2015 and September 30, 2016, respectively, which are included in accounts payable and accrued expenses. The long-term portion is included in other long-term liabilities.

(2) Adjustments include accretion of interest on lease costs, partially offset by changes in the timing and expected income from sublease agreements.

## 5. Fair Value Measurement

Assets and liabilities measured at fair value on a recurring basis consist of the following as of September 30, 2016 (in thousands):

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		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	September 30, 2016			
<b>Assets:</b>				
Money market funds	\$ 10,108	\$ 10,108	\$ —	\$ —
<b>Liabilities:</b>				
Deferred payments	\$ 12,340	\$ —	\$ —	\$ 12,340

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Assets and liabilities measured at fair value on a recurring basis consist of the following as of December 31, 2015 (in thousands):

		Fair Value Measurements at Reporting Date Using		
		Quoted Prices in	Significant	Significant
		Active Markets	Other	Unobservable
		for Identical	Observable	Inputs
	December 31,	Assets/Liabilities	Inputs	(Level 3)
	2015	(Level 1)	(Level 2)	
Assets:				
Money market funds	\$ 100	\$ 100	\$ —	\$ —
Liabilities:				
Deferred payments	\$ 3,278	\$ —	\$ —	\$ 3,278

The Company measures the above items on a recurring basis at fair value as follows:

- Money market funds – Classified in Level 1 is excess cash the Company holds in both taxable and tax-exempt money market funds and are included in cash and cash equivalents in the accompanying unaudited condensed consolidated balance sheets. The Company records any net unrealized gains and losses for changes in fair value as a component of Accumulated other comprehensive income in stockholders' equity. The Company's cash and cash equivalents held at December 31, 2015 and September 30, 2016, approximate fair value and are not disclosed in the above tables because of the short-term nature of the financial instruments.
- Deferred payments – The Company acquired certain assets and entered into deferred payment arrangements with the sellers in transactions in 2011 and January 2016, which are classified within Level 3 as there is no liquid market for similarly priced instruments. The deferred payments are valued using a discounted cash flow model that encompasses significant unobservable inputs to estimate the operating results of the acquired assets. The assumptions used to prepare the discounted cash flows include estimates for interest rates, enrollment growth, retention rates, obtaining regulatory approvals for expansion into new markets, and pricing strategies. These assumptions are subject to change as the underlying data sources evolve and the programs mature. The short-term portion of deferred payments was \$1.1 million as of September 30, 2016 and is included in accounts payable and accrued expense.

The Company's lease loss liability incorporates an assessment of current sublease market conditions and uses Level 3 inputs, but is not deemed a fair value liability as the future lease payments are required to be discounted using the Company's incremental borrowing rate at the date of lease abandonment without subsequent adjustment. See Note 4 for further discussion of the Company's lease loss liability.

The Company did not change its valuation techniques associated with recurring fair value measurements from prior periods, and no assets or liabilities were transferred between levels of the fair value hierarchy during the nine months ended September 30, 2015 or 2016.

Changes in the fair value of the Company's Level 3 liabilities during the nine months ended September 30, 2016 are as follows (in thousands):

	Deferred
	Payments
Balance at December 31, 2015	\$ 3,278
Amounts paid	(7,358)
Contingent consideration in connection with NYCDA acquisition	14,500
Other adjustments to fair value	1,920
Balance at September 30, 2016	\$ 12,340

#### 6. Long Term Debt

On July 2, 2015, the Company entered into an amended credit facility (the "Amended Credit Facility") which provides for a revolving line of credit (the "Revolver") up to \$150 million and provides the Company with an option, under certain conditions, to increase the commitments under the Revolver or establish one or more incremental term loans in an amount up to \$50 million in the aggregate in the future. The maturity date of the Amended Credit Facility is July 2, 2020. The Amended Credit Facility

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replaced the Company's prior credit agreement (the "Prior Credit Agreement"), dated November 8, 2012, which had provided for both a term loan and revolving line of credit and an original maturity date of December 31, 2016. All amounts outstanding under the Prior Credit Agreement were repaid upon execution of the Amended Credit Facility. The Company paid approximately \$0.9 million in debt financing costs associated with the Amended Credit Facility.

Borrowings under the Revolver will bear interest at a per annum rate equal to, at the Company's election, LIBOR or a base rate, plus a margin ranging from 1.75% to 2.25% depending on the Company's leverage ratio. The Company also is subject to a quarterly unused commitment fee ranging from 0.25% to 0.35% per annum, depending on the Company's leverage ratio, times the daily unused amount under the Revolver.

All other remaining terms of the Prior Credit Agreement remain in full force and effect. The Amended Credit Facility is guaranteed by the University and is secured by substantially all of the personal property and assets of the Company and its subsidiaries. The Amended Credit Facility contains customary affirmative and negative covenants, representations, warranties, events of default and remedies upon default, including acceleration and rights to foreclose on the collateral securing the Amended Credit Facility. In addition, as with the Prior Credit Agreement, the Amended Credit Facility requires that the Company satisfy certain financial maintenance covenants, including:

- A leverage ratio of not greater than 2 to 1. Leverage ratio is defined as the ratio of total debt to trailing four-quarter EBITDA (earnings before interest, taxes, depreciation, amortization and non-cash charges such as stock-based compensation).
- A coverage ratio of not less than 1.75 to 1. Coverage ratio is defined as the ratio of trailing four-quarter EBITDA and rent expense to trailing four-quarter interest and rent expense.
- A Department of Education Financial Responsibility Composite Score of not less than 1.5.

The Company was in compliance with all the terms of the Amended Credit Facility as of September 30, 2016.

During the three and nine months ended September 30, 2016, the Company paid cash interest of \$0.2 million and \$0.3 million, respectively, compared to \$0.1 million and \$2.3 million during the three and nine months ended September 30, 2015, respectively. The Company had no balance outstanding under the Revolver as of September 30, 2016.

7. Stock Options, Restricted Stock and Restricted Stock Units

On May 5, 2015, the Company's shareholders approved the Strayer Education, Inc. 2015 Equity Compensation Plan (the "2015 Plan"), which provides for the granting of restricted stock, restricted stock units, stock options intended to qualify as incentive stock options, options that do not qualify as incentive stock options, and other forms of equity compensation and performance-based awards to employees, officers and directors of the Company, or to a consultant or advisor to the Company, at the discretion of the Board of Directors. Vesting provisions are at the discretion of the Board of Directors. Options may be granted at option prices based at or above the fair market value of the shares at the date of grant. The maximum term of the awards granted under the 2015 Plan is ten years. The number of shares of common stock reserved for issuance under the 2015 Plan is 500,000 authorized but unissued shares, plus the number of shares available for grant under the Company's previously existing equity compensation plans at the time of stockholder approval of the 2015 Plan, and plus the number of shares which may in the future become available under any previously existing equity compensation plan due to forfeitures of outstanding awards.

In February 2016, the Company's Board of Directors approved grants of 176,802 shares of restricted stock and restricted stock units to certain employees. These shares, which vest over a two to four year period, were granted pursuant to the 2015 Plan. The Company's stock price closed at \$50.67 on the date of these restricted stock grants.

In May 2016, the Company's Board of Directors approved grants of 11,365 shares of restricted stock. These shares, which vest annually over a three-year period, were awarded to non-employee members of the Company's Board of Directors, as part of the Company's annual director compensation program and the 2015 Plan. The Company's stock price closed at \$49.27 on the date of these restricted stock grants.

Dividends paid on unvested restricted stock are reimbursed to the Company if the recipient forfeits his or her shares as a result of termination of employment prior to vesting in the award, unless waived by the Board of Directors.



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## Restricted Stock and Restricted Stock Units

The table below sets forth the restricted stock and restricted stock units activity for the nine months ended September 30, 2016:

	Number of	Weighted-
	shares or units	average
		Grant price
Balance, December 31, 2015	634,327	\$ 104.66
Grants	188,167	50.59
Vested shares	(23,539)	50.43
Forfeitures	(71,386)	61.64
Balance, September 30, 2016	727,569	\$ 97.58

## Stock Options

The table below sets forth the stock option activity and other stock option information as of and for the nine months ended September 30, 2016:

	Number of	Weighted-	Weighted-	Aggregate
	shares	average	remaining	intrinsic value(1)
		exercise price	contractual	(in thousands)
			life (years)	
Balance, December 31, 2015	100,000	\$ 51.95	5.1	\$ 817
Grants	—	—		
Exercises	—	—		
Forfeitures/Expirations	—	—		
Balance, September 30, 2016	100,000	\$ 51.95	4.3	\$ —
Exercisable, September 30, 2016	100,000	\$ 51.95	4.3	\$ —

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

Valuation and Expense Information under Stock Compensation Topic ASC 718

At September 30, 2016, total stock-based compensation cost which has not yet been recognized was \$23.6 million for unvested restricted stock, restricted stock units, and stock option awards. This cost is expected to be recognized over the next 28 months on a weighted-average basis. Awards of approximately 550,000 shares of restricted stock and restricted stock units are subject to performance conditions. The accrual for stock-based compensation for performance awards is based on the Company's estimates that such performance criteria are probable of being achieved over the respective vesting periods. Such a determination involves significant judgment surrounding the Company's ability to maintain regulatory compliance. If the performance targets are not reached during the respective vesting period, or it is determined it is more likely than not that the performance criteria will not be achieved, related compensation expense is adjusted.

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The following table sets forth the amount of stock-based compensation expense recorded in each of the expense line items for the three and nine months ended September 30, 2015 and 2016 (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2015	2016	2015	2016
Instruction and educational support	\$ 619	\$ 522	\$ 1,532	\$ 678
Marketing	—	—	—	—
Admissions advisory	—	—	—	—
General and administration	2,034	1,882	6,044	6,652
Stock-based compensation expense included in operating expense	2,653	2,404	7,576	7,330
Tax benefit	1,048	957	2,990	2,857
Stock-based compensation expense, net of tax	\$ 1,605	\$ 1,447	\$ 4,586	\$ 4,473

During the nine months ended September 30, 2015 and 2016, the Company recognized a tax shortfall related to share-based payment arrangements of approximately \$25,000 and \$51,000, respectively. No stock options were exercised during the nine months ended September 30, 2015 or 2016.

## 8. Other Long-Term Liabilities

Other long-term liabilities consist of the following (in thousands):

	December 31, 2015	September 30, 2016
Deferred payments related to acquisitions	\$ 6,078	\$ 14,353
Deferred revenue, net of current portion	14,429	16,961
Loss on facilities not in use	15,229	8,891
Deferred rent and other facility costs	8,993	8,601
Lease incentives	3,125	2,825
Deferred gain on sale of campus building	133	—
	\$ 47,987	\$ 51,631

## Deferred Payments Related to Acquisitions

In the first quarter of 2016, the Company acquired NYCDA and entered into deferred payment arrangements with the sellers in connection with this transaction. In April and August 2016, NYCDA achieved certain performance targets and the Company subsequently paid \$6.0 million and \$0.5 million of deferred payments to the sellers, respectively. The deferred payment arrangements of up to \$11.5 million are valued at approximately \$8.7 million as of September 30, 2016. See Note 3 for further information on the NYCDA deferred payments.

In 2011, the Company acquired certain assets and entered into deferred payment arrangements with the sellers in connection with that acquisition. The deferred payment arrangements are valued at approximately \$3.3 million and \$2.9 million as of December 31, 2015 and September 30, 2016, respectively. In addition, one of the sellers contributed \$2.8 million to the Company representing the seller's continuing interest in the assets acquired.

#### Deferred Revenue

The Company provides for certain scholarship and awards programs, such as the Graduation Fund (see Note 2 for additional information), that are earned by students when they successfully complete course requirements. The Company also has licensed certain of its non-credit bearing course content to a third party. Included in long-term deferred revenue is the amount of revenue under these arrangements that the Company expects will be realized after one year.

#### Loss on Facilities Not in Use and Deferred Rent and Other Facility Costs

The Company records a liability for lease costs of campuses and non-campus facilities that are not currently in use (see Note 4). For facilities still in use, the Company records rent expense on a straight-line basis over the initial term of a lease. The difference between the rent payment and the straight-line rent expense is recorded as a liability.

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### Lease Incentives

In conjunction with the opening of new campuses or renovating existing ones, the Company, in some instances, was reimbursed by the lessors for improvements made to the leased properties. In accordance with ASC 840-20, the underlying assets were capitalized as leasehold improvements and a liability was established for the reimbursements. The leasehold improvements and the liability are amortized on a straight-line basis over the corresponding lease terms, which generally range from five to 10 years.

### Deferred Gain on Sale of Campus Building

In June 2007, the Company sold one of its campus buildings for \$5.8 million. The Company is leasing back most of the campus building over a 10-year period. In conjunction with this sale and lease back transaction, the Company realized a gain of \$2.8 million before tax, which is deferred and recognized over the 10-year lease term.

## 9. Income Taxes

The Company had \$0.2 million of unrecognized tax benefits at September 30, 2016, all of which resulted from tax positions taken prior to the year ended December 31, 2015. The Company recognized approximately \$0.3 million of benefits in the nine months ended September 30, 2016. The Company also recorded approximately \$0.1 million of expense in the nine months ended September 30, 2016, related to interest and penalties.

It is reasonably possible that approximately \$0.1 million of unrecognized tax benefits will be reduced in the next twelve months due to expiration of the applicable statutes of limitations, which would favorably affect the Company's effective tax rate if recognized. If amounts accrued are less than amounts ultimately assessed by taxing authorities, the Company would record additional income tax expense. The Company does not anticipate significant changes to other unrecognized tax benefits.

The Company paid \$21.0 million and \$25.0 million in income taxes during the nine months ended September 30, 2015 and 2016, respectively.

## 10. Litigation

From time to time, the Company is involved in litigation and other legal proceedings arising out of the ordinary course of its business. There are no pending material legal proceedings to which the Company or its property are subject.

## 11. Regulation

The Company, the University, and NYCDA are subject to significant state and regulatory oversight, as well as federal oversight in the case of the Company and the University.

### Gainful Employment

The Department of Education (the “Department”) previously attempted to define “an eligible program of training to prepare students for gainful employment in a recognized occupation.” After a federal court invalidated the Department’s regulation, the Department established a negotiated rulemaking committee to consider the issue of gainful employment. The negotiations did not result in consensus. On March 25, 2014, the Department issued a Notice of Proposed Rulemaking for public comment, and on October 31, 2014, the Department published the final regulation which became effective on July 1, 2015.

The new requirements, which are applicable to the University but not NYCDA, include two debt-to-earnings measures, consisting of an annual earnings rate and a discretionary income rate. The annual earnings rate is calculated by comparing (1) the annual loan payment required on the median student loan debt incurred by students receiving Title IV funds who completed a particular program and (2) the higher of the mean or median of those graduates’ annual earnings two to four years after graduation. The discretionary income rate is calculated by comparing (1) the annual loan payment required on the median student loan debt incurred by students receiving Title IV funds who completed a particular program and (2) the higher of the mean or median annual earnings of those graduates two to four years after graduation, less 1.5 times the government issued Poverty Guideline. Under the new gainful employment regulation, a program would pass if:

- the annual loan payment required on the median student loan debt is less than or equal to 8% of the higher of the mean or median annual earnings of graduates in the relevant period; or

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- the annual loan payment required on the median student loan debt is less than or equal to 20% of the discretionary income of graduates in the relevant period.

In addition, a program that does not pass either of the debt-to-earnings metrics, and that has an annual earnings rate between 8% and 12%, or a discretionary income rate between 20% and 30%, would be considered to be in the “Zone”. A program would fail if the program’s graduates have an annual earnings rate of 12% or greater and a discretionary income rate of 30% or greater. A program would become Title IV-ineligible for three years if it fails both metrics for two out of three consecutive years, or is in the Zone (or fails) for four consecutive award years. If an institution is notified by the Secretary of Education that a program could become ineligible, based on its final rates, for the next award year:

- The institution must provide a warning with respect to the program to students and prospective students indicating, among other things, that students may not be able to use Title IV funds to attend or continue in the program; and
- The institution must not enroll, register or enter into a financial commitment with a prospective student until a specified time after providing the warning to the prospective student.

On October 20, 2016, the Department issued to institutions draft debt-to-earnings rates for the first gainful employment debt measurement year and certain underlying data used to calculate those rates. According to the Department’s draft rates, none of the University’s programs fail. The draft rates did indicate that two current associate’s degree programs are in the Zone. The Company is currently analyzing the underlying data provided, and has until December 7, 2016, to appeal any inaccuracies it finds in the draft metrics. The Department has indicated that the final rates will be made public in January of 2017.

The new regulation also requires institutions to report student and program level data to the Department, and comply with additional disclosure requirements beginning in January 2017.

In addition, the gainful employment regulation required institutions to certify by December 31, 2015, among other things, that each eligible gainful employment program is programmatically accredited if required by a federal governmental entity or a state governmental entity in the state in which it is located or is otherwise required to obtain state approval, and that each eligible program satisfies the applicable educational prerequisites for professional licensure or certification requirements in each state in which it is located or is otherwise required to obtain state approval, so that a student who completes the program and seeks employment in that state qualifies to take any licensure or certification exam that is needed for the student to practice or find employment in an occupation that the program prepares students to enter. The Company timely made the required certification.

The requirements associated with the gainful employment regulations may substantially increase the Company’s administrative burdens and could affect student enrollment, persistence and retention. Further, although the regulations provide opportunities for an institution to correct any potential deficiencies in a program prior to the loss of Title IV eligibility, the continuing eligibility of the University’s academic programs will be affected by factors beyond management’s control such as changes in the University’s graduates’ income levels, changes in student borrowing levels, increases in interest rates, changes in the percentage of former students who are current in the

repayment of their student loans, and various other factors. Even if the Company were able to correct any deficiency in the gainful employment metrics in a timely manner, the disclosure requirements associated with a program's failure to meet at least one metric may adversely affect student enrollments in that program and may adversely affect the reputation of the University.

#### Borrower Defenses to Repayment

The Department's current regulations permit a Federal Direct Loan borrower to obtain a loan discharge if the institution's acts or omissions give rise to a cause of action against the institution under state law. The regulations do not address the applicable process. In January 2016, the Department of Education convened a negotiated rulemaking committee to discuss the processes and standards for the discharge of Federal Direct Loans, commonly known as defenses to repayment, and other issues. The committee failed to reach consensus. In June 2016, the Department issued a Notice of Proposed Rulemaking to establish a new federal standard and processes for determining whether a borrower has a defense to repayment and a right to recover amounts previously paid to the Department on Federal Direct Loans based on an act or omission of a school. While Federal Direct Loans disbursed prior to July 1, 2017 would remain subject to the current rule, the proposed regulations would provide three categories of borrower defenses that could be asserted by students with Federal Direct Loans disbursed on or after July 1, 2017, including:

- the institution has had a judgment issued against it in an action brought by a student or a government official or entity, related to the loan or educational services, in a contested proceeding;



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- the institution failed to perform its obligations under the terms of a contract with the student; or
- the institution made a “substantial misrepresentation” about the nature of its programs, financial charges or employability of its graduates that the borrower reasonably relied upon on when he or she decided to attend or continue attending the institution.

In addition, the proposed regulation would permit the Department to grant relief to an individual or group of individuals, including individuals who have not applied to the Department seeking relief. In most cases, the proposed regulation would entitle the Department to seek reimbursement from the institution for any loans discharged under the new procedure.

The proposed regulation would also specify triggering events that would automatically lead to a determination that an institution is not able to meet its financial or administrative obligations, to include:

- certain lawsuits and other legal actions, including, among others:
  - o the institution incurring a debt or liability arising from an audit, investigation, or similar action initiated by a state, federal, or other oversight entity, including settlements, that is based on claims related to the making of federal loans or the provision of educational services, for an amount that exceeds the lesser of \$750,000 or 10% of the institution’s current assets;
  - o the commencement of a suit initiated by a state, federal, or other oversight entity based on claims of any kind, where the potential monetary sanctions or damages arising from the suit are in an amount that exceeds 10% of the institution’s current assets;
- a judicial or administrative proceeding, that is not part of a state or federal action, that the institution discloses in a report filed with the SEC;
- payment to the Department of substantial monetary liabilities from claims asserted under borrower defense procedures;
- action by the institution’s accreditor that could result in the loss of accreditation;
- failure of the 90/10 regulation in any given year; and/or

- default by the school on its debt obligations.

In addition, other triggering events could lead to a determination that the institution is not able to meet its financial obligations, if the Secretary of the Department determines that the event is reasonably likely to have a material effect on the institution, as determined in the discretion of the Secretary. If any of the automatic or discretionary triggering events materialize, the institution would be required to post a letter of credit, for each triggering event, in an amount of at least 10% of the school's annual Title IV disbursements, and to provide warnings to prospective and current students that the institution has been required to provide enhanced financial protection to the Department.

Further, the proposed regulation would establish a new metric to measure student loan repayment rates as a ratio of present balance to original principal balance, and proprietary institutions which fall below an established threshold would be required to provide prospective and current students with disclosures regarding the repayment rate.

The Company cannot predict the impact, if any, that these proposed regulations would have if adopted.

The effective date of the proposed regulations, if adopted, cannot be determined at this time, but the proposed regulations could be effective as early as July 1, 2017.

#### State authorization for distance education and foreign locations

Under the Higher Education Act and the Department's implementing regulations, in order to be eligible to participate in Title IV programs, an institution must be legally authorized to offer a program of postsecondary education in the state in which the institution is physically located. The Department previously attempted to regulate the state authorization that an institution

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offering distance education programs must have in order to offer Title IV aid to students enrolled in such programs. After a federal court vacated the Department's regulation on procedural grounds, the Department established a negotiated rulemaking committee to consider state authorization for distance education and foreign locations, among other topics. The negotiations resulted in consensus as to foreign locations, but not as to distance education. In June 2016, the Department issued a Notice of Proposed Rulemaking for public comment.

The proposed regulations, among other things, would require an institution offering distance education or correspondence courses to be authorized by each state in which the institution enrolls students, if such authorization is required by the state, in order to award Title IV aid to such students. An institution could obtain such authorization directly from the state or through a state authorization reciprocity agreement. A state authorization reciprocity agreement would be defined as an agreement between two or more states that authorizes an institution located and legally authorized in a state covered by the agreement to provide postsecondary education through distance education or correspondence courses to students in other states covered by the agreement and does not prohibit a participating state from enforcing its own consumer protection laws. The proposed regulations would also require an institution to document the state process for resolving complaints from students enrolled in programs offered through distance education or correspondence courses for each state in which such students reside.

The proposed regulations would require an institution to provide public and individualized disclosures to enrolled and prospective students regarding its programs offered solely through distance education or correspondence courses. The public disclosures would include state authorization for the program or course, the process for submitting complaints to relevant states, any adverse actions by a state or accrediting agency related to the distance education program or correspondence course within the past five years, refund policies, and applicable licensure or certification requirements for a career a student prepares to enter and the program's sufficiency to meet those requirements. An institution must disclose directly to all prospective students when a distance education or correspondence course does not meet the licensure or certification requirements for a state. An institution must disclose to each enrolled and prospective student when an adverse action is taken against an institution's postsecondary distance education or correspondence program and any determination that a program ceases to meet licensure or certification requirements.

The Company cannot predict the impact, if any, that these proposed regulations would have if adopted. The effective date of the proposed regulations, if adopted, cannot be determined at this time, but the proposed regulations could be effective as early as July 1, 2017.

The Clery Act

Strayer University must comply with the campus safety and security reporting requirements as well as other requirements in the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act (the "Clery Act"), including recent changes made to the Clery Act by the Violence Against Women Reauthorization Act of 2013, which was signed into law on March 7, 2013. On April 1, 2014, a negotiated rulemaking committee reached consensus on proposed regulations, and on October 20, 2014, the Department promulgated regulations implementing

the recent amendments to the Clery Act, effective July 1, 2015. In addition, the Department has interpreted Title IX to categorize sexual violence as a form of prohibited sex discrimination and to require institutions to follow certain disciplinary procedures with respect to such offenses. Failure to comply with the Clery Act or Title IX requirements or regulations thereunder could result in action by the Department to require correction action, fine the Company or limit or suspend its participation in Title IV programs, could lead to litigation, and could harm the Company's reputation. The Company is in compliance with these requirements.

#### Compliance Reviews

Strayer University is subject to announced and unannounced compliance reviews and audits by various external agencies, including the Department, its Office of Inspector General, state licensing agencies, and accrediting agencies. The Department conducted four campus-based program reviews of Strayer University campuses in three states and the District of Columbia during 2014. The reviews covered federal financial aid years 2012-2013 and 2013-2014, and two of the reviews also covered compliance with the Clery Act, the Drug-Free Schools and Communities Act, and regulations related thereto. Strayer University received Final Program Review Determination letters for each of the four program reviews, closing out each with no further action required.

#### Program Participation Agreement

As a participant in Title IV programs, the University must enter into a Program Participation Agreement with the Department. Under the agreement, the institution agrees to follow the Department's rules and regulations governing Title IV programs. On

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October 1, 2014, Strayer University received an executed provisional Program Participation Agreement from the Department allowing it to participate in Title IV programs until June 30, 2017. The Program Participation Agreement was issued on a provisional basis because of the Department's program reviews open at the time of issuance. Under the provisional agreement, the only material additional condition that the University must comply with is obtaining Department approval for substantial changes, including the addition of any new location, level of academic offering, non-degree program, or degree program.

NYCDA

NYCDA is licensed to operate in New York, Texas, Georgia, Utah, North Carolina, Washington, Colorado, Washington, D.C., Pennsylvania, New Jersey, and South Carolina, but is not accredited, does not participate in state or federal student financial aid programs, and is not subject to the regulatory requirements applicable to accredited schools and schools that participate in such financial aid programs such as those described above. Programs such as those offered by NYCDA are regulated by each individual state, and the Company is in the process of seeking authorizations in additional states to offer NYCDA programs.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Notice Regarding Forward-Looking Statements

Certain of the statements included in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as elsewhere in this report on Form 10-Q are forward-looking statements made pursuant to the Private Securities Litigation Reform Act of 1995 ("Reform Act"). Such statements may be identified by the use of words such as "expect," "estimate," "assume," "believe," "anticipate," "will," "forecast," "plan," "project," or similar words, and include, without limitation, statements relating to future enrollment, revenues, revenues per student, earnings growth, operating expenses and capital expenditures. These statements are based on the Company's current expectations and are subject to a number of assumptions, risks and uncertainties. In accordance with the Safe Harbor provisions of the Reform Act, the Company has identified important factors that could cause the actual results to differ materially from those expressed in or implied by such statements. The assumptions, risks and uncertainties include the pace of growth of student enrollment, our continued compliance with Title IV of the Higher Education Act, and the regulations thereunder, as well as regional accreditation standards and state regulatory requirements, rulemaking by the Department of Education and increased focus by the U. S. Congress on for-profit education institutions, competitive factors, risks associated with the opening of new campuses, risks associated with the offering of new educational programs and adapting to other changes, risks associated with the acquisition of existing educational institutions, risks relating to the timing of regulatory approvals, our ability to implement our growth strategy, risks associated with the ability of our students to finance their education in a timely manner, and general economic and market conditions. Further information about these and other relevant risks and uncertainties may be found in the Company's Annual Report on Form 10-K and its other filings with the Securities and Exchange Commission. The Company undertakes no obligation to update or revise forward-looking statements, except as may be required by law.

Additional Information

We maintain a website at <http://www.strayereducation.com>. The information on our website is not incorporated by reference in this Quarterly Report on Form 10-Q, and our web address is included as an inactive textual reference only. We make available, free of charge through our website, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

Background and Overview

We are an education services holding company that owns Strayer University (the “University”) and, as of January 13, 2016, the New York Code and Design Academy (“NYCDA”). The University is an institution of higher education which offers undergraduate and graduate degree programs at physical campuses, predominantly located in the eastern United States, and online.

The University derives approximately 95% of its revenue from tuition for educational programs, whether delivered in person at a physical campus or delivered online. The academic year of the University is divided into four quarters, which approximately coincide with the four quarters of the calendar year. Students make payment arrangements for the tuition for each course at the time of enrollment. Tuition revenue is recognized in the quarter of instruction. If a student withdraws from a course prior to completion, the University refunds a portion of the tuition depending on when the withdrawal occurs. Tuition revenue is shown net of any refunds, withdrawals, corporate discounts, employee tuition discounts and scholarships. The University also derives revenue from other sources such as textbook-related income, certificate revenue, certain academic fees, licensing revenue, and other income, which are all recognized when earned. NYCDA provides non-degree courses in web and application software development and revenue is recognized ratably as services are provided.

Tuition receivable and deferred revenue for our students are recorded upon the start of the academic term or program. Because the University’s academic quarters coincide with the calendar quarters, at the end of the fiscal quarter (and academic term), tuition receivable generally represents amounts due from students for educational services already provided and deferred revenue generally represents advance payments for academic services to be provided in the future. Based upon past experience and judgment, the University establishes an allowance for doubtful accounts with respect to accounts receivable. Any uncollected account more than one year past due is charged against the allowance. Accounts less than one year past due are reserved according to the length of time the balance has been outstanding. In establishing reserve amounts, we also consider the status of students as

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to whether or not they are currently enrolled for the next term, as well as the likelihood of recovering balances that have previously been written off, based on historical experience. Bad debt expense as a percentage of revenues for the third quarter of 2016 and 2015 was 3.8% and 2.3%, respectively.

Below is a description of the nature of the consolidated costs included in our operating expense categories:

- Instruction and educational support expenses generally contain items of expense directly attributable to educational activities of the University. This expense category includes salaries and benefits of faculty and academic administrators, as well as administrative personnel who support and serve student interests. Instruction and educational support expenses also include costs of educational supplies and facilities, including rent for campus facilities, certain costs of establishing and maintaining computer laboratories and all other physical plant and occupancy costs, with the exception of costs attributable to the corporate offices. Bad debt expense incurred on delinquent student account balances is also included in instruction and educational support expenses.
- Marketing expenses include the costs of advertising and production of marketing materials and related personnel costs.
- Admissions advisory expenses include salaries, benefits and related costs of personnel engaged in admissions.
- General and administration expenses include salaries and benefits of management and employees engaged in accounting, human resources, legal, regulatory compliance, and other corporate functions, along with the occupancy and other related costs attributable to such functions.

Investment income consists primarily of earnings and realized gains or losses on investments. Interest expense consists of interest incurred on our outstanding borrowings, fees on the unused portion of our revolving credit facility, and amortization of deferred financing costs.

We acquired NYCDA on January 13, 2016. NYCDA provides non-degree courses in web and application software development, primarily at its campus in New York City. The acquisition did not impact our 2015 results and NYCDA's results of operations are included in our results from the acquisition date.

Critical Accounting Policies and Estimates

“Management’s Discussion and Analysis of Financial Condition and Results of Operations” discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the



United States of America. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosures of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates and judgments related to its allowance for doubtful accounts; income tax provisions; the useful lives of property and equipment; redemption rates for scholarship programs; fair value of future contractual operating lease obligations for facilities that have been closed; valuation of deferred tax assets, goodwill, and intangible assets; forfeiture rates and achievability of performance targets for stock-based compensation plans; and accrued expenses. Management bases its estimates and judgments on historical experience and various other factors and assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments regarding the carrying values of assets and liabilities that are not readily apparent from other sources. Management regularly reviews its estimates and judgments for reasonableness and may modify them in the future. Actual results may differ from these estimates under different assumptions or conditions.

Management believes that the following critical accounting policies are its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Revenue recognition — Like many traditional institutions, Strayer University offers its educational programs on a quarter system having four academic terms, which coincide with our quarterly financial reporting periods. Approximately 95% of our revenues during the three months ended September 30, 2016 consisted of tuition revenue. Tuition revenue is recognized ratably in the quarter of instruction as the University provides academic services in a given term, whether delivered in person at a physical campus or online. Tuition revenue is shown net of any refunds, withdrawals, corporate discounts, scholarships and employee tuition discounts. The University also derives revenue from other sources such as textbook-related income, certificate revenue, certain academic fees, licensing revenue, and other income, which are all recognized when earned. At the start of each academic term or program, a liability (deferred revenue) is recorded for academic services to be provided and a tuition receivable is recorded

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for the portion of the tuition not paid in advance. Any cash received prior to the start of an academic term is recorded as deferred revenue. NYCDA provides non-degree courses in web and application software development and tuition revenue is recognized ratably over the duration of each course.

Students finance their education in a variety of ways, and historically about three quarters of our students participated in one or more financial aid programs provided through Title IV of the Higher Education Act. In addition, many of our working adult students finance their own education or receive full or partial tuition reimbursement from their employers. Those students who are veterans or active duty military personnel have access to various additional government-funded educational benefit programs.

A typical University class is offered in weekly increments over a ten-week period and is followed by an exam. Students who withdraw from a course may be eligible for a refund of tuition charges based on the timing of the withdrawal. We use the student's last date of attendance for this purpose. Student attendance is based on physical presence in class for on-ground classes. For online classes, attendance consists of logging into one's course shell and performing an academically related activity (e.g., engaging in a discussion post or taking a quiz).

If a student withdraws from a course prior to completion, a portion of the tuition is refundable depending on when the withdrawal occurs. Our refund policy typically permits students who complete less than half of a course to receive a partial refund of tuition for that course. Refunds reduce the tuition revenue that would have otherwise been recognized for that student. Since the University's academic terms coincide with our financial reporting periods, nearly all refunds are processed and recorded in the same quarter as the corresponding revenue. The amount of tuition revenue refundable to students may vary based on the student's state of residence.

For undergraduate students who withdraw from all their courses during the quarter of instruction, we reassess collectibility of tuition and fees for revenue recognition purposes. In addition, we cease revenue recognition when a student fully withdraws from all of his or her courses in the academic term. Tuition charges billed in accordance with our billing schedule may be greater than the pro rata revenue amount, but the additional amounts are not recognized as revenue unless they are collected in cash.

For students who receive funding under Title IV, funds are subject to return provisions as defined by the Department of Education. If Title IV funds are returned to the Department of Education, the student is responsible for paying the amount of prorated tuition charged to him or her. Loss of financial aid eligibility during an academic term is rare and would normally coincide with the student's withdrawal from the institution. As discussed above, we cease revenue recognition upon a student's withdrawal from all of his or her classes in an academic term.

New University students registering in credit-bearing courses in any undergraduate program for the summer 2013 term (fiscal third quarter) and subsequent terms qualify for the Graduation Fund, whereby qualifying students will

receive one free course for every three courses that are successfully completed. Students must meet all of the University's admission requirements and not be eligible for any previously offered scholarship program. Our employees and their dependents are not eligible for the program. To maintain eligibility, students must be enrolled in a bachelor's degree program. Students who have more than one consecutive term of non-attendance lose any Graduation Fund credits earned to date, but may earn and accumulate new credits if the student is reinstated or readmitted by the University in the future. Revenue and the value of the benefit earned by students participating in the Graduation Fund is recognized based on a systematic and rational allocation of the cost of honoring the benefit earned to each of the underlying revenue transactions that result in progress by the student toward earning the benefit. The estimated value of awards under the Graduation Fund that will be recognized in the future is based on historical experience of students' persistence in completing their course of study and earning a degree. Estimated redemption rates of eligible students vary based on their term of enrollment. As of September 30, 2016, we had deferred \$26.6 million for estimated redemptions earned under the Graduation Fund, as compared to \$18.1 million at September 30, 2015. Each quarter we assess our methodologies and assumptions underlying our estimates for persistence and estimated redemptions based on actual experience. To date, any adjustments to our estimates have not been material. However, if actual persistence or redemption rates change, adjustments to the reserve may be necessary and could be material.

**Tuition receivable** — We record estimates for our allowance for doubtful accounts for tuition receivable from students primarily based on our historical collection rates by age of receivable, net of recoveries, and consideration of other relevant factors. Our experience is that payment of outstanding balances is significantly influenced by whether the student returns to the institution as we require students to make payment arrangements for their outstanding balances prior to enrollment. Therefore, we monitor outstanding tuition receivable balances through subsequent terms, increasing the reserve on such balances over time as the likelihood of returning to the institution diminishes and our historical experience indicates collection is less likely. We periodically assess our methodologies for estimating bad debts in consideration of actual experience. If the financial condition of

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our students were to deteriorate, resulting in evidence of impairment of their ability to make required payments for tuition payable to us, additional allowances or write-offs may be required. For the third quarter of 2016, our bad debt expense was 3.8% of revenue, compared to 2.3% for the same period in 2015. A change in our allowance for doubtful accounts of 1% of gross tuition receivable as of September 30, 2016 would have changed our income from operations by approximately \$0.3 million.

Accrued lease and related costs — We estimate potential sublease income and vacancy periods for space that is not in use, adjusting our estimates when circumstances change. If our estimates change or if we enter into subleases at rates that are substantially different than our current estimates, we will adjust our liability for lease and related costs. During the nine months ended September 30, 2016 and 2015, we reduced our liability for leases by approximately \$2.0 million and \$0.4 million, respectively.

Other estimates — We record estimates for certain of our accrued expenses and income tax liabilities. We estimate the useful lives of our property and equipment. We periodically assess goodwill and intangible assets for impairment. We periodically review our assumed forfeiture rates and ability to achieve performance targets for stock-based awards and adjust them as necessary. Should actual results differ from our estimates, revisions to our accrued expenses, carrying amount of goodwill and intangible assets, stock-based compensation expense, and income tax liabilities may be required.

Results of Operations

In the third quarter of 2016, we generated \$102.2 million in revenue, a 3% increase compared to 2015, principally due to a 4% increase in total enrollment and partially offset by slightly lower revenue per student. Income from operations was \$4.8 million for the third quarter of 2016, and includes approximately \$0.2 million in adjustments to reduce our liability for losses on facilities no longer in use. Income from operations for the third quarter of 2015 was \$7.3 million, which includes \$0.4 million in adjustments to our liability for losses on facilities no longer in use. Net income in the third quarter of 2016 was \$2.9 million, including approximately \$0.1 million in after-tax benefits from adjustments to the Company's liability for facilities no longer in use, compared to \$3.7 million for the same period in 2015, which reflected approximately \$0.2 million in after-tax benefits from adjustments to the Company's liability for facilities no longer in use. Diluted earnings per share was \$0.27 compared to \$0.35 for the same period in 2015. Diluted earnings per share for the third quarter of 2016 and 2015 includes \$0.01 per share and \$0.02 per share in after-tax earnings, respectively, related to the reduction of the Company's liability for losses on facilities no longer in use.

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Key enrollment trends by quarter for the University were as follows:

Enrollment

% Change vs Prior Year

Since 2013, we have introduced a number of initiatives in response to the variability in our enrollment. Recognizing that affordability is an important factor in a prospective student's decision to seek a college degree, we reduced Strayer University undergraduate tuition for new students by 20% beginning in our 2014 winter academic term. We also introduced the Graduation Fund in mid-2013, whereby qualifying students can receive one free course for every three courses successfully completed. The free courses are redeemable in the student's final academic year. In 2015, we launched Strayer@Work, which works with Fortune 1000 companies to structure customized degree and certificate programs for their employees, often with significant discounts to our published tuition rates. In January 2016, we acquired the New York Code and Design Academy, which charges variable tuition by program based on the number of hours of instruction. These initiatives could result in increased volatility in our revenue per student. However, we believe these initiatives, and others, will continue to support our competitive position in adult education and, over the long term, will lead to growth.

Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015

**Enrollment.** Total enrollments at Strayer University for the summer term 2016 increased to 38,813 students, from 37,221 for the summer term 2015. New student enrollments increased by 6%, and continuing student enrollments increased by 4%.

**Revenues.** Revenues increased 3% to \$102.2 million in the third quarter of 2016 from \$99.1 million in the third quarter of 2015, principally due to higher enrollment growth, partially offset by a decline in revenue per student of 1%. The decline in revenue per student is largely attributable to a new pricing structure which was implemented for the first quarter of 2014 which reduced tuition for new undergraduate students by approximately 20%. Revenues for undergraduate students increased 6% in the three months ended September 30, 2016, driven by an increase in total undergraduate enrollment of 8%, offset by a decline of 2% in revenue per student. We expect this decline in revenue per student to continue at the undergraduate level, though more gradually, as we enroll more new undergraduate students. For graduate students, revenues decreased 2% in 2016, driven by an increase in revenue per student of 2%, offset by a decline in total enrollment of 4%. The increase in graduate revenue per student was due primarily to increased average tuition per class compared to 2015.

Instruction and educational support expenses. Instruction and educational support expenses increased \$1.0 million, or 2%, to \$56.3 million in the third quarter of 2016 from \$55.3 million in the third quarter of 2015. The increase primarily resulted from

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instructional costs for NYCDA, which was acquired in the first quarter of 2016. Instruction and educational support expenses as a percentage of revenues decreased to 55.1% in the third quarter of 2016 from 55.8% in the third quarter of 2015.

Marketing expenses. Marketing expenses increased \$3.8 million, or 18%, to \$25.4 million in the third quarter of 2016 from \$21.6 million in the third quarter of 2015, principally due to increased investments in branding initiatives at NYCDA and Strayer University. Marketing expenses as a percentage of revenues increased to 24.9% in 2016 from 21.8% in 2015. We expect to continue to invest in our marketing efforts such that marketing expenses may increase in absolute terms and as a percentage of revenue in 2016 as compared to 2015.

Admissions advisory expenses. Admissions advisory expenses increased \$0.6 million, or 15%, to \$4.7 million in the third quarter of 2016 from \$4.1 million in the third quarter of 2015. Admissions advisory expenses as a percentage of revenues increased to 4.6% in the third quarter of 2016 from 4.1% in the third quarter of 2015.

General and administration expenses. General and administration expenses increased \$0.1 million to \$11.0 million in the third quarter of 2016 from \$10.9 million in 2015. General and administration expenses as a percentage of revenues decreased to 10.7% in the third quarter of 2016 from 11.0% in the third quarter of 2015.

Income from operations. Income from operations decreased \$2.5 million, or 33%, to \$4.8 million in the third quarter of 2016 from \$7.3 million in the third quarter of 2015.

Interest expense. Interest expense decreased to \$0.2 million in the third quarter of 2016 from \$1.1 million in the third quarter of 2015 following the repayment in July 2015 of all our outstanding debt in connection with our amended credit facility. We have \$150.0 million available under our revolving credit facility and no balance outstanding as of September 30, 2016.

Provision for income taxes. Income tax expense decreased \$0.5 million, or 22%, to \$1.9 million in the third quarter of 2016 from \$2.4 million in the third quarter of 2015, primarily due to the decrease in income before income taxes attributable to the factors discussed above. Our effective tax rate was 39.8% for the third quarter of 2016 compared to 39.5% for the same period in 2015.

Net income. Net income decreased \$0.8 million to \$2.9 million in the third quarter of 2016 from \$3.7 million in the third quarter of 2015 due to the factors discussed above.

Nine Months Ended September 30, 2016 Compared to Nine Months Ended September 30, 2015

**Enrollment.** Average enrollments at Strayer University increased 2% to 40,238 students for the nine months ended September 30, 2016 compared to 39,608 students for the same period in 2015.

**Revenues.** Revenues increased less than 1% to \$321.8 million in the nine months ended September 30, 2016 from \$320.8 million in the nine months ended September 30, 2015, principally due to a decline in revenue per student of 1%, partially offset by slightly higher enrollment growth. The decline in revenue per student is largely attributable to a new pricing structure which was implemented for the first quarter of 2014 which reduced tuition for new undergraduate students by approximately 20%. Revenues for undergraduate students increased by 2%, driven by an increase in total enrollment of 5% and a decline of 3% in revenue per student. We expect this decline in revenue per student to continue at the undergraduate level, though more gradually, as we enroll more new undergraduate students. For graduate students, revenues decreased 3% in 2016, driven by an increase in revenue per student of 2%, offset by a decline in total enrollment of 5%. The increase in graduate revenue per student was due primarily to increased tuition.

**Instruction and educational support expenses.** Instruction and educational support expenses increased \$2.0 million, or 1%, to \$176.2 million in the nine months ended September 30, 2016 from \$174.2 million in the nine months ended September 30, 2015. We recorded adjustments in each of the nine months ended September 30, 2016 and 2015, resulting from changes in the timing and expected income from settlements and sublease agreements, and may record additional adjustments in the future. These adjustments were partially offset by the instruction and educational costs of NYCDA following the acquisition, as well as costs associated with new academic content. Instruction and educational support expenses as a percentage of revenues increased to 54.7% in the nine months ended September 30, 2016 from 54.3% in the nine months ended September 30, 2015.

**Marketing expenses.** Marketing expenses increased \$8.5 million, or 16%, to \$61.4 million in the nine months ended September 30, 2016 from \$52.9 million in the nine months ended September 30, 2015, principally due to increased investments in branding initiatives at NYCDA and Strayer University. Marketing expenses as a percentage of revenues increased to 19.1% in 2016 from



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16.5% in 2015. We expect to continue to invest in our marketing efforts such that marketing expenses may increase in absolute terms and as a percentage of revenue in 2016 as compared to 2015.

Admissions advisory expenses. Admissions advisory expenses increased by \$1.1 million, or 9%, to \$13.2 million in the nine months ended September 30, 2016 from \$12.1 million in the nine months ended September 30, 2015, primarily as a result of higher personnel costs. Admissions advisory expenses as a percentage of revenues increased to 4.1% in the nine months ended September 30, 2016 from 3.8% in the nine months ended September 30, 2015.

General and administration expenses. General and administration expenses decreased \$0.2 million to \$33.2 million in the nine months ended September 30, 2016 from \$33.4 million in the nine months ended September 30, 2015. During the nine months ended September 30, 2016 we recorded an adjustment to reduce our lease loss liability resulting from the sublease of a portion of our corporate office space, partially offset by higher regulatory and related costs associated with expanding NYCDA's operations into new markets. General and administration expenses as a percentage of revenues decreased to 10.3% in the nine months ended September 30, 2016 from 10.4% in the nine months ended September 30, 2015.

Income from operations. Income from operations decreased \$10.2 million, or 21%, to \$37.8 million in the nine months ended September 30, 2016 from \$48.0 million in the nine months ended September 30, 2015.

Interest expense. Interest expense decreased to \$0.5 million in the nine months ended September 30, 2016 from \$3.7 million in the nine months ended September 30, 2015 following the repayment in July 2015 of all our outstanding debt in connection with our amended credit facility. We have \$150.0 million available under our revolving credit facility and no balance outstanding as of September 30, 2016.

Provision for income taxes. Income tax expense decreased \$3.0 million, or 17.1%, to \$14.6 million in the nine months ended September 30, 2016 from \$17.6 million in the nine months ended September 30, 2015, primarily due to the decrease in income before income taxes attributable to the factors discussed above. Our effective tax rate was 38.7% in the nine months ended September 30, 2016, compared to 39.5% for the nine months ended September 30, 2015.

Net income. Net income decreased \$3.9 million to \$23.1 million in the nine months ended September 30, 2016 from \$27.0 million in the nine months ended September 30, 2015 due to the factors discussed above.

Liquidity and Capital Resources

At September 30, 2016, we had cash and cash equivalents of \$120.5 million compared to \$106.9 million at December 31, 2015 and \$86.9 million at September 30, 2015. At September 30, 2016, most of our cash was invested in bank overnight deposits.

In January 2016, we completed the acquisition of New York Code and Design Academy, which provides non-degree courses in web and application software development, primarily at its campus in New York City. We have paid \$8.9 million to date and may pay up to an additional \$11.5 million based on NYCDA's results of operations over a five-year period. In addition, we paid \$4.6 million to the founders in connection with their continued employment, which is reimbursable to us if either of the founders voluntarily terminates his employment within three years of the acquisition date.

In July 2015, we repaid all balances outstanding under a prior credit facility, and entered into an amended credit agreement which provides for a \$150 million revolving credit facility and an option to establish incremental term loans under certain conditions. The amended credit agreement has a maturity date of July 2, 2020. We had no borrowings outstanding under the revolving credit facility as of September 30, 2016.

Borrowings under the revolving credit facility bear interest at LIBOR or a base rate, plus a margin ranging from 1.75% to 2.25%, depending on our leverage ratio. An unused commitment fee ranging from 0.25% to 0.35%, depending on our leverage ratio, accrues on unused amounts under the revolving credit facility. During the nine months ended September 30, 2016 and 2015, we paid cash interest of \$0.3 million and \$3.4 million, respectively.

The amended credit agreement is guaranteed by our subsidiaries and is secured by substantially all of the personal property and assets of the Company and the guarantors. The amended credit agreement contains customary covenants, representations, warranties, events of default and remedies upon default. In addition, we must satisfy certain financial maintenance covenants, including a total leverage ratio, a coverage ratio and a U.S. Department of Education financial responsibility composite score. We were in compliance with all applicable covenants related to the amended credit agreement as of September 30, 2016.

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Our net cash from operating activities for the nine months ended September 30, 2016 decreased to \$30.1 million, as compared to \$54.5 million for the same period in 2015. The decrease in net cash from operating activities was largely due to changes in working capital, the timing of income tax payments, and payment of retention agreements in connection with the NYCDA acquisition. Capital expenditures were \$7.5 million for the nine months ended September 30, 2016, compared to \$9.6 million for the same period in 2015.

For the nine months ended September 30, 2016, we did not repurchase any shares of common stock and, at September 30, 2016, had \$70 million in repurchase authorization to use through December 31, 2016. We did not pay a regular quarterly dividend in either 2016 or 2015.

For the third quarter of 2016, bad debt expense as a percentage of revenue was 3.8% compared to 2.3% for 2015.

We have available \$150 million under our revolving credit facility. We believe that existing cash and cash equivalents, cash generated from operating activities, and if necessary, cash borrowed under the credit facility, will be sufficient to meet our requirements for at least the next 12 months. Currently, we maintain our cash in mostly FDIC-insured bank accounts. Excess cash is invested in money market funds, which is included in cash and cash equivalents at September 30, 2016 and 2015. During the nine months ended September 30, 2016 and 2015, we earned interest income of \$0.3 million and \$0.2 million, respectively.

The table below sets forth our contractual commitments associated with operating leases, excluding subleases as of September 30, 2016 (in thousands):

	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating leases	\$ 141,861	\$ 34,595	\$ 55,624	\$ 35,156	\$ 16,486

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ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to the impact of interest rate changes and may be subject to changes in the market values of our future investments. We invest our excess cash in bank overnight deposits, money market funds and marketable securities. We have not used derivative financial instruments in our investment portfolio. Earnings from investments in bank overnight deposits, money market mutual funds, and marketable securities may be adversely affected in the future should interest rates decline, although such a decline may reduce the interest rate payable on any borrowings under our revolving credit facility. Our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates. As of September 30, 2016, a 1% increase or decrease in interest rates would not have a material impact on our future earnings, fair values, or cash flows related to investments in cash equivalents or interest earning marketable securities.

Changing interest rates could also have a negative impact on the amount of interest expense we incur. On July 2, 2015, we used approximately \$116 million of our existing cash and cash equivalents to prepay our term loan and terminate an interest rate swap as part of an amendment to our credit and term loan agreement. The amended credit agreement provides for a \$150 million revolving credit facility and an option to establish incremental term loans under certain conditions. The amended credit agreement has a maturity date of July 2, 2020. We had no borrowings outstanding under the revolving credit facility after prepayment of the term loan facility, and as of September 30, 2016. Borrowings under the revolving credit facility bear interest at LIBOR or a base rate, plus a margin ranging from 1.75% to 2.25%, depending on our leverage ratio. An unused commitment fee ranging from 0.25% to 0.35%, depending on our leverage ratio, accrues on unused amounts under the revolving credit facility. An increase in LIBOR would affect interest expense on any outstanding balance of the revolving credit facility. For every 100 basis points increase in LIBOR, we would incur an incremental \$1.5 million in interest expense per year assuming the entire \$150 million revolving credit facility was utilized.

ITEM 4: CONTROLS AND PROCEDURES

a) Disclosure Controls and Procedures. The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2016. Based upon such review, the Chief Executive Officer and Chief Financial Officer have concluded that the Company had in place, as of September 30, 2016, effective disclosure controls and procedures designed to ensure that information required to be disclosed by the Company (including consolidated subsidiaries) in the reports it files or submits under the Securities Exchange Act of 1934, as amended, and the rules thereunder, is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in reports it files or submits under the Securities Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate

to allow timely decisions regarding required disclosure.

- b) **Internal Control Over Financial Reporting.** There have not been any changes in the Company's internal control over financial reporting during the quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in litigation and other legal proceedings arising out of the ordinary course of our business. There are no pending material legal proceedings to which we or our property are subject.

Item 1A. Risk Factors

You should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, and in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2016, which could materially affect our business, adversely affect the market price of our common stock and could cause you to suffer a partial or complete loss of your investment. There have been no material changes to the risk factors previously described in Part I, Item 1A included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, and in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2016. Those risks are incorporated herein by this reference. The risks described in our Annual Report on Form 10-K and in our Quarterly Report are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business. See “Cautionary Notice Regarding Forward-Looking Statements.”

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

During the three months ended September 30, 2016, we did not repurchase any shares of common stock under our repurchase program. The remaining authorization for our common stock repurchases was \$70.0 million at September 30, 2016, and is available for use through December 31, 2016.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

On October 25, 2016, upon the recommendation of the Nominating and Corporate Governance Committee, the Board of Directors of the Company unanimously voted to elect Nathaniel Fick to serve as a Director of the Company and as a member of the Audit Committee. Mr. Fick is the Chief Executive Officer of Endgame, a technology firm focusing on cybersecurity. He previously served as a Captain in the United States Marine Corps leading infantry and reconnaissance units in combat in Afghanistan and Iraq. His book about that experience, "One Bullet Away," was a New York Times bestseller, a Washington Post "Best Book of the Year," and one of the Military Times' "Best Military Books of the Decade." Mr. Fick is a graduate of Dartmouth College, the Harvard Kennedy School, and the Harvard Business School, and serves as a Trustee of Dartmouth College. Mr. Fick will receive compensation for his service on the Board of Directors in accordance with the Company's standard compensation arrangements for non-employee directors, a description of which can be found under the caption "Director Compensation" in the Company's definitive proxy statement filed with the Securities and Exchange Commission on March 17, 2016.

Item 6. Exhibits

The exhibits required to be filed as part of this Quarterly Report on Form 10-Q are listed in the Exhibit Index attached hereto and are incorporated herein by reference.

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SIGNATURES

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

STRAYER EDUCATION,  
INC.

By: /s/ Daniel W. Jackson  
Daniel W. Jackson  
Executive Vice President  
and Chief Financial Officer  
Date: October 27, 2016



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Exhibit Index

Exhibit	Description
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.	INS XBRL Instance Document
101.	SCH XBRL Schema Document
101.	CAL XBRL Calculation Linkbase Document
101.	DEF XBRL Definition Linkbase Document
101.	LAB XBRL Label Linkbase Document
101.	PRE XBRL Presentation Linkbase Document

