

Grand Canyon Education, Inc.
Form 10-Q
April 28, 2009

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009

or

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

For the transition period from _____ to _____

Commission File Number: 001-34211

GRAND CANYON EDUCATION, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
*(State or other jurisdiction of
Incorporation or organization)*

20-3356009
*(I.R.S. Employer
Identification No.)*

**3300 W. Camelback Road
Phoenix, Arizona 85017**
(Address, including zip code, of principal executive offices)
(602) 639-7500

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 Smaller reporting company
(Do not check if a smaller reporting company)

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

The total number of shares of common stock outstanding as of April 23, 2009, was 45,485,765.

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(In thousands, except per share data)	Three Months Ended	
	March 31,	
	2008	2009
	(Unaudited)	
Net revenue	\$ 35,709	\$ 58,964
Costs and expenses:		
Instructional costs and services	11,620	18,332
Selling and promotional, including \$1,512 and \$1,612 for the three months ended March 31, 2008 and 2009, respectively, to related parties	12,586	19,670
General and administrative	4,541	8,833
Royalty to former owner	1,022	74
Total costs and expenses	29,769	46,909
Operating income	5,940	12,055
Interest expense	(813)	(667)
Interest income	252	108
Income before income taxes	5,379	11,496
Income tax expense	2,076	4,593
Net income	3,303	6,904
Preferred dividends	(253)	
Net income available to common stockholders	\$ 3,050	\$ 6,904
Earnings per share:		
Basic income per share	\$ 0.16	\$ 0.15
Diluted income per share	\$ 0.09	\$ 0.15
Basic weighted average shares outstanding	19,036	45,474
Diluted weighted average shares outstanding	33,849	45,821

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

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GRAND CANYON EDUCATION, INC.
Balance Sheets

(In thousands, except share data)	December 31, 2008	March 31, 2009 (Unaudited)
ASSETS:		
Current assets		
Cash and cash equivalents	\$ 35,152	\$ 68,275
Restricted cash and cash equivalents	2,197	3,946
Accounts receivable, net of allowance for doubtful accounts of \$6,356 and \$6,068 at December 31, 2008 and March 31, 2009, respectively	9,442	10,509
Income taxes receivable	1,576	938
Deferred income taxes	2,603	2,175
Other current assets	2,629	2,660
Total current assets	53,599	88,503
Property and equipment, net	41,399	45,922
Restricted cash and investments (of which \$2,928 and \$0 is restricted at December 31, 2008 and March 31, 2009, respectively)	3,403	483
Prepaid royalties	8,043	7,860
Goodwill	2,941	2,941
Deferred income taxes	7,404	12,018
Other assets	201	166
Total assets	\$ 116,990	\$ 157,893
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities		
Accounts payable	\$ 5,770	\$ 7,547
Accrued liabilities	9,674	11,935
Income taxes payable	172	4,123
Deferred revenue and student deposits	14,262	31,995
Due to related parties	1,197	2,429
Current portion of capital lease obligations	1,125	1,746
Current portion of notes payable	357	447
Total current liabilities	32,557	60,222
Capital lease obligations, less current portion	29,384	30,332
Notes payable, less current portion and other	1,459	1,713
Total liabilities	63,400	92,267
Commitments and contingencies		
Stockholders equity		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized; 0 shares issued and outstanding at December 31, 2008 and March 31, 2009		
Common stock, \$0.01 par value, 100,000,000 shares authorized; 45,465,160 and 45,485,765 shares issued and outstanding at December 31, 2008 and	455	455

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March 31, 2009, respectively

Additional paid-in capital	64,808	69,935
Accumulated other comprehensive income	16	21
Accumulated deficit	(11,689)	(4,785)
Total stockholders equity	53,590	65,626
Total liabilities and stockholders equity	\$ 116,990	\$ 157,893

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

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GRAND CANYON EDUCATION, INC.
Statement of Stockholders Equity
(In thousands, except share data)
(Unaudited)

	Common Stock		Additional	Accumulated		
	Shares	Par Value	Paid-in Capital	Comprehensive Income	Other Accumulated Deficit	Total
Balance at December 31, 2008	45,465,160	\$ 455	\$ 64,808	\$ 16	\$ (11,689)	\$ 53,590
Net income					6,904	6,904
Unrealized losses on available for-sale securities, net of taxes of \$3				5		5
Comprehensive income						6,909
Share-based compensation			764			764
Exercise of stock options	20,605		247			247
Excess tax benefit from share-based compensation			9			9
Tax benefit on Spirit warrant intangible			4,107			4,107
Balance at March 31, 2009	45,485,765	\$ 455	\$ 69,935	\$ 21	\$ (4,785)	\$ 65,626

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

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GRAND CANYON EDUCATION, INC.
Statements of Cash Flows

(\$ in thousands)	Three Months Ended	
	March 31,	
	2008	2009
	(Unaudited)	
Cash flows provided by operating activities:		
Net income	\$ 3,303	\$ 6,904
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation		764
Excess tax benefits from share-based compensation		(9)
Provision for bad debts	1,680	3,295
Depreciation and amortization	1,090	1,632
Deferred income taxes	2	(79)
Other		(14)
Changes in assets and liabilities:		
Accounts receivable	(2,465)	(4,362)
Prepaid expenses and other assets	(199)	185
Due to/from related parties	809	1,232
Accounts payable	1,667	2,435
Accrued liabilities	659	2,261
Income taxes payable	2,014	4,598
Royalty payable to former owner	1,022	
Deferred revenue and student deposits	8,958	17,733
Net cash provided by operating activities	18,540	36,575
Cash flows used in investing activities:		
Capital expenditures	(1,583)	(4,500)
Change in restricted cash and cash equivalents	(1,390)	1,187
Purchases of investments	(2,399)	(11)
Proceeds from sale or maturity of investments	2,342	
Net cash used in investing activities	(3,030)	(3,324)
Cash flows used in financing activities:		
Principal payments on notes payable and capital lease obligations	(321)	(384)
Repayment on line of credit	(6,000)	
Proceeds from related party payable on preferred stock	5,725	
Net proceeds from exercise of stock options		247
Excess tax benefits from share-based compensation		9
Net cash used in financing activities	(596)	(128)
Net increase in cash and cash equivalents	14,914	33,123
Cash and cash equivalents, beginning of period	18,930	35,152

Cash and cash equivalents, end of period	\$ 33,844	\$ 68,275
Supplemental disclosure of cash flow information		
Cash paid for interest	\$ 687	\$ 673
Cash paid for income taxes	\$ 53	\$ 138
Supplemental disclosure of non-cash investing and financing activities		
Purchase of equipment through capital lease obligations	\$ 760	\$ 2,116
Purchases of property and equipment included in accounts payable	\$ 349	\$ 658
Tax benefit of Spirit warrant intangible	\$	\$ 4,107
Accretion of dividends on Series C convertible preferred stock	\$ 253	\$

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

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GRAND CANYON EDUCATION, INC.
Notes to Financial Statements
(In thousands, except share and per share data)
(Unaudited)

1. Nature of Business

Grand Canyon Education, Inc. (the Company) is a regionally accredited provider of online postsecondary education services focused on offering graduate and undergraduate degree programs in its core disciplines of education, business, and healthcare. In addition to online programs, the Company offers courses at its campus in Phoenix, Arizona and onsite at the facilities of employers. The Company is accredited by The Higher Learning Commission of the North Central Association of Colleges and Schools.

2. Summary of Significant Accounting Policies

Unaudited Interim Financial Information

The accompanying unaudited interim financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles, consistent in all material respects with those applied in its financial statements included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2008. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. Such interim financial information is unaudited but reflects all adjustments that in the opinion of management are necessary for the fair presentation of the interim periods presented. Interim results are not necessarily indicative of results for a full year. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's financial statements and footnotes included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

Use of Estimates

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

Segment Information

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

Reclassifications

Certain reclassification of prior year amounts have been made to the prior year balances to conform to the current period.

Comprehensive income

Total comprehensive income includes net income and other comprehensive income (loss), which consists solely of unrealized gains and losses on available-for-sale investments. Total comprehensive income for the three months ended March 31, 2009 and 2008 was \$6,909 and \$3,308, respectively.

3. Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per common share reflects the assumed conversion of all potentially dilutive securities, consisting of stock options, preferred stock and common stock warrants for which the estimated fair value exceeds the exercise price, less shares which could have been purchased with the related proceeds, unless anti-dilutive. For employee equity awards, repurchased shares are also included for any unearned compensation adjusted for tax.

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(In thousands, except share and per share data)
(Unaudited)

The table below reflects the calculation of the weighted average number of common shares outstanding, on an as if converted basis, used in computing basic and diluted earnings per common share.

	Three Months Ended March 31,	
	2008	2009
Denominator:		
Basic common shares outstanding	19,036,050	45,474,318
Effect of dilutive preferred stock	10,870,178	
Effect of dilutive warrants	3,943,187	
Effect of dilutive stock options and restricted stock		347,000
Diluted common shares outstanding	33,849,415	45,821,318

4. Valuation and Qualifying Accounts

	Balance at Beginning of Year	Charged to Expense	Deductions⁽¹⁾	Balance at End of Period
Allowance for doubtful accounts receivable:				
Three months ended March 31, 2008	\$ 12,158	1,680	(424)	\$ 13,414
Three months ended March 31, 2009	\$ 6,356	3,295	(3,583)	\$ 6,068

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

5. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31, 2008	March 31, 2009
Accrued compensation and benefits	\$ 5,340	\$ 7,955
Accrued interest	284	290
Deferred rent	34	39
Tax reserves, non-income tax related	710	810
FIN 48 accrual	299	238
Other accrued expenses	3,007	2,603

\$ 9,674 \$ 11,935

6. Commitments and Contingencies

Leases

The Company leases certain land, buildings and equipment under non-cancelable operating leases expiring at various dates through 2023. Future minimum lease payments under operating leases due each year are as follows at March 31, 2009:

2009	\$ 2,753
2010	4,487
2011	4,187
2012	3,688
2013	3,538
Thereafter	20,319
Total minimum payments	\$ 38,972

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Total rent expense and related taxes and operating expenses under operating leases for the three months ended March 31, 2008 and 2009 was \$553, and \$1,135, respectively.

Legal Matters

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

We were previously a party to a dispute with SunGard Higher Education Managed Services Inc. (SunGard). On October 22, 2008, an arbitration panel issued a final award pursuant to which the Company and SunGard were awarded damages, with a net award to SunGard in the amount of approximately \$250 plus interest. The arbitration panel also held that each party would be responsible for its own attorneys' fees and that the parties would equally share the arbitration costs. On January 14, 2009, we entered into a settlement agreement with SunGard regarding payment of the arbitration award and effecting a mutual release between the parties regarding all claims that were brought, or could have been brought, in the litigation and related arbitration, and all administrative matters relating to this dispute have been resolved. Therefore, as of March 31, 2009 there are no reserves for litigation related to this matter.

On August 14, 2008, the Office of Inspector General of the United States Department of Education (OIG) served an administrative subpoena on the Company requiring it to provide certain records and information related to performance reviews and salary adjustments for all of its enrollment counselors and managers from January 1, 2004 to the present. The Company is cooperating with the OIG to facilitate its investigation and is now in the discovery phase of this investigation. The Company cannot presently predict the ultimate outcome of the investigation or any liability or other sanctions that may result.

On September 11, 2008, the Company was served with a *qui tam* lawsuit that had been filed against the Company in August 2007 in the United States District Court for the District of Arizona by a then-current employee on behalf of the federal government. All proceedings in the lawsuit had been under seal until September 5, 2008, when the court unsealed the first amended complaint, which was filed on August 11, 2008. The *qui tam* lawsuit alleges, among other things, that the Company violated the False Claims Act by knowingly making false statements, and submitting false records or statements, from at least 2001 to the present, to get false or fraudulent claims paid or approved, and asserts that the Company improperly compensated certain of its enrollment counselors in violation of the Title IV law governing compensation of such employees, and as a result, improperly received Title IV program funds. The complaint specifically alleges that some of the Company's compensation practices with respect to its enrollment personnel, including providing non-cash awards, have violated the Title IV law governing compensation. While the Company believes that the compensation policies and practices at issue in the complaint have not been based on success in enrolling students in violation of applicable law, the Department of Education's regulations and interpretations of the incentive compensation law do not establish clear criteria for compliance in all circumstances, and some of these practices, including the provision of non-cash awards, are not within the scope of any explicit "safe harbor" provided in the compensation regulations. The complaint seeks treble the amount of unspecified damages sustained by the federal government in connection with the Company's receipt of Title IV funding, a civil penalty for each violation of the False Claims Act, attorneys' fees, costs, and interest. A number of similar lawsuits have been filed in recent years against for-profit educational institutions that receive Title IV funds. While the Company's motion to dismiss the *qui tam* lawsuit has been denied, the Company is currently conducting discovery and plans to vigorously contest the lawsuit. Based on information available to date, management does not believe that the outcome of this

proceeding would have a material adverse effect on the Company's financial condition, results of operations or cash flows. However, the outcome of this proceeding is uncertain and the Company cannot presently predict the ultimate outcome of this case or any liability or other sanctions that may result. If it were determined that any of the Company's compensation practices violated the incentive compensation law, the Company could be subject to substantial monetary liabilities, fines, and other sanctions or could suffer monetary damages.

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

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Tax Reserves, Non-Income Tax Related

From time to time the Company has exposure to various non-income tax related matters that arise in the ordinary course of business. At March 31, 2009 and December 31, 2008, the Company has reserved approximately \$810 and \$710, respectively, for tax matters where its ultimate exposure is considered probable and the potential loss can be reasonably estimated.

7. Income Taxes

The Company's uncertain tax positions are related to tax years that remain subject to examination by tax authorities. As of March 31, 2009, the earliest tax year still subject to examination for federal and state purposes is 2005. During the second quarter ended June 30, 2008, the Internal Revenue Service (IRS) commenced an examination of the Company's 2005 income tax return.

During the three months ended March 31, 2009, the Company determined that it was entitled to a deferred tax benefit in the amount of \$4,107 related to the fair value of the exercised warrant by Spirit Management Company. This exercise generated a leasehold intangible for income tax purposes that will be amortized over the life of the original term of the lease agreement. Given that the tax benefit related to an equity transaction, the benefit of this long-term deferred tax asset has been recorded as a credit to additional paid-in capital.

8. Share-Based Compensation

On September 27, 2008 the Company's shareholders approved the adoption of the 2008 Equity Incentive Plan (Incentive Plan) and the 2008 Employee Stock Purchase (ESPP). A total of 4,199,937 shares of our common stock were originally authorized for issuance under the Incentive Plan. On January 1, 2009 and in accordance with the terms of the Incentive Plan, the number of shares authorized for issuance under the Incentive Plan automatically increased by 2.5% of the number of shares of common stock issued and outstanding on December 31, 2008, or 1,136,629 shares, raising the total number of shares of common stock authorized for issuance under the Incentive Plan to 5,336,566 shares. Although the ESPP is not in use, a total of 1,049,984 shares of our common stock have been authorized for sale under the ESPP.

The table below reflects our share-based compensation expense recognized in the three months ended March 31, 2008 and 2009 related to stock options granted under the Incentive Plan:

	Three Months Ended	
	March 31,	
	2008	2009
Instructional costs and services	\$	\$ 83
Selling and promotional		35
General and administrative		643
Stock-based compensation expense included in operating expenses		761
Tax effect of share-based compensation		(304)
Share-based compensation expense, net of tax	\$	\$ 457

Stock Grant

On March 3, 2009, the Company granted 1,307 shares of restricted common stock with a fair value of \$15.30 per share to each of David J. Johnson and Jack A. Henry, each of whom was appointed to the Company's board of directors in November 2008. The fair value of this grant is reflected as share-based compensation expense in the first quarter of 2009 in the amount of \$3 in general and administrative expense. The restricted shares have voting rights and vest on March 3, 2010.

9. Regulatory

The Company is subject to extensive regulation by federal and state governmental agencies and accrediting bodies. In particular, the Higher Education Act of 1965, as amended (the Higher Education Act), and the regulations

promulgated thereunder by the Department of Education subject the Company to significant regulatory scrutiny on the basis of numerous standards that schools must satisfy in order to participate in the various federal student financial assistance programs under Title IV of the Higher Education Act.

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To participate in the Title IV programs, an institution must be authorized to offer its programs of instruction by the relevant agency of the state in which it is located, accredited by an accrediting agency recognized by the Department of Education and certified as eligible by the Department of Education. The Department of Education will certify an institution to participate in the Title IV programs only after the institution has demonstrated compliance with the Higher Education Act and the Department of Education's extensive regulations regarding institutional eligibility. An institution must also demonstrate its compliance to the Department of Education on an ongoing basis. The Company submitted its application for recertification in March 2008 in anticipation of the expiration of its provisional certification on June 30, 2008. The Department of Education did not make a decision on the Company's recertification application by June 30, 2008, and therefore the Company's participation in the Title IV programs has been automatically extended on a month-to-month basis until the Department of Education makes its decision. As of December 31, 2008 and March 31, 2009, management believes the Company is in compliance with the applicable regulations in all material respects.

The Higher Education Act requires accrediting agencies to review many aspects of an institution's operations in order to ensure that the training offered is of sufficiently high quality to achieve satisfactory outcomes, and that the institution is complying with accrediting standards. Failure to demonstrate compliance with accrediting standards may result in the imposition of probation or Show Cause orders, or the requirements of periodic reports, and ultimately the loss of accreditation if deficiencies are not remediated.

Political and budgetary concerns significantly affect the Title IV programs. Congress must reauthorize the student financial assistance programs of the Higher Education Act on a periodic basis. On July 31, 2008, Congress passed the Higher Education Opportunity Act (the 2008 Act), which reauthorized and made numerous changes to the Higher Education Act and its programs. President Bush signed the 2008 Act on August 14, 2008. The Higher Education Act, as reauthorized and amended by the 2008 Act, continues the access of the Company and its students to Title IV funds. In addition, changes made by the 2008 Act will affect how the Company complies with the requirement that it receive a certain proportion of its revenue from other than the Title IV programs. Other recent changes made by Congress expanded the access of the Company and its students to Title IV funds by increasing loan limits for first and second year students and lifting restrictions on online education programs and students.

A significant component of Congress' initiative to reduce abuse in the Title IV programs has been the imposition of limitations on institutions whose former students default on the repayment of their federally guaranteed or funded student loans above specific rates (cohort default rate). Although the Company is not obligated to repay any of its students' or former students' defaults on payments of their federally guaranteed student loans, if such default rates equal or exceed 25% for three consecutive years, the institution may lose its eligibility to participate in, and its students will be denied access to, the federally guaranteed and funded student loan programs and the Federal Pell Grant program. An institution whose cohort default rate for any federal fiscal year exceeds 40% may have its eligibility to participate in all of the Title IV programs limited, suspended or terminated by the Department of Education. The 2008 Act included significant revisions to the requirements concerning institutions' cohort default rates, including revisions to the formula for calculating an institution's annual cohort default rate, and increases to the threshold for ending an institution's participation in the relevant Title IV programs from 25% to 30%.

All institutions participating in the Title IV programs must satisfy specific standards of financial responsibility. The Department of Education evaluates institutions for compliance with these standards each year, based on the institution's annual audited financial statements, and also following a change in ownership, as defined by the Department of Education.

The Higher Learning Commission considered our initial public offering to be a change in control under its policies. While we obtained the Higher Learning Commission's approval to consummate the offering, as a result of its determination that the public offering constituted a change in control, the Higher Learning Commission informed us that it would conduct a site visit to confirm the appropriateness of the approval and to evaluate whether we continue to

meet the Higher Learning Commission's eligibility criteria. The Higher Learning Commission conducted its site visit in March 2009 and determined, among other things, that the initial public offering was conducted in a manner that did not disrupt the ongoing operations of the University and that no further action would be required as a result of the change in control.

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

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GRAND CANYON EDUCATION, INC.
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(In thousands, except share and per share data)
(Unaudited)

10. Subsequent Events

On April 27, 2009, we signed a purchase agreement pursuant to which we agreed to acquire our campus land and buildings and 909,348 shares