Grand Canyon Education, Inc.
Form 10-K
February 16, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended: December 31, 2016

OR

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

For the transition period from [ ] to [ ]

Commission file number: 001-34211

GRAND CANYON EDUCATION, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**20-3356009**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

3300 W. CAMELBACK ROAD, PHOENIX, ARIZONA 85017

(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: (602) 639-7500

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

(Title of Each Class)	**(Name of Each Exchange on Which Registered)**
Grand Canyon Education, Inc. Common stock, $.01 par value	**The NASDAQ Global Market**

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

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 the 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 Securities Exchange Act). Yes No

The total number of shares of common stock outstanding as of February 10, 2017 was 47,742,773.

As of June 30, 2016, the last business day of the registrant s most recently completed second fiscal quarter, the registrant s common stock was listed on the NASDAQ Global Market. As of June 30, 2016, the aggregate market value of the registrant s common stock held by non-affiliates was approximately $1.8 billion.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant s Definitive Proxy Statement for its 2017 Annual Meeting of Stockholders (which is expected to be filed with the Commission within 120 days after the end of the registrant s 2016 fiscal year) are incorporated by reference into Part III of this Report.

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Special Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K, including Item 1, *Business*; Item 1A, *Risk Factors*; and Item 7, *Management s Discussion and Analysis of Financial Condition and Results of Operations*, contains certain forward-looking statements, which include information relating to future events, future financial performance, strategies, expectations, competitive environment, regulation, and availability of resources. These forward-looking statements include, without limitation, statements regarding proposed new programs; statements as to whether regulatory developments or other matters may or may not have a material adverse effect on our financial position, results of operations, or liquidity; statements concerning projections, predictions, expectations, estimates, or forecasts as to our business, financial and operational results, and future economic performance; and statements of management s goals and objectives and other similar expressions concerning matters that are not historical facts. Words such as may, should, could, would, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates and si well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made or management s good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause such differences include, but are not limited to:

- our failure to comply with the extensive regulatory framework applicable to our industry, including Title IV of the Higher Education Act and the regulations thereunder, state laws and regulatory requirements, and accrediting commission requirements;

- the ability of our students to obtain federal Title IV funds, state financial aid, and private financing;

- potential damage to our reputation or other adverse effects as a result of negative publicity in the media, in the industry or in connection with governmental reports or investigations or otherwise, affecting us or other companies in the for-profit postsecondary education sector;

- risks associated with changes in applicable federal and state laws and regulations and accrediting commission standards, including pending rulemaking by the Department of Education;

- competition from other universities in our geographic region and market sector, including competition for students, qualified executives and other personnel;

- our ability to properly manage risks and challenges associated with strategic initiatives, including the expansion of our campus, potential acquisitions of, or investments in, new businesses, acquisitions of new properties, or the development of new campuses;

- our ability to hire and train new, and develop and train existing employees and faculty;

- the pace of growth of our enrollment;

- our ability to convert prospective students to enrolled students and to retain active students;

- our success in updating and expanding the content of existing programs and developing new programs in a cost-effective manner or on a timely basis;

- industry competition, including competition for qualified executives and other personnel;

- risks associated with the competitive environment for marketing our programs;

- failure on our part to keep up with advances in technology that could enhance the online experience for our students;

- the extent to which obligations under our credit agreement, including the need to comply with restrictive and financial covenants and to pay principal and interest payments, limits our ability to conduct our operations or seek new business opportunities;

- our ability to manage future growth effectively;

- general adverse economic conditions or other developments that affect the job prospects of our students; and

- other factors discussed under the headings Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business, and Regulation.

Forward-looking statements speak only as of the date the statements are made. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions, or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

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Part I

Item 1. *Business*
Overview

We are a comprehensive regionally accredited university that offers over 200 graduate and undergraduate degree programs and certificates across nine colleges both online and on ground at our over 260 acre campus in Phoenix, Arizona, at leased facilities and at facilities owned by third party employers of our students. We are committed to providing an academically rigorous educational experience with a focus on professionally relevant programs that meet the objectives of our students. Our undergraduate programs are designed to be innovative and meet the future needs of employers, while providing students with the needed critical thinking and effective communication skills developed through a Christian-oriented, liberal arts foundation. We offer master s and doctoral degrees in contemporary fields that are designed to provide students with the capacity for transformational leadership in their chosen industry, emphasizing the immediate relevance of theory, application, and evaluation to promote personal and organizational change. We believe the growing brand of the University and the value proposition for both traditional aged students attending on our campus in Phoenix, Arizona and working adult students attending on our campus or at off-site locations in cohorts (referred to by us as professional studies students) or online, has enabled us to increase enrollment to approximately 81,900 students at December 31, 2016. At December 31, 2016, 78.9% of our students were enrolled in our online programs, and, of our working adult students (online and professional studies students), 49.5% were pursuing master s or doctoral degrees.

We define working adults as students age 25 or older who are pursuing a degree while employed. As of December 31, 2016, 86.5% of our online and professional studies students were age 25 or older. We believe that working adults are attracted to the convenience and flexibility of our online programs because they can study and interact with faculty and classmates during times that suit their schedules. We also believe that working adults, particularly those who have some college experience, represent an attractive student population because they are better able to more readily recognize the benefits of a postsecondary degree, have higher persistence and completion rates than other students, and to finance their education generally.

In 2016, we continued to increase the number of students in attendance at our expanding traditional ground campus. We attribute the significant growth in our enrollment to our increasing brand recognition and the value proposition that our ground traditional campus affords to traditional-aged students and their parents. After scholarships, our ground traditional students pay for tuition, room, board, and fees, often half to a third of what it costs to attend a private, traditional university in another state and an amount comparable to what it costs to attend a public university. We plan to continue increasing enrollment growth for our traditional campus over the next few years, and seek to have 19,000 traditional ground students in attendance at the beginning of our 2017-2018 academic year. In November 2012, we accepted an invitation to become a member of the Division I Western Athletic Conference beginning with the 2013-2014 academic year, and in 2013 we began the four-year process to reclassify our NCAA membership from Division II to Division I. During the reclassification process we are considered a Division I university and are playing full conference schedules but are ineligible to compete for national championships which, for example, precludes us from playing in the end-of-year NCAA basketball tournament during that period of time.

We continue to experience growth in enrollment, net revenue, and operating income over the last several years. Our enrollment at December 31, 2016 was approximately 81,900, representing an increase of approximately 9.9% over our enrollment at December 31, 2015. Our net revenue and operating income for the year ended December 31, 2016 were $873.3 million and $237.2 million, respectively, representing increases of 12.2% and 12.8%, respectively, over the year ended December 31, 2015. Our net revenue and operating income for the year ended December 31, 2015 were $778.2 million and $210.4 million, respectively, representing increases of 12.6% and 16.3%, respectively, over the year ended December 31, 2014. We seek to achieve continued growth in a manner that reinforces our reputation for providing academically rigorous, professionally relevant educational programs that advance the educations and careers of our students.

History

Grand Canyon College was founded in Prescott, Arizona in 1949 as a traditional, private, non-profit college and moved to its existing campus in Phoenix, Arizona in 1951. Established as a Baptist-affiliated institution with a strong emphasis on religious studies, the school initially focused on offering bachelor s degree programs in education. Over the years, the school expanded its curricula to include programs in the sciences, nursing, business, music, and arts. The college obtained regional accreditation in 1968 from the Commission on Institutions of Higher Education, North Central Association of Colleges and Schools, the predecessor to the Higher Learning Commission, and began offering nursing programs and master s degree programs in education and business in the 1980s. In 1989, it achieved university status and became Grand Canyon University. The university introduced its first distance learning programs in 1997, and launched its first online programs in 2003 in business and education. In early 2000, it discontinued its Baptist affiliation and became an interdenominational Christian university.

In late 2003, the school s Board of Trustees initiated a process to evaluate alternatives as a result of the school s poor financial condition and, in February 2004, a group of investors acquired the assets of the school and converted the school into a for-profit institution.

Our Approach to Academic Quality

Some of the key elements that we focus on to promote a high level of academic quality include:

Academically rigorous, professionally relevant curricula. We prepare learners to become global citizens, critical thinkers, effective communicators and responsible leaders by providing an academically challenging, values-based curriculum from the context of our Christian heritage. We create academically rigorous curricula that are designed to enable all students to gain the foundational knowledge, professional competencies, and demonstrable skills required to be successful in their chosen fields. Our curriculum is designed and delivered by faculty and industry-specific subject-matter experts who are committed to high quality, rigorous education and professional preparedness. We design our curricula to address specific objectives that pre-career and working-adult students need and are seeking. Through this combination, we believe that we produce graduates that can compete with integrity and become leaders in their chosen fields.

Qualified faculty. We demonstrate our commitment to high quality education by hiring qualified faculty with relevant practical experience. Substantially all of our current faculty members hold at least a master s degree in their respective fields and approximately 47% of our faculty members of record are doctorate prepared. Further, the University has implemented a full time faculty model for online course instruction. In 2016, almost all of the online first year courses were taught by an online, full time faculty member. We believe the presence of a full time faculty member in the classroom for the first year students results in increased student retention. We invest in the professional development of our faculty members by providing online and ground pedagogical training along with hosting events that encourage the development and sharing of best practices. Additionally, we also monitor and evaluate teaching effectiveness through assessment content reviews, peer reviews, and student evaluations.

Centralized program design and curriculum development. We employ a college driven highly collaboratively designed curriculum development process to ensure a consistent learning experience. We continuously review our programs at least every 3 years in an effort to ensure that they remain consistent, up-to-date, relevant, and effective in producing the desired learning outcomes. We also annually review programmatic assessment results, mission based competency results, graduation rates, retention rates and constituency surveys to identify opportunities for course modifications and upgrades.

Effective student services. We establish teams comprised of admissions and student services counselor personnel that act as the primary support contact point for each of our students, beginning at the application stage and continuing through graduation. We also continually focus on improving the technology used to support student learning, including delivering a new online learning platform and further improving student services through the implementation of online interfaces. As a result, many of our support services, including academic, administrative, financial, library, and career services, are accessible online, generally allowing users to access these services at a time and in a manner that is convenient to them.

Continual academic oversight. We have centralized the support functions of assessment for all of our programs through our Office of Assessment. While each of our colleges continuously evaluates the desired learning outcomes for each of their programs, the Office of Assessment provides data collection and analysis support. We continuously assess outcomes data to determine whether our students graduate with the knowledge, competencies, and skills that are necessary to succeed in the workplace. The Office of Assessment also initiates and manages periodic examinations of the mission-based competencies in our curricula by full-time and adjunct reviewers to evaluate and verify mission-based competency attainment. Based on these processes and student feedback from both programmatic and mission-based assessment, we determine whether to modify or discontinue programs that do not meet our standards or market needs, or to create new programs.

We also offer the following features in an effort to enrich the academic experience of current and prospective students:

Flexibility in program delivery. We seek to meet market demands by providing students with the flexibility to take courses exclusively online or to combine online coursework with various campus and onsite options. For example, based on market demand, particularly in connection with our nursing programs, we have established satellite locations at multiple hospitals that allow nursing students to take clinical courses onsite while completing other course work online. We have established similar onsite arrangements with other major employers, including schools and school districts through which students can pursue student teaching opportunities. This flexibility raises our profile among employers, encourages students to take and complete courses, and eliminates inconveniences that tend to lessen student persistence.

Small class size. At December 31, 2016, 95.1% of our online and professional studies classes had 25 or fewer students. Our average, class size on our ground traditional campus is 25 students. These class sizes provide each student with the opportunity to interact directly with course faculty and to receive individualized feedback and attention while also affording our faculty with the opportunity to engage proactively with a manageable number of students. We believe this interaction enhances the academic quality of our programs by promoting opportunities for students to participate actively and thus build the requisite knowledge, competencies, and skills.

We have been regionally accredited by the Higher Learning Commission and its predecessor since 1968. We were reaccredited in 2007 for the maximum term of ten years and expect to have our accreditation reaffirmed in the Spring of 2017. We believe that our regional accreditation, together with appropriate specialized programmatic accreditations, reflect the quality of our programs, enhance their marketability to students, and improve the employability of our graduates.

Curricula

We offer the degrees of Doctor of Education, Doctor of Business Administration, Doctor of Nursing Practice, Doctor of Philosophy, Education Specialist, Master of Divinity, Master of Arts, Master of Education, Master of Business Administration, Master of Public Administration, Master of Public Health, Master of Science, Bachelor of Arts, and Bachelor of Science and a variety of programs leading to each of these degrees. Many of our degree programs also offer a selection of emphases. We also offer certificate programs, which consist of a series of courses focused on a particular area of study, for both the post-baccalaureate and post-graduate students who seek to enhance their skills and knowledge or achieve additional licensure.

We offer over 200 graduate and undergraduate degree programs and certificates through our nine distinct colleges:

the Colangelo College of Business, which has a well-known brand among our target student population, an advisory board that includes nationally recognized business leaders, and a reputation for offering professionally relevant degree programs;

the College of Doctoral Studies, which utilizes innovative technology, collaboration, and learning communities to develop expert practitioners and researchers who can become leaders in the disciplines and communities they serve;

the College of Education, which has greater than a 60-year history as one of Arizona s leading teacher s colleges and consistently graduates teachers who meet or exceed state averages on the Arizona Educator Proficiency Assessment exams;

the College of Fine Arts and Production, which continues the long and highly regarded tradition that the University has in the Fine Arts;

the Honors College, which serves to develop our most ambitious students across any of our programs and many of these students participate in the Honors Research Fellowship program, which partners students with faculty or industry partners on scientific and applied research projects;

the College of Humanities and Social Sciences, which develops and provides many of the general education course requirements in our other colleges and also serves as one of the vehicles through which we offer programs in additional targeted disciplines;

the College of Nursing and Health Care Professions, which has a strong reputation within the Arizona nursing community and is the largest nursing program in Arizona when considering total college enrollment (bachelor and master s degree students);

the College of Science, Engineering, and Technology, which with science, engineering, technology, and mathematics professions in extremely high demand, driving our economy, continuously evolving, and redefining modern day life is focused on preparing exceptionally competent graduates to enter the dynamic and highly competitive workforce of the 21^{st} century; and

the College of Theology, which serves as one of the many vehicles through which the University affirms its Christian heritage.

Under the overall leadership of our senior academic affairs personnel and the deans of the individual colleges, each of the colleges organizes its academic programs through various departments and schools.

We have established relationships with community colleges, health-care systems, school districts, and other employers through which we offer programs to provide flexibility and convenience to students and their employers. For example, for our nursing programs, we offer clinical courses onsite at hospitals and other health-care centers with which we have partnerships, and also arrange to allow these students to complete their clinical work onsite.

We currently offer our ground-based programs to traditional students through three 15-week semesters in a calendar year and to online students in courses that generally range from five to sixteen weeks throughout the calendar year. Traditional students generally enroll in three or four courses per semester while online students typically concentrate on one course at a time. We require our online students to be actively engaged in their online student classroom at least three or four times each week, depending on the content and degree level of the class, in order to maintain an active dialogue with their professors and classmates. Our online programs provide a digital record of student interactions for the course instructor to assess students levels of engagement and demonstration of required competencies.

New Program Development

To aid us in the identification of potentially new degree programs or emphasis areas, we investigate market demand and review proposals developed by faculty, staff, students, alumni, college specific advisory boards comprised of leaders in their field or other partners. We then perform an analysis of the consistency of the proposed program or emphasis with our mission, long-term demand, and development costs. If, following this analysis, the University Development Committee decides to proceed with a new program, our college faculty and administrators approve subject-matter experts with whom our Curriculum Design and Development Team members, including instructional designers, curriculum developers, librarians, and editors, work to design the program competencies so that it is consistent with our academically rigorous, professionally oriented program standards. The program is then reviewed by the dean of the applicable college, the Program Standards and Evaluation Faculty Committee, the Academic Affairs Committee, and finally, our Provost and Chief Academic Officer. Upon accreditation and regulatory approval, the subject matter experts develop course syllabi, and our Marketing Department creates a marketing plan to publicize the new program. Our average program development process is six months from proposal to course introduction. The development process is typically longer if we are expanding into a new field or offering a new level of degree.

Assessment

Our Office of Assessment serves as our central resource for measuring learning outcomes and student satisfaction and driving systematically engineered and data-driven continuous-improvement cycles for updating our curricula. Among other things, the assessment team reviews student course satisfaction surveys; analyzes archived student assignments to assess whether a given program is developing students foundational knowledge, professional competencies, and college skills to achieve the expected learning outcomes; and provides feedback as to program effectiveness. Based on this data and the conclusions of the assessment team, we modify programs as necessary to meet our student satisfaction and educational development standards.

Faculty

Our faculty includes full-time faculty, as well as adjunct faculty with relevant practical experience whom we employ to teach on a course-by-course basis for a specified fee. Our current faculty members hold at least a master s degree in their respective fields and approximately 47% of our teaching faculty of record hold doctorate degrees.

We believe that the quality of our faculty is critical to our success, particularly because faculty members have more interaction with our students than any other university employee. Accordingly, we regularly review the performance of our faculty, including, but not limited to, engaging our full-time faculty and other specialists to conduct peer reviews of our adjunct faculty, monitoring the amount of contact and the quality of feedback that faculty have with students in our online programs, reviewing student feedback, conducting content reviews and evaluating the learning outcomes achieved by students. If we determine that a faculty member is not performing at the level that we require, we work with the faculty member to improve performance, including, among other things, assigning him or her a mentor or through other means. If the faculty member s performance does not improve, we terminate the faculty member s contract and employment.

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Student Support Services

Encouraging students that enter Grand Canyon University to complete their degree programs is critical to our success. We focus on developing and providing resources that simplify the student enrollment process, acclimate students to our programs and our online environment, support the student educational experience, and track student performance toward degree completion. Many of our support services, including academic, administrative, and library services, are accessible online and are available to our online and ground students, allowing users to access these services at a time and in a manner that is generally convenient to them. The student support services we provide include:

Academic services. We provide students with a variety of services designed to support their academic studies. Our Learning Lounges offer research services, writing services, and other tutoring services. Learning sessions are offered on a one-on-one basis and group sessions.

Administrative services. We provide students with the ability to access a variety of administrative services both telephonically and via the Internet. For example, students can apply for financial aid, pay their tuition, order their transcripts online, and apply for graduation. We believe this online accessibility provides the convenience and self-service capabilities that our students value. Our student services counselors provide personalized online and telephonic support to our students.

Library services. We provide a mix of online and ground resources, services, and instruction to support the educational and research endeavors of all students, faculty, and staff, including ground and online libraries and a qualified library staff that is available to help faculty and students with research, teaching, and library resource instruction. Collectively, our library services meet, or exceed, the requirements set by relevant accrediting bodies for us to offer undergraduate, master s, and doctoral programs.

Career services. For those students seeking to change careers or explore new career opportunities, we offer career services support, including resume review and evaluation, career planning workshops, and access to career services specialists for advice and support. Other resources that we offer include a Job Readiness Program, which advises students on matters such as people skills, resumes and cover letters, mock interviews, and business etiquette; a job board, which advertises employment postings and career exploration opportunities; career counseling appointments and consultations; and career fairs.

Technology support services. We provide online technical support 18 hours per day during the week and 17 hours per day on weekends to help our students remedy technology-related issues. We also provide online tutorials and Frequently Asked Questions for students who are new to online coursework.

Marketing, Recruitment, Admissions and Retention

Marketing. We engage in a range of marketing activities designed to position us as a provider of academically rigorous, professionally relevant educational programs, build strong brand recognition in our core disciplines, differentiate us from other educational providers, raise awareness among prospective students, generate enrollment inquiries, and stimulate student and alumni referrals. We target our online programs to working adults focused on program quality, convenience, and career advancement goals. We target our ground programs to traditional college students, working adults seeking a high quality education in a traditional college setting, and working adults seeking to take classes with a cohort onsite at our leased facilities or at their employer s facility. In marketing our programs to prospective students, we emphasize the value of the educational experience and the academic rigor and professional relevancy of the programs, as well as the cost of the program. We believe this approach reinforces the qualities that we want associated with our brand and also attracts students who tend to be more persistent in starting and finishing their programs.

Recruitment. Once a prospective student has indicated an interest in enrolling in one of our programs, our lead management system identifies and directs a university counselor to initiate immediate communication. The university counselor serves as the primary, direct contact for the prospective student and the counselor s goal is to help that individual gain sufficient knowledge and understanding of our programs so that he or she can assess whether there is a good match between our offerings and the prospective student s goals. Upon the prospective student s submission of an application, the university counselor, together with our student services personnel, works with the applicant to gain acceptance, arrange financial aid, if needed, register for courses, and prepare for matriculation.

Admissions. Admission to Grand Canyon University is available to qualified students who are at least 16 years of age. Undergraduate applicants may qualify in various ways, including by having a high school diploma, certain minimum grade point average levels, certain minimum composite scores on the Scholastic Aptitude Test or on the ACT test, or certain minimum scores on the General Education Development (GED) tests. Some of our programs require a higher grade point average and/or other criteria to qualify for admission. Applicants to our graduate programs must generally have an undergraduate degree from an accredited college, university, or program with a grade point average of 2.8 or greater, or a graduate degree from an accredited college, university, or program. In addition, some students who do not meet the qualifications for admission may be accepted with specification. A student being considered for such admission may be asked to submit additional information such as personal references and an essay addressing academic history. Students may also need to schedule an interview to help clarify academic goals and help us make an informed decision.

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Retention. A key component in retaining our students is providing an outstanding learning experience. We feel that our team-based, proactive approach to recruitment and enhanced student services results in increased retention due to our systematic approach to contacting students at key milestones during their enrollment, providing encouragement and highlighting their achievements. Our student services counselors proactively assist each student with the student s selection of an appropriate payment option, and monitor the student s progress and account balance to ensure a smooth financial aid experience and to help ensure our students are well prepared for the financial obligations they incur. These counselors also assist students with their academic schedules and regularly monitor triggering events, such as the failure to participate in the classroom or failure to matriculate in a timely manner, which signal that a student may be at-risk for dropping out. Upon identifying an at-risk student, these counselors proactively interact with the student to resolve any issues and encourage the student to continue with his or her program. We have found that personally involving our employees in the student educational process, and proactively seeking to resolve issues before they become larger problems, can significantly increase retention rates among students. These frequent interactions between student services counselors and students are a key component to our retention strategy.

Enrollment

At December 31, 2016, we had 81,908 students enrolled in our courses, of which 64,646, or 78.9%, were enrolled in our online programs, and 17,262, or 21.1%, were enrolled in our ground programs. Of our students in online programs, which were geographically distributed throughout all 50 states of the United States, and Canada, and in professional studies programs, 86.5% were age 25 or older. Of our traditional on-campus students, 94.6% were under age 25 and, although we draw students from throughout the United States, a majority were from Arizona.

The following is a summary of our student enrollment at December 31, 2016 and 2015 by degree type and by instructional delivery method:

	December 31, 2016[1]		December 31, 2015[1]	
	# of Students	% of Total	# of Students	% of Total
Graduate degree[2]	33,215	40.6%	29,237	39.2%
Undergraduate degree	48,693	59.4%	45,269	60.8%
Total	81,908	100.0%	74,506	100.0%

	December 31, 2016[1]		December 31, 2015[1]	
	# of Students	% of Total	# of Students	% of Total
Online[3]	64,646	78.9%	59,311	79.6%
Ground[4]	17,262	21.1%	15,195	20.4%
Total	81,908	100.0%	74,506	100.0%

(1) Enrollment at December 31, 2016 and 2015 represents individual students who attended a course during the last two months of the calendar quarter. Includes 847 and 679 students pursuing non-degree certificates at December 31, 2016 and 2015, respectively.

(2) Includes 7,084 and 6,302 students pursuing doctoral degrees at December 31, 2016 and 2015, respectively.

(3) As of December 31, 2016 and 2015, 49.5% and 47.8%, respectively, of our working adult students (online and professional studies students) were pursuing graduate or doctoral degrees.
(4) Includes our traditional on-campus students, as well as our professional studies students.

Tuition and Fees

For the 2016-17 academic year (the academic year begins in May), our prices per credit hour range from $355 to $470 for undergraduate online and professional studies courses, $330 to $630 for graduate online courses, $640 for doctoral online programs, and $688 for undergraduate courses for ground students. For our active duty military and active reserve online and professional studies students, our prices per credit hour are $250 for undergraduate, $400 for graduate courses and $608 for doctoral courses. The overall price of each course varies based upon the number of credit hours per course (with most courses representing four credit hours), the degree level of the program, and the discipline. In addition, we charge a fixed $8,250 block tuition for undergraduate ground students taking between 12 and 18 credit hours per semester, with an additional $688 per credit hour for credits in excess of 18. A traditional undergraduate degree typically requires a minimum of 120 credit hours. The minimum number of credit hours required for a master s degree and overall cost for such a degree varies by program, although such programs typically require approximately 36 credit hours. The doctoral program requires approximately 60 credit hours and on average, doctoral students who graduated during the 2014-2015 academic year required 5.25 dissertation continuation courses to complete their degree. The University did not raise tuition in any of our programs for our 2016-2017 academic year and has not raised tuition for its traditional ground programs in eight years.

Based on current tuition rates, tuition for a full program would generally equate to between $15,450 and $37,000 for an online master s program, between $42,600 and $56,400 for a full four-year online bachelor s program, approximately $66,000 for a full four-year bachelor s program taken on our ground campus, and $48,000 for a full doctoral program including five dissertation continuation courses. Students requiring dissertation continuation courses in excess of five are only charged $500 per course. The tuition amounts referred to above assume no reductions for transfer credits or scholarships, which many of our students utilize to reduce their total program costs. For example, the average student on our ground traditional campus will pay approximately $8,600 in tuition in the 2016-17 school year after scholarships. Thus, based on the number of transfer credits and the scholarships they receive it is likely that a student will pay less than $35,000 in tuition for a bachelor s degree on our ground campus. For the fiscal years ended December 31, 2016, 2015 and 2014, our revenue was reduced by approximately $179.2 million, $163.9 million and $140.0 million, respectively, as a result of scholarships that we offered to our students. The increase in scholarships reflects our increasing use of academic scholarships, to attract high performing students to our ground traditional campus.

We have established a refund policy for tuition and fees based upon individual course start dates. Under our policy, for courses offered through a working adult modality, generally if a student drops or withdraws from a course before the course begins, 100% of the charges for tuition and fees are refunded. If a student drops or withdraws from a course during the first week of the course, 75% of the charges for tuition are refunded. If a student drops or withdraws from a course during or after the second week of a course, tuition charges and fees are not refunded. Most fees, including materials fees, are non-refundable for non-traditional students after the start of a course. We will refund tuition and fees according to the above policy unless a student attending courses online is a resident of a state that requires us to comply with different, state specific guidelines. For traditional students attending 15-week courses, generally if a student withdraws before the course begins, 100% of the charges for tuition and fees are refunded. If a student withdraws during the first week of the course, 90% of the charges for tuition are refunded and instructional fees and ground campus-related fees are refunded. If a student drops or withdraws from a course during the second week of a course, 75% of the tuition charges are refunded but most fees are non-refundable. If a student drops during the third week of a course, 50% of the tuition charges are refunded and during or after the fourth week, there are no refunds for tuition charges. Fees charged by us include graduation fees as well as fees for access to certain educational resources such as online materials. This tuition and fees refund policy is different from, and applies in addition to, the return of Title IV funds policy we are required to follow as a condition of our participation in the Title IV programs.

Sources of Student Financing

Our students finance their education through a combination of methods, as follows:

Title IV programs. The federal government provides for grants and loans to students under the Title IV programs, and students can use those funds at any institution that has been certified as eligible by the Department of Education. Student financial aid under the Title IV programs is primarily awarded on the basis of a student s financial need, which is generally defined as the difference between the cost of attending the institution and the amount the student and the student s family can reasonably contribute to that cost. All students receiving Title IV program funds must maintain satisfactory academic progress toward completion of their program of study. In addition, each school must ensure that Title IV program funds are properly accounted for and disbursed in the correct amounts to eligible students.

During fiscal 2016 and 2015, we derived approximately 72.3% and 74.8%, respectively, of our net revenues (calculated on a cash basis in accordance with Department of Education standards currently in effect) from tuition financed under the Title IV programs. The primary Title IV programs that our students receive funding from are the Federal Direct Loan program or FDL Program, and the Federal Pell Grant, or Pell, Program.

Student loans administered through the FDL Program are currently the most significant source of U.S. federal student aid. There are two types of federal student loans: subsidized loans, which are based on the U.S. federal statutory calculation of student need, and unsubsidized loans, which are not need-based. Neither type of student loan is based on creditworthiness although annual and aggregate loan limits apply based on a student s grade level. Students are generally not responsible for interest on subsidized loans while the student is enrolled in school. Students are responsible for the interest on unsubsidized loans while enrolled in school, but have the option to defer payment while enrolled. Repayment on federal student loans begins six months after the date the student ceases to be enrolled. The loans are repayable over the course of 10 years and, in some cases, longer. Both graduate and undergraduate students are eligible for loans. During fiscal 2016, federal student loans (both subsidized and unsubsidized) represented approximately 81.9% of the gross Title IV funds that we received.

Grants under the Pell Program (Pell Grants) are awarded based on need and only to undergraduate students who have not earned a bachelor s or professional degree. Unlike loans, Pell Grants are not repayable. During fiscal year 2016, Pell Grants represented approximately 13.6% of the gross Title IV funds that we received. For the 2015-16 award year, the maximum amount available under Pell Grants was $5,775 and the maximum income that makes an applicant for Title IV Program funds eligible for an automatic zero Expected Family Contribution was $24,000. For the 2016-2017 award year, the maximum amount available under Pell Grants was increased to $5,815 and the maximum income that makes an applicant to Title IV Program funds eligible for an automatic zero Expected Family Contribution increased to $25,000.

Our students also receive funding under other Title IV programs, including the Federal Perkins Loan Program, the Federal Supplemental Educational Opportunity Grant Program, the Federal Work-Study Program, and the Teacher Education Assistance for College and Higher Education Grant Program.

Other financial aid programs. In addition to the Title IV programs listed above, eligible students may participate in several other financial aid programs or receive support from other governmental sources. These include veterans educational benefits administered by the U.S. Department of Veterans Affairs and state financial aid programs. During fiscal 2016 and 2015, we derived an immaterial amount of our net revenue from tuition financed by such programs.

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Private loans. Some of our students also use private loan programs to help finance their education. Students can apply to a number of different lenders for private loans at current market interest rates. Private loans are intended to fund a portion of students cost of education not covered by the Title IV programs and other financial aid. During fiscal 2016 and 2015, payments derived from private loans constituted less than 1% of our net revenues for each year, respectively.

Other sources. We derived the remainder of our net revenue from tuition that is self-funded or attributable to employer tuition reimbursements.

Technology Systems and Management

We believe that we have established secure, reliable and scalable technology systems that provide a high quality educational environment and that give us the capability to substantially grow our online and traditional programs and enrollment.

Online course delivery and management. Our online delivery platform was developed in partnership with a third party and put into full production in 2011. We have a prepaid license for this platform for the foreseeable future as well as full source code rights. Because of its modular implementation, this platform can easily and reliably scale as our student population increases. The platform provides in depth analytics that allows us to closely monitor student success and the quality of our instructional resources. All ground and online students receive online course delivery and resources through this learning management platform.

Internal administration. We utilize a commercial customer relations management development platform to distribute, manage, track, and report on all interactions with prospective student leads as well as all active and inactive students. This software is scalable to capacity levels well in excess of current requirements. We also utilize a commercial software package to track Title IV funds, student records, grades, accounts receivable, accounts payable and general ledger.

Infrastructure. We operate two data centers, one at our campus and one at another Phoenix-area location. All of our servers are networked and we have redundant data backup. We manage our technology environment internally. Our wide area network is fully redundant to ensure maximum uptime, bandwidth capacity and network performance. Student access is load balanced for maximum performance. Real-time monitoring provides current system status across network, server, and storage components.

Ground Campus

We own our ground campus, which is located on over 260 acres in the center of the Phoenix, Arizona metropolitan area, near downtown Phoenix. Our on-campus facilities currently consist of classroom buildings, lecture halls, a 300-seat theater, a 155,000-volume newly renovated library, a media arts complex that provides communications students with audio and video equipment, a 55,000 square foot recreation center for both student-athletes and on-campus students, a 140,000 square foot/ 7,500 seat basketball and entertainment arena, a gymnasium, an activity center that contains a food court, a bowling alley and other student services, a student union which was recently remodeled and expanded, residence halls, apartments, campus pools, athletic facilities and parking garages. Additionally, we have several office buildings used for administration. In order to accommodate the continued growth of our traditional ground population, we completed four additional residence halls, a classroom building for our College of Science, Engineering and Technology and a third parking structure prior to the 2015/2016 school year and prior to the 2016/2017 school year we completed construction on three apartment style residence halls, an additional 170,000 square foot classroom building for its College of Science, Engineering and Technology, a student service center and a fourth parking structure.

We have 21 intercollegiate athletic teams that currently compete in Division I of the National Collegiate Athletic Association (NCAA). Our athletic facilities include the University Arena (a 7,500 seat venue for all men s and women s basketball games plus select other GCU athletic competitions, concerts, speakers and other events); a stadium that hosts NCAA men s and women s soccer as well as several club sports programs; a basketball practice facility; on-campus tennis courts; beach volleyball courts; and a competition/practice gymnasium, which accommodates men s and women s volleyball and competitive events. In addition, the University s 55,000 square foot student recreation center has state of the art training facilities for our 400 student-athletes plus practice space and locker rooms for men s and women s basketball. Our baseball, softball and track and field programs utilize on-campus practice and competition sites. In January 2016 the Grand Canyon University Championship golf course opened to the public. The men s and women s golf teams have dedicated practice facilities, a team room and coaches offices at the course. The cross-country and swimming programs utilize off-campus sites for practice and competition. The University won the 2012-13 and 2011-12 Learfield Sports Directors Cup as the top overall NCAA Division II intercollegiate athletic program based on the combined success in all of the sports in which we competed. We advanced 16 programs into NCAA Championship competition and gained top 10 finishes in nine separate sports. In November 2012, we accepted an invitation to be a member of the NCAA Division I Western Athletic Conference beginning with the 2013-14 academic year and in September 2013 we began playing full Division I schedules. In June 2016, the University successfully completed all year three requirements and was advanced to the fourth and final year of reclassification. During the 2015-2016 academic year, men s tennis won its first ever conference title while the men s and women s track teams swept the indoor and outdoor track and field conference championships. GCU televises home athletic events in multiple sports highlighted by the men s basketball games that have averaged approximately 5,800 fans per night with most games played when the students are not on semester break at or near capacity.

We believe our ground-based programs and traditional campus not only offer our ground students, faculty, and staff an opportunity to participate in a traditional college experience, but also provide our online students, faculty, and staff with a sense of connection to a traditional university. Additionally, our full-time ground faculty play an important role in integrating online faculty into our academic programs and ensuring the overall consistency and quality of the ground and online student experience. We believe the mix of our online program with our traditional ground-based program with a greater than 60-year history and heritage differentiates us from other for-profit postsecondary education providers.

We intend to continue to expand the size and enhance the profile and reputation of our ground campus by, among other things, adding faculty, excelling in the performance areas such as athletics, debate, theatre, music and dance, expanding upon our campus infrastructure and technological capabilities, and potentially adding additional locations in the Southwest United States. These activities will require significant capital expenditures.

Employees

As of December 31, 2016, we employed approximately 3,850 full-time faculty, and staff and administrative personnel in university services, academic advising and academic support, enrollment services, university administration, financial aid, information technology, human resources, corporate accounting, finance, and other administrative functions. None of our employees is a party to any collective bargaining or similar agreement with us. We consider our relationships with our employees to be good.

Community Involvement and the Public Good

The University has embarked on a five-point plan to revitalize its West Phoenix neighborhood through the following initiatives. We believe these initiatives reflect well on the University and its employees, make the University more appealing to students and prospective students, help us develop strong working relationships with local government bodies, and continue to build the Grand Canyon University brand.

Significant support for K-12 education. We have expanded our free tutoring/mentoring program to 25 Phoenix-area high schools. This program, which is served by over 1,200 University students, operates in partnership with Phoenix-area businesses to provide 100 full-tuition scholarships to attend Grand Canyon University each year for students from inner-city schools.

Increased home values. Together with Habitat for Humanity, we participated in the largest home renovation project in the country in the West Phoenix area. These efforts, combined with the University s expanded presence in the community, has resulted in a 30 percent increase in home values in the 85017 zip code in the past year.

Improved safety. We are in the fourth year of a $1.0 million partnership with City of Phoenix Police Department that focuses on improving safety and reducing crime in the communities surrounding our campus. Since the initiation of this program, crime has decreased by 30 percent in the two-mile radius surrounding the University.

Job creation on the campus. We have tripled the number of our full-time employees from 1,219 in 2008 to nearly 4,000 by the end of 2016.

Job creation off campus. We are launching ten new business enterprises that will provide management opportunities for recent graduates and employment opportunities for current students and neighborhood residents, while spurring economic growth in the area.

The University is also involved in countless community events and projects throughout the year, helping organizations such as the Phoenix Dream Center, Feed My Starving Children, Hopefest, Arizona Foster Care, Phoenix Rescue Mission, Boy/Girl Scouts, Goodwill Arizona, St. Vincent de Paul, Young Life, Elevate Phoenix and St. Mary s Food Bank. The University also puts on popular gift drives at Christmas and Easter to help brighten those seasons for many underprivileged families. Our faculty, staff and students also go out into our surrounding neighborhoods to participate in University-sponsored programs such as Serve the City, Canyon Kids, Salute Our Troops, Colter Commons senior home visits and the Run to Fight Children s Cancer.

Competition

There are more than 4,000 U.S. colleges and universities serving traditional and adult students. Competition is highly fragmented and varies by geography, program offerings, modality, ownership, quality level, and selectivity of admissions. No one institution has a significant share of the total postsecondary market.

Our ground program competes with Arizona State University, Northern Arizona University, and the University of Arizona, the in-state public universities, as well as two-year colleges within the state community college system. Our ground program also competes with geographically proximate universities with similar religious heritages, including Azusa Pacific University, Baylor University, and Pepperdine University. Our online programs compete with local, traditional universities geographically located near each of our prospective students, and with other for-profit postsecondary schools that offer online degrees, particularly those schools that offer online graduate programs within our core disciplines.

Non-profit institutions receive substantial government subsidies, and have access to government and foundation grants, tax-deductible contributions and other financial resources generally not available to for-profit schools. Accordingly, non-profit institutions may have instructional and support resources that are superior to those in the for-profit sector. In addition, some of our competitors, including both traditional colleges and universities and other for-profit schools, have substantially greater name recognition and financial resources than we have, which may enable them to compete more effectively for potential students. We also expect to face increased competition as a result of new entrants to the online education market, including established colleges and universities that had not previously offered online education programs.

We believe that the competitive factors in the postsecondary education market include:

- availability of professionally relevant and accredited program offerings;
- the types of degrees offered and the marketability of those degrees;
- reputation, regulatory approvals, and compliance history of the school;
- convenient, flexible and dependable access to programs and classes;
- qualified and experienced faculty;
- quality of the ground campus facilities;
- level of student support services;

cost of the program;

the effectiveness of marketing and sales efforts; and

the time necessary to earn a degree.

Proprietary Rights

We own or are licensed to use various intellectual property rights, including copyrights, trademarks, service marks, trade secrets and domain names. We license the right to utilize the name of Jerry Colangelo in connection with our business school and our Colangelo School of Sports Business that we operate within our business school, and we have spent significant resources in related branding efforts. While such intellectual property rights are important to us, we do not believe that the loss of any individual property right or group of related rights would have a material adverse effect on our overall business.

Available Information

Our Internet address is www.gcu.edu. We make available free of charge on our website our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Forms 3, 4, and 5 filed on behalf of directors and executive officers, and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission (hereafter, the SEC). In addition, our earnings conference calls are web cast live via our website. In addition to visiting our website, you may read and copy any document we file with the SEC at the SEC s Public Reference Room at 100 F. Street NE, Washington, D.C. 20549 or at www.sec.gov. Please call the SEC at 1-800-SEC-0330 for information on the Public Reference Room.

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REGULATION

We are subject to extensive regulation by state education agencies, accrediting commissions, and the federal government through the Department of Education under the Higher Education Act. The regulations, standards, and policies of these agencies cover the vast majority of our operations, including our educational programs, facilities, instructional and administrative staff, administrative procedures, marketing, recruiting, financial operations, athletics and financial condition.

As an institution of higher education that grants degrees and certificates, we are required to be authorized by appropriate state education authorities. In addition, in order to participate in the federal student financial aid programs, we must be accredited by an accrediting commission recognized by the Department of Education. Accreditation is a private, non-governmental process for evaluating the quality of educational institutions and their programs in areas including student performance, governance, integrity, educational quality, faculty, physical resources, administrative capability and resources, and financial stability. The Higher Education Act requires accrediting commissions recognized by the Department of Education to review and monitor many aspects of an institution s operations and to take appropriate action if the institution fails to meet the accrediting commission s standards.

Our operations are also subject to regulation by the Department of Education due to our participation in the federal student financial aid programs under Title IV of the Higher Education Act. Those Title IV programs include educational loans with below-market interest rates that are issued by the federal government under the Federal Direct Loan program (the FDL Program), as well as grant programs for students with demonstrated financial need. To participate in the Title IV programs, a school must receive and maintain authorization by the appropriate state education agency or agencies, be accredited by an accrediting commission recognized by the Department of Education, and be certified as an eligible institution by the Department of Education.

Our business activities are planned and implemented to comply with the standards of these regulatory agencies. We employ a Vice President of Student Financial Aid Compliance who is knowledgeable about regulatory matters relevant to student financial aid programs and our Chief Financial Officer, Chief Risk Officer, Senior Vice President of Academic Affairs and General Counsel also provide oversight designed to ensure that we meet the requirements of our regulated operating environment.

State Education Licensure and Regulation

We are authorized to offer our educational programs by the Arizona State Board for Private Postsecondary Education, the regulatory agency governing private postsecondary educational institutions in the State of Arizona, where we are located. We do not presently have campuses in any states other than Arizona, although we do have one location in Albuquerque, New Mexico. We are required by the Higher Education Act to maintain authorization from the Arizona State Board for Private Postsecondary Education in order to participate in the Title IV programs. This authorization is very important to us and our business. To maintain our state authorization, we must continuously meet standards relating to, among other things, educational programs, facilities, instructional and administrative staff, marketing and recruitment, financial operations, addition of new locations and educational programs, and various operational and administrative procedures. Our failure to comply with the requirements of the Arizona State Board for Private Postsecondary Education could result in us losing our authorization to offer our educational programs, which would cause us to lose our eligibility to participate in the Title IV programs and could force us to cease operations. Alternatively, the Arizona State Board for Private Postsecondary Education could restrict our ability to offer certain degree and non-degree programs.

The Department of Education released a final rule on state authorizations of distance learning programs, which will become effective on July 1, 2018, unless repealed or overruled. As written, the rule provides that programs may be authorized pursuant to certain reciprocity agreements among states. We are an approved institutional participant in the State Authorization Reciprocity Agreement (SARA). SARA is an agreement among member states, districts and territories that establishes comparable national standards for interstate offering of postsecondary distance education courses and programs. It is intended to make it easier for students to take online courses offered by postsecondary institutions based in another state. SARA is overseen by a national council (NC-SARA) and administered by four regional education compacts, for which Arizona is a W-SARA member. There is a yearly renewal for participating in NC-SARA and AZ-SARA and institutions must agree to meet certain requirements to participate. As of December 31, 2016, 47 states are members of SARA.

Some states that do not participate in SARA impose regulatory requirements on out-of-state educational institutions operating within their boundaries, such as those having a physical facility or conducting certain academic activities within the state. We currently enroll students in all 50 states and the District of Columbia. Although we are currently licensed, authorized, in-process, or exempt in all non-SARA jurisdictions in which we operate, if we fail to comply with state licensing or authorization requirements for a state, or fail to obtain licenses or authorizations when required, we could lose our state license or authorization by that state or be subject to other sanctions, including restrictions on our activities in, and fines and penalties imposed by, that state, as well as fines, penalties, and sanctions imposed by the Department of Education. The loss of licensure or authorization in any non-SARA state could prohibit us from recruiting prospective students or offering services to current students in that state, which could significantly reduce our enrollments.

Individual state laws establish standards in areas such as instruction, qualifications of faculty, administrative procedures, marketing, recruiting, financial operations, and other operational matters, some of which are different than the standards prescribed by the Department of Education or the Arizona State Board for Private Postsecondary Education. Laws in some states limit schools ability to offer educational programs and award degrees to residents of those states. Some states also prescribe financial regulations that are different from those of the Department of Education, and may require the posting of surety bonds.

State Professional Licensure

Many states have specific requirements that an individual must satisfy in order to be licensed as a professional in specified fields, including fields such as education and healthcare, and counseling. These requirements vary by state and by field. A student s success in obtaining licensure following graduation typically depends on several factors, including the background and qualifications of the individual graduate, as well as the following factors, among others:

- whether the institution and the program were approved by the state in which the graduate seeks licensure, or by a professional association;
- whether the program from which the student graduated meets all requirements for professional licensure in that state;
- whether the institution and the program are accredited and, if so, by what accrediting commissions; and
- whether the institution s degrees are recognized by other states in which a student may seek to work.

Many states also require that graduates pass a state test or examination as a prerequisite to becoming certified in certain fields, such as teaching and nursing. Many states will certify individuals if they have already been certified in another state.

Our College of Education is approved by the Arizona State Department of Education to offer Institutional Recommendations (credentials) for the certification of elementary, secondary, and special education teachers and school administrators. Our College of Nursing and Health Care Professions is approved by the Arizona State Board of Nursing for the Bachelor of Science in Nursing and advanced practice Master of Science in Nursing degrees. Our College of Humanities and Social Sciences is approved by the National Addiction Studies Accreditation Commission (NASAC). Due to varying requirements for professional licensure and certification in states other than Arizona, we inform students of the risks associated with obtaining professional licensure or certification and that it is each student s responsibility to determine what state, local or professional licensure and certification requirements are necessary in his or her individual state.

Accreditation

Accreditation is a private, non-governmental process for evaluating the quality of educational institutions and their programs in areas including student performance, governance, integrity, educational quality, faculty, physical resources, administrative capability and resources, and financial stability. To be recognized by the Department of

Education, accrediting commissions must adopt specific standards for their review of educational institutions, conduct peer-review evaluations of institutions, and publicly designate those institutions that meet their criteria. An accredited school is subject to periodic review by its accrediting commissions to determine whether it continues to meet the performance, integrity and quality required for accreditation.

Grand Canyon University has been regionally accredited by the Higher Learning Commission and its predecessor since 1968, most recently obtaining reaccreditation in 2007 for the ten-year period through 2017. Following a comprehensive evaluation by the Higher Learning Commission during the Fall of 2016, we expect our accreditation to be reaffirmed in the Spring of 2017. Accreditation by the Higher Learning Commission is important to us for several reasons, including the fact that it enables our students to receive Title IV financial aid. Other colleges and universities depend, in part, on an institution s accreditation in evaluating transfers of credit and applications to graduate schools. Employers rely on the accredited status of institutions when evaluating candidates credentials, and students and corporate and government sponsors under tuition reimbursement programs look to accreditation for assurance that an institution maintains quality educational standards.

In addition to our institutional accreditation, we have specialized accreditations for certain programs, including from the National Addiction Studies Accreditation Commission (NASAC), the Accreditation Council for Business Schools and Programs (ACBSP), the Commission on Collegiate Nursing Education (CCNE), and the Commission on Accreditation of Athletic Training Education (CAATE). In addition, Grand Canyon Theological Seminary is an Associate Member of the Association of Theological Schools in the United States and Canada (ATS). We believe that our institution-wide regional accreditation, together with these specialized accreditations, reflect the quality of our programs, enhance their marketability to students, and improve the employability of our graduates.

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Regulation of Federal Student Financial Aid Programs

To be eligible to participate in the Title IV programs, an institution must comply with specific requirements contained in the Higher Education Act and the regulations issued thereunder by the Department of Education. An institution must, among other things, be licensed or authorized to offer its educational programs by the state in which it is physically located (in our case, Arizona) and maintain institutional accreditation by an accrediting commission recognized by the Department of Education (in our case, the Higher Learning Commission).

The substantial amount of federal funds disbursed to schools through the Title IV programs, the large number of students and institutions participating in these programs, and allegations of fraud and abuse by certain for-profit educational institutions have caused Congress to require the Department of Education to exercise considerable regulatory oversight over for-profit educational institutions. As a result, our institution is subject to extensive oversight and review. Because the Department of Education periodically revises its regulations and changes its interpretations of existing laws and regulations, we cannot predict with certainty how the Title IV program requirements will be applied in all circumstances.

Significant regulations and other factors relating to the Title IV programs that could adversely affect us include the following:

Congressional action. Congress must reauthorize the Higher Education Act on a periodic basis, usually every five to six years, and the most recent reauthorization occurred in August 2008. The reauthorized Higher Education Act reauthorized all of the Title IV programs in which we participate, but made numerous revisions to the requirements governing the Title IV programs, including provisions relating to student loan default rates and the formula for determining the maximum amount of revenue that institutions are permitted to derive from the Title IV programs. In addition, members of Congress periodically introduce legislation that would impact Title IV programs and our industry generally. Moreover, the Congressional Review Act provides Congress an expedited path to disapproving rules made by federal agencies, including the Department of Education, during transitions between presidential administrations, which could also impact Title IV programs and our industry generally. Because a significant percentage of our revenue is derived from the Title IV programs, any action by Congress that significantly reduces Title IV program funding or our ability or the ability of our students to participate in the Title IV programs could increase our costs of compliance, reduce the ability of some students to finance their education at our institution, require us to seek to arrange for other sources of financial aid for our students and materially decrease our student enrollment.

Regulatory changes. In October 2016, the Department of Education announced the final regulations relating to a new federal standard and a process for determining whether a borrower has a defense to repayment on federal student loans based on an act or omission of a school. The new regulations, which largely go into effect as of July 1, 2017, will provide repayment relief to students in respect of student loans first disbursed after July 1, 2017 where: a school breaches contractual promises to a student; certain judgments are entered against a school related to the loan or the educational services after a contested proceeding; or the school makes substantial misrepresentations about the nature of its educational programs, financial charges or employability of graduates, or insubstantial misrepresentations where other factors are present, such as pressure to enroll quickly or taking advantage of students distress or lack of knowledge or sophistication. The regulations will allow the Department of Education to identify and grant relief to groups of students where there are common facts, including students who have not requested relief, and will entitle the Department of Education to seek reimbursement from the school in most cases in respect of loans discharged under the new procedure. Schools will be completely barred from requiring, or even asking, students to agree to settle future disputes through arbitration.

In addition, the final regulations will automatically require a school to post a letter of credit in the amount of at least 10% of the school s annual Title IV disbursements upon the occurrence of specified events such as the commencement of a major lawsuit by a state or federal government entity; the filing of a substantial number of borrower defense claims; a default by the school on its debt obligations; the failure of the school to satisfy the 90/10 Rule; and/or action by the school s accreditor that could result in the school losing its accreditation. If a school experiences any of these triggers, the school will be required to warn prospective and current students that it has been required to provide enhanced financial protection to the Department of Education. The final regulations also will require disclosure by proprietary institutions to prospective and enrolled students if student loan repayment rates fall below specified levels.

Under the final regulations, the precise standards for student loan discharge may be unclear or subject to interpretation or Department of Education discretion in a manner that is adverse to us and not fully known or predictable in advance. In addition, certain of the potential adverse consequences could arise from actions or claims, such as the mere commencement of enforcement actions by state or federal government entities or the filing of student claims for debt relief, which ultimately are found to lack merit. Each of these consequences could materially and adversely affect our business or require us to change our practices and procedures in a manner that materially increases our costs and reduces our administrative effectiveness. In addition, our flexibility in responding to state or federal and certain private lawsuits may be materially reduced because of the possible significant ancillary consequences of an adverse judgment or finding.

Eligibility and certification procedures. Each institution must apply periodically to the Department of Education for continued certification to participate in the Title IV programs. Such recertification generally is required every six years, but may be required earlier, including when an institution undergoes a change in control. An institution may also come under the Department of Education s review when it expands its activities in certain ways, such as opening an additional location, adding a new educational program or modifying the academic credentials it offers. The Department of Education may place an institution on provisional certification status if it finds that the institution does not fully satisfy all of the eligibility and certification standards and in certain other circumstances, such as when an institution is certified for the first time or undergoes a change in control. During the period of provisional certification, the institution must comply with any additional conditions included in the school s program participation agreement with the Department of Education. In addition, the Department of Education may more closely review an institution that is provisionally certified if it applies for recertification or approval to open a new location, add an educational program, acquire another school, or make any other significant change. If the Department of Education determines that a provisionally certified institution is unable to meet its responsibilities under its program participation agreement, it may seek to revoke the institution s certification to participate in the Title IV programs without advance notice or opportunity for the institution to challenge the action. Students attending provisionally certified institutions remain eligible to receive Title IV program funds.

On October 28, 2013, the University received a new program participation agreement with full certification from the Department of Education, which gives the University the ability to participate in the Title IV programs through September 30, 2017.

Administrative capability. Department of Education regulations specify extensive criteria by which an institution must establish that it has the requisite administrative capability to participate in the Title IV programs. To meet the administrative capability standards, an institution must, among other things:

- comply with all applicable Title IV program requirements;
- have an adequate number of qualified personnel to administer the Title IV programs;
- have acceptable standards for measuring the satisfactory academic progress of its students;
- not have student loan cohort default rates above specified levels;
- have various procedures in place for awarding, disbursing and safeguarding Title IV funds and for maintaining required records;
- administer the Title IV programs with adequate checks and balances in its system of internal controls;
- not be, and not have any principal or affiliate who is, debarred or suspended from federal contracting or engaging in activity that is cause for debarment or suspension;

provide financial aid counseling to its students;

refer to the Department of Education s Office of Inspector General any credible information indicating that any student, parent, employee, third-party servicer or other agent of the institution has engaged in any fraud or other illegal conduct involving the Title IV programs;

submit all required reports and consolidated financial statements in a timely manner; and

not otherwise appear to lack administrative capability.

If an institution fails to satisfy any of these criteria, the Department of Education may:

require the institution to repay Title IV funds its students previously received;

transfer the institution from the advance method of payment of Title IV funds to heightened cash monitoring status or the reimbursement system of payment;

place the institution on provisional certification status; or

commence a proceeding to impose a fine or to limit, suspend or terminate the institution s participation in the Title IV programs.

Financial responsibility. The Higher Education Act and Department of Education regulations establish extensive standards of financial responsibility that institutions such as Grand Canyon University must satisfy in order to participate in the Title IV programs. The Department of Education evaluates institutions for compliance with these standards on an annual basis based on the institution s annual audited consolidated financial statements, as well as when the institution applies to the Department of Education to have its eligibility to participate in the Title IV programs recertified. The most significant financial responsibility standard is the institution s composite score, which is derived from a formula established by the Department of Education based on three financial ratios:

equity ratio, which measures the institution s capital resources, financial viability and ability to borrow;

primary reserve ratio, which measures the institution s ability to support current operations from expendable resources; and

net income ratio, which measures the institution s ability to operate at a profit or within its means.

The Department of Education assigns a strength factor to the results of each of these ratios on a scale from negative 1.0 to positive 3.0, with negative 1.0 reflecting financial weakness and positive 3.0 reflecting financial strength. The Department of Education then assigns a weighting percentage to each ratio and adds the weighted scores for the three ratios together to produce a composite score for the institution. The composite score for an institution s most recent fiscal year must be at least 1.5 for the institution to be deemed financially responsible without the need for further Department of Education oversight. Our composite scores for our fiscal years ended December 31, 2015, 2014 and 2013 were 2.6, 3.0 and 3.0, respectively, and, therefore, we are considered financially responsible for purposes of these regulations. We have not yet submitted our consolidated financial statements to the Department of Education for our 2016 fiscal year, but have calculated that our composite score for the 2016 fiscal year will be 2.5. We have modeled our composite score for future years using, among other estimates, our estimated ground campus capital expenditures and believe that our composite score will remain at a financially responsible level for the foreseeable future.

In addition to having an acceptable composite score, an institution must, among other things, provide the administrative resources necessary to comply with Title IV program requirements, meet all of its financial obligations, including required refunds to students and any Title IV liabilities and debts, be current in its debt payments, and not receive an adverse, qualified, or disclaimed opinion by its accountants in its audited consolidated financial statements. If the Department of Education were to determine that we did not meet the financial responsibility standards due to a failure to meet the composite score or other factors, we would expect to be able to establish financial responsibility on an alternative basis permitted by the Department of Education, which could include, in the Department of Education s discretion, posting a letter of credit, accepting provisional certification, complying with additional Department of Education monitoring requirements, agreeing to receive Title IV program funds under an arrangement other than the Department of Education s standard advance funding arrangement, such as the reimbursement system of payment or heightened cash monitoring, and complying with or accepting other limitations on our ability to increase the number of programs we offer or the number of students we enroll.

Return of Title IV funds for students who withdraw. When a student who has received Title IV program funds withdraws from school, the institution must determine the amount of Title IV program funds the student has earned and then must return the unearned Title IV program funds (a return to Title IV) to the appropriate lender or the Department of Education in a timely manner, which is generally no later than 45 days after the date the institution determined that the student withdrew. If such payments are not timely made, the institution will be required to submit a letter of credit to the Department of Education equal to 25% of the Title IV funds that the institution should have returned for withdrawn students in its most recently completed fiscal year. Under Department of Education regulations, the letter of credit requirement is triggered by late returns of Title IV program funds for 5% or more of the withdrawn students (and involving more than two student refunds) in the audit sample in the institution s annual Title IV compliance audit for either of the institution s two most recent fiscal years or in a Department of Education program review. We did not exceed this 5% threshold in our annual Title IV compliance audits for 2015 (the most recent year for which we have completed a Title IV compliance audit), 2014 or 2013.

The 90/10 Rule. A requirement of the Higher Education Act, commonly referred to as the 90/10 Rule, that is applicable only to for-profit, postsecondary educational institutions like us, provides that an institution loses its eligibility to participate in the Title IV programs if the institution derives more than 90% of its revenue for each of two consecutive fiscal years from Title IV program funds. For purposes of the 90/10 Rule, revenue is calculated under a complex regulatory formula that requires cash basis accounting and other adjustments to the calculation of an institution s revenue under generally accepted accounting principles that appears in its consolidated financial statements. Under the 90/10 Rule, an institution becomes ineligible to participate in the Title IV programs as of the first day of the fiscal year following the second consecutive fiscal year in which it exceeds the 90% threshold, and its period of ineligibility extends for at least two consecutive fiscal years. If an institution exceeds the 90% threshold for two consecutive fiscal years and it and its students have received Title IV funds during the subsequent period of ineligibility, the institution will be required to return those Title IV funds to the applicable lender or the Department of Education. If an institution s rate exceeds 90% for any single fiscal year, it will be placed on provisional certification for at least two fiscal years.

Using the Department of Education s cash-basis, regulatory formula under the 90/10 Rule as currently in effect, for our 2016, 2015, and 2014 fiscal years, we derived approximately 72.3%, 74.8%, and 76.5%, respectively, of our 90/10 Rule revenue from Title IV program funds.

As a result of the continuing increase in the number of students attending our ground campus, who typically finance a greater percentage of their educational costs with non-Title IV sources of funds, we expect the percentage of our revenue that we receive from Title IV programs to remain stable or to continue to decrease in the future, although this may be impacted by recent changes in federal law that increased Title IV grant and loan limits, as well as the ongoing economic environment, which has adversely affected the employment circumstances of our students and their parents and increased their reliance on Title IV programs.

Student loan defaults. Under the Higher Education Act, an educational institution may lose its eligibility to participate in some or all of the Title IV programs if defaults by its students on the repayment of their federal student loans exceed certain levels. For each federal fiscal year, the Department of Education calculates a rate of student defaults for each institution (known as a cohort default rate). The reauthorization of the Higher Education Act in 2008 extended the measurement period for cohort default rates so that the rate is calculated by determining the rate at which borrowers who became subject to their repayment obligation in one federal fiscal year default in that same year or by the end of the second year following the first federal fiscal year (the three-year method).

The Department of Education applies legal thresholds to measure an institution s compliance. If the Department of Education notifies an institution that its cohort default rates exceeded 30%, for each of its three most recent federal fiscal years, the institution s participation in the FDL Program and the Pell grant program would end 30 days after that notification, unless the institution appeals that determination in a timely manner on specified grounds and according to specified procedures. In addition, an institution s participation in the FDL Program would end 30 days after notification by the Department of Education that its most recent cohort default rate, is greater than 40%, unless the institution timely appeals that determination on specified grounds and according to specified procedures. An institution whose participation ends under either of these provisions may not participate in the relevant programs for the remainder of the fiscal year in which the institution receives the notification or for the next two fiscal years. If an institution s cohort default rate for any single federal fiscal year equals or exceeds 30%, the Department of Education may place the institution on provisional certification status.

Our cohort default rates on federal student loans for the 2013, 2012 and 2011 federal fiscal years, the latest years for which such rates are available, were 9.2%, 10.3% and 15.7%, respectively.

Incentive compensation rule. An institution that participates in the Title IV programs may not provide any commission, bonus, or other incentive payment based directly or indirectly on success in securing enrollments or financial aid to any person or entity engaged in any student recruitment, admissions, or financial aid awarding activity. Prior to July 1, 2011, Department of Education regulations included 12 safe harbors that described payments and arrangements that did not violate the incentive compensation rule. Under new rules effective July 1, 2011, the 12 safe harbors were eliminated. The restrictions of the incentive compensation rule, which extend to any third-party companies that an educational institution contracts with for student recruitment, admissions, or financial aid awarding services, increase the uncertainty about what constitutes incentive compensation and which employees are covered by the regulation. This makes the development of effective and compliant performance metrics more difficult to establish. As such, these changes limit our ability to compensate our employees based on their performance of their job responsibilities, which could make it more difficult to attract and retain highly-qualified employees.

Compliance reviews. We are subject to announced and unannounced compliance reviews and audits by various external agencies, including the Department of Education, its Office of Inspector General, state licensing agencies, the applicable state approving agencies for financial assistance to veterans, and accrediting commissions. As part of the Department of Education s ongoing monitoring of institutions administration of the Title IV programs, the Higher Education Act also requires institutions to annually submit to the Department of Education a Title IV compliance audit conducted by an independent certified public accountant in accordance with applicable federal and Department of Education audit standards. In addition, to enable the Department of Education to make a determination of an institution s financial responsibility, each institution must annually submit audited financial statements prepared in accordance with Department of Education regulations.

In connection with its administration of the Title IV federal student financial aid programs, the Department of Education periodically conducts program reviews at selected schools that receive Title IV funds. In April 2014, the Department of Education initiated a program review of Grand Canyon University that focused on the University s administration of the Title IV programs in which it participates, its administration of the Clery Act and related regulations, and its compliance with the requirements of the Drug-Free Schools and Communities Act for the 2012-2013 and 2013-2014 award years. The final program review determination letter received in June 2014 set forth three findings, each of which involved individual student-specific information gathering and/or reporting errors and all of which the University promptly corrected to the Department of Education s satisfaction. Accordingly, the final program review determination letter concluded that the University had taken all corrective actions necessary to resolve the findings and that the program review had been closed with no further action required.

Gainful employment rules. Under the Higher Education Act, proprietary schools are eligible to participate in Title IV programs in respect of educational programs that lead to gainful employment in a recognized occupation, with the limited exception of qualified programs leading to a bachelor s degree in liberal arts. Historically, this concept has not been defined in detail. In October 2014, the Department of Education published final regulations, effective July 1, 2015, on the metrics for determining whether an academic program prepares students for gainful employment in a recognized occupation. This rule establishes requirements related to the debt to earnings ratio of graduates of our programs, and sets additional disclosure requirements for students. Under the final regulations, which apply on a program-by-program basis, students enrolled in a program will be eligible for Title IV student financial aid only if that program satisfies at least one of two tests relating to student debt service-to-earnings ratios. The two tests specify minimum debt service-to-earnings ratios calculated on the basis of the earnings of program graduates. One test measures student loan debt service as a percentage of total earnings, and 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 other test measures student loan debt service as a percentage of discretionary earnings and 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

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 annual loan payment on the median student loan debt is greater than 12% of the mean or median annual earnings of the graduates or the annual loan payment on the median student debt is greater than 30% of the discretionary income of the graduates. 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. In the first four years that the debt-to-earnings metrics are calculated under the rule (award years 2014-15, 2015-16, 2016-17, and 2017-18), if a program would be failing or in the Zone based on the typical approach to calculating debt-to-earnings metrics, transitional debt-to-earnings rates would be calculated using the most currently available yearly earnings two years after graduation and the annual loan payments of students who completed the program in the most recently completed award year. Transitional rates will be used to assess the program if they are lower than what the rates would be under the normal calculation. This allows programs that promptly lower tuition and fees to realize the benefit of their changes.

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 four current degree programs are in the Zone, including three undergraduate education programs and the Masters in Theology. The University is currently analyzing the data for these programs to determine what changes, if any, should be made.

Schools are also required to certify to the Department the following for each Title IV eligible program:

The program is included in the schools accreditation;

The program is programmatically accredited, if required by a federal government entity, or by a government entity in any state in which the school is located or is required to obtain state approval;

- The program satisfies any applicable state licensing and certification requirements for the occupations for which the program prepares students to enter; and

- The program is not substantially similar to a program offered by the school that became ineligible due to the student debt service-to-earnings ratios.

We believe we successfully submitted the certifications required for all pre-existing programs prior to the December 31, 2015 deadline for doing so. We continue to follow this protocol on an ongoing basis.

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.

This is a complicated rule and, although management will work to achieve compliance with this new rule, the continuing eligibility of our educational programs for Title IV funding is at risk due to factors measured by this rule and beyond our control, such as changes in the actual or deemed income level of our graduates, changes in student borrowing levels, increases in interest rates, changes in the federal poverty income level relevant for calculating discretionary income, and other factors. The exposure to these external factors could reduce our ability to confidently offer or continue certain types of programs for which there is market demand, and therefore would impact our ability to maintain or grow our business.

Substantial misrepresentation. The Higher Education Act prohibits an institution that participates in Title IV programs from engaging in substantial misrepresentation of the nature of its educational program, its financial charges, or the employability of its graduates. The Department of Education has defined a misrepresentation as any statement made by the institution or a third party that provides educational programs, marketing, advertising, recruiting, or admissions services to the institution that is false, erroneous or has the likelihood or tendency to deceive. A substantial misrepresentation is any misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to that person s detriment. Considering the breadth of the definition of substantial misrepresentation, it is possible that despite our efforts to prevent such misrepresentations, our employees or service providers may make statements that could be construed as substantial misrepresentations. As a result, we may face complaints from students and prospective students over statements made by us and our agents throughout the enrollment, admissions and financial aid process, as well as throughout attendance at the University, which would expose us to increased risk of enforcement action and applicable sanctions or other penalties and increased risk of private qui tam actions under the Federal False Claims Act. Under the new rules, if the Department of Education determines that an institution has engaged in substantial misrepresentation, the Department of Education may revoke an institution s program participation agreement, impose limitations on the institution s participation in Title IV programs, deny applications from the institution for approval of new programs or locations or other matters, or initiate proceedings to fine the institution or limit, suspend, or terminate its eligibility to participate in Title IV programs. If the Department of Education determines that statements made by us or on our behalf are in violation of the regulations, we could be subject to sanctions and other liability, which could have a material adverse effect on our business.

Regulatory Standards that May Restrict Institutional Expansion or Other Changes

Many actions that we may wish to take in connection with expanding our operations or other changes are subject to review or approval by the applicable regulatory agencies. In addition to those matters described in detail below, most state education agencies impose regulatory requirements on educational institutions operating within their boundaries.

Adding teaching locations, implementing new educational programs, and increasing enrollment. The requirements and standards of state education agencies, accrediting commissions, and the Department of Education limit our ability in certain instances to establish additional teaching locations, implement new educational programs, or increase enrollment in certain programs. Many states require review and approval before institutions can add new locations or programs, and Arizona also limits the number of pre-licensure nursing students we may enroll (which represents a small portion of our overall nursing program). The Arizona State Board for Private Postsecondary Education, the Higher Learning Commission, and other state education agencies and specialized accrediting commissions that authorize or accredit us and our programs generally require institutions to notify them in advance of adding new locations or implementing new programs, and upon notification may undertake a review of the quality of the facility or the program and the financial, academic, and other qualifications of the institution.

With respect to the Department of Education, if an institution participating in the Title IV programs plans to add a new location or educational program, the institution must generally apply to the Department of Education to have the additional location or educational program designated as within the scope of the institution s Title IV eligibility. However, a degree-granting institution, like Grand Canyon University, that is fully certified to participate in the Title IV programs is not required to obtain the Department of Education s approval of additional programs that lead to a bachelor s, professional, or graduate degree at the same degree level as programs previously approved by the Department of Education, and, similarly, is not required to obtain advance approval for new programs that prepare students for gainful employment in the same or a related recognized occupation as an educational program that has previously been designated by the Department of Education as an eligible program at that institution if it meets certain minimum-length requirements.

Acquiring other schools. While we have not acquired any other schools in the past, we may seek to do so in the future. The Department of Education and virtually all state education agencies and accrediting commissions require a company to seek their approval if it wishes to acquire another school. In our case, we would need to obtain the approval of the Arizona State Board for Private Postsecondary Education or other state education agency that licenses the school being acquired, the Higher Learning Commission, any other accrediting commission that accredits the school being acquired, and the Department of Education. The level of review varies by individual state and accrediting commission, with some requiring approval of such an acquisition before it occurs and others only considering approval after the acquisition has occurred. The Higher Learning Commission would require us to obtain its advance approval of such an acquisition. The approval of the applicable state education agencies and accrediting commissions is a necessary prerequisite to the Department of Education certifying the acquired school to participate in the Title IV programs under our ownership. The restrictions imposed by any of the applicable regulatory agencies could delay or prevent our acquisition of other schools in some circumstances.

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Change in ownership resulting in a change in control. The Department of Education, as well as many accrediting commissions and states, require institutions of higher education to report or obtain approval of certain changes in control and changes in other aspects of institutional organization or control. With respect to publicly traded corporations, like us, Department of Education regulations provide that a change in control occurs if, among other things, the corporation has a stockholder that owns, or has voting control over, at least 25% of the total outstanding voting stock of the corporation and is the largest stockholder of the corporation (defined in the regulations as a controlling shareholder), and that controlling shareholder ceases to own, or have voting control over, at least 25% of such stock or ceases to be the largest stockholder. Under Department of Education regulations, an institution that undergoes a change in control as defined by the Department of Education loses its eligibility to participate in the Title IV programs and must apply to the Department of Education in order to reestablish such eligibility.

The Higher Learning Commission provides that an institution must obtain its approval in advance of a change in ownership, corporate control or structure in order for the institution to retain its accredited status. In certain circumstances that process may require several weeks or several months or more to complete. In addition, following a change in control, the Higher Learning Commission will conduct an onsite evaluation within six months in order to continue the institution s accreditation.

Many states include the sale of a controlling interest of common stock in the definition of a change in control requiring approval, but their thresholds for determining a change in control vary widely. The standards of the Arizona State Board for Private Postsecondary Education provide that an institution that is owned by a publicly traded company whose control is vested in the voting members of the board of directors, such as Grand Canyon Education, undergoes a change in control if 50% or more of the voting members of the board of directors change within a 12-month period or the chief executive officer of the corporation changes. A change in control under the definition of one of the other state agencies that regulate us might require us to obtain approval of a change in control in order to maintain our authorization to operate in that state, and in some cases such states could require us to obtain advance approval of the change in control. If we were to undergo a change in control under the standards of the Arizona State Board of Private Postsecondary Education at any time in the future, we would be required to file an application with the Arizona State Board for Private Postsecondary Education in order to obtain approval for such change in control. We cannot predict whether the Arizona State Board for Private Postsecondary Education would impose any limitations or conditions on us, or identify any compliance issues related to us in the context of the change in control process, that could result in our loss of authorization in Arizona. Any such loss would result in our loss of eligibility to participate in the Title IV programs which would cause a significant decline in our student enrollment.

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Item 1A. *Risk Factors*

You should carefully consider the risks and uncertainties described below and all other information contained in this Annual Report on Form 10-K. In order to help assess the major risks in our business, we have identified many, but not all, of these risks. Due to the scope of our operations, a wide range of factors could materially affect future developments and performance.

If any of the following risks, or risks that we do not anticipate, are realized, our business, financial condition, cash flow or results of operations could be materially and adversely affected, and as a result, the trading price of our common stock could be materially and adversely impacted. These risk factors should be read in conjunction with other information set forth in this Annual Report, including Item 7, *Management s Discussion and Analysis of Financial Condition and Results of Operations*, and Item 8, *Consolidated Financial Statements and Supplementary Data,* including the related Notes to Consolidated Financial Statements.

Risks Related to the Extensive Regulation of Our Industry

Our failure to comply with the extensive regulatory requirements governing our school could result in financial penalties, restrictions on our operations or growth, or loss of external financial aid funding for our students.

To participate in the Title IV programs, a school must be authorized by the appropriate state education agency or agencies, be accredited by an accrediting commission recognized by the Department of Education, and be certified as an eligible institution by the Department of Education. In addition, our operations and programs are regulated by other state education agencies and additional accrediting commissions. As a result of these requirements, we are subject to extensive regulation by the Arizona State Board for Private Postsecondary Education and education agencies of other states, the Higher Learning Commission, which is our primary accrediting commission, specialized accrediting commissions, and the Department of Education. These regulatory requirements cover the vast majority of our operations, including our educational programs, instructional and administrative staff, administrative procedures, marketing, recruiting, financial operations, and financial condition. These regulatory requirements also affect our ability to open additional schools and locations, add new educational programs, change existing educational programs, and change our corporate or ownership structure. The agencies that regulate our operations periodically revise their requirements and modify their interpretations of existing requirements. Regulatory requirements are not always precise and clear, and regulatory agencies may sometimes disagree with the way we have interpreted or applied these requirements. Any misinterpretation by us of regulatory requirements could materially adversely affect us. If we fail to comply with any of these regulatory requirements, we could suffer financial penalties, limitations on our operations, loss of accreditation, termination of or limitations on our ability to grant degrees and certificates, or limitations on or termination of our eligibility to participate in the Title IV programs, each of which could materially adversely affect us. In addition, if we are charged with regulatory violations, our reputation could be damaged, which could have a negative impact on our stock price and our enrollments. The Department of Education and other regulators have increased the frequency and severity of their enforcement actions against postsecondary schools. In some cases, these enforcement actions have resulted in material sanctions, letter of credit requirements, loss of Title IV eligibility, or closure in schools. We cannot predict with certainty how all of these regulatory requirements will be applied, or whether we will be able to comply with all of the applicable requirements in the future.

Rulemaking by the U.S. Department of Education could materially and adversely affect our business.

Over the past few years, the U.S. Department of Education has regularly promulgated new regulations that impact our business. These regulations have increased our operating costs and in some cases required us to change the manner in which we operate our business. In addition, because certain of these regulations have been vacated or blocked as a result of litigation challenging the regulations, there remains substantial uncertainty regarding their present or future effectiveness or enforcement. New or amended regulations in the future, particularly regulations focused on the proprietary sector, could further negatively impact our business.

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If the Department of Education does not recertify us to continue participating in the Title IV programs, our students would lose their access to Title IV program funds, or we could be recertified but required to accept significant limitations as a condition of our continued participation in the Title IV programs.

Department of Education certification to participate in the Title IV programs lasts a maximum of six years, and institutions are thus required to seek recertification from the Department of Education on a regular basis in order to continue their participation in the Title IV programs. An institution must also apply for recertification by the Department of Education if it undergoes a change in control, as defined by Department of Education regulations, and may be subject to similar review if it expands its operations or educational programs in certain ways.

On October 28, 2013, the University received a new program participation agreement with full certification from the Department of Education, which gives the University the ability to participate in the Title IV programs through September 30, 2017. There can be no assurance that the Department of Education will recertify us at that time or that it will not impose conditions or other restrictions on us as a condition of approving our application with respect to any future recertification. If the Department of Education does not renew or withdraws our certification to participate in the Title IV programs at any time, our students would no longer be able to receive Title IV program funds. Alternatively, the Department of Education could renew our certification, but restrict or delay our students receipt of Title IV funds, limit the number of students to whom we could disburse such funds, or place other restrictions on us, or it could delay our recertification after our program participation agreement expires on September 30, 2017, in which case our certification would continue on a month-to-month basis. Any of these outcomes could have a material adverse effect on our enrollments and us.

We would lose our ability to participate in the Title IV programs if we fail to maintain our institutional accreditation, and our student enrollments could decline if we fail to maintain any of our accreditations or approvals.

An institution must be accredited by an accrediting commission recognized by the Department of Education in order to participate in the Title IV programs. We have institutional accreditation by the Higher Learning Commission, which is an accrediting commission recognized by the Department of Education. To remain accredited, we must continuously meet accreditation standards relating to, among other things, performance, institutional control, institutional integrity, educational quality, faculty, administrative capability, resources, and financial stability. We most recently obtained reaccreditation in 2007 for the ten-year period through 2017. Following a comprehensive evaluation by the Higher Learning Commission during the Fall of 2016, we expect our accreditation to be reaffirmed in the Spring of 2017. If we fail to satisfy any of the Higher Learning Commission s standards, however, we could lose our accreditation by the Higher Learning Commission, which would cause us to lose our eligibility to participate in the Title IV programs, could cause a significant decline in our total student enrollments, and could have a material adverse effect on us. In addition, many of our individual educational programs are also accredited by specialized accrediting commissions or approved by specialized state agencies. If we fail to satisfy the standards of any of those specialized accrediting commissions or state agencies, we could lose the specialized accreditation or approval for the affected programs, which could result in materially reduced student enrollments in those programs and have a material adverse effect on us.

If the percentage of our revenue that is derived from the Title IV programs is too high, we may lose our eligibility to participate in those programs.

A requirement of the Higher Education Act, commonly referred to as the 90/10 Rule, that is applicable only to for-profit, postsecondary educational institutions like us provides that an institution loses its eligibility to participate in the Title IV programs if the institution derives more than 90% of its revenue for each of two consecutive fiscal years from Title IV program funds. For purposes of the 90/10 Rule, revenue is calculated under a complex regulatory formula that requires cash basis accounting and other adjustments to the calculation of an institution s revenue under generally accepted accounting principles that appears in its consolidated financial statements. Under the 90/10 Rule, an institution becomes ineligible to participate in the Title IV programs as of the first day of the fiscal year following the second consecutive fiscal year in which it exceeds the 90% threshold, and its period of ineligibility extends for at least two consecutive fiscal years. If an institution exceeds the 90% threshold for two consecutive fiscal years and it and its students have received Title IV funds during the subsequent period of ineligibility, the institution will be required to return those Title IV funds to the applicable lender or the Department of Education. If an institution s rate exceeds 90% for any single fiscal year, it will be placed on provisional certification for at least two fiscal years.

Using the Department of Education s cash-basis, regulatory formula under the 90/10 Rule as currently in effect, for our 2016, 2015, and 2014 fiscal years, we derived approximately 72.3%, 74.8%, and 76.5%, respectively, of our 90/10 Rule revenue from Title IV program funds.

As a result of the continuing increase in the number of students attending our ground campus, who typically finance a greater percentage of their educational costs with non-Title IV sources of funds, we expect the percentage of our revenue that we receive from Title IV programs to remain stable or decrease in the future, although this may be impacted by recent changes in federal law that increased Title IV grant and loan limits, as well as the ongoing economic environment, which has adversely affected the employment circumstances of our students and their parents and increased their reliance on Title IV programs. If we were to exceed the 90% threshold for two consecutive years such that we lost our eligibility to participate in the Title IV programs, or if Congress passed legislation changing how certain funds are counted under this rule, revising the percentage of income that proprietary schools must derive from non-federal sources, or both, it would have a material adverse effect on our business, prospects, financial condition, and results of operations.

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We may lose our eligibility to participate in the Title IV programs if our student loan default rates are too high.

An institution may lose its eligibility to participate in some or all of the Title IV programs if, for three consecutive years, 30% or more of its students who were required to begin repayment on their student loans in one year default on their payment by the end of the second year. In addition, an institution may lose its eligibility to participate in some or all of the Title IV programs if the default rate of its students exceeds 40% for any single year. While our cohort default rates have historically been significantly below these levels, we cannot assure you that this will continue to be the case. Increases in interest rates or declines in income or job losses for our students could contribute to higher default rates on student loans. Exceeding the student loan default rate thresholds and losing our eligibility to participate in the Title IV programs would have a material adverse effect on our business, prospects, financial condition, and results of operations. Any future changes in the formula for calculating student loan default rates, economic conditions, or other factors that cause our default rates to increase, could place us in danger of losing our eligibility to participate in some or all of the Title IV programs and materially adversely affect us.

If we do not meet specific financial responsibility standards established by the Department of Education, we may be required to post a letter of credit or accept other limitations in order to continue participating in the Title IV programs, or we could lose our eligibility to participate in the Title IV programs.

To participate in the Title IV programs, an institution must either satisfy specific quantitative standards of financial responsibility prescribed by the Department of Education, or post a letter of credit in favor of the Department of Education and possibly accept operating restrictions as well. These financial responsibility tests are applied to each institution on an annual basis based on the institution s audited consolidated financial statements, and may be applied at other times, such as if the institution undergoes a change in control. These tests may also be applied to an institution s parent company or other related entity. The operating restrictions that may be placed on an institution that does not meet the quantitative standards of financial responsibility include being transferred from the advance payment method of receiving Title IV program funds to either the reimbursement or the heightened cash monitoring system, which could result in a significant delay in the institution s receipt of those funds. If, in the future, we fail to satisfy the Department of Education s financial responsibility standards, we could experience increased regulatory compliance costs or delays in our receipt of Title IV program funds because we could be required to post a letter of credit or be subjected to operating restrictions, or both. Our failure to secure a letter of credit in these circumstances could cause us to lose our ability to participate in the Title IV programs, which would materially adversely affect us.

If we do not comply with the Department of Education s administrative capability standards, we could suffer financial penalties, be required to accept other limitations in order to continue participating in the Title IV programs, or lose our eligibility to participate in the Title IV programs.

To continue participating in the Title IV programs, an institution must demonstrate to the Department of Education that the institution is capable of adequately administering the Title IV programs under specific standards prescribed by the Department of Education. These administrative capability criteria require, among other things, the institution to have an adequate number of qualified personnel to administer the Title IV programs, have adequate procedures for disbursing and safeguarding Title IV funds and for maintaining records, submit all required reports and consolidated financial statements in a timely manner, and not have significant problems that affect the institution s ability to administer the Title IV programs. If we fail to satisfy any of these criteria, the Department of Education may assess financial penalties against us, restrict the manner in which we receive Title IV funds, require us to post a letter of credit, place us on provisional certification status, or limit or terminate our participation in the Title IV programs, any of which could materially adversely affect us.

A finding that we violated the Department of Education s substantial misrepresentation regulation could materially and adversely affect our business.

The Higher Education Act prohibits an institution that participates in Title IV programs from engaging in substantial misrepresentation of the nature of its educational program, its financial charges, or the employability of its graduates. Under these rules, a misrepresentation is any statement made by the institution or a third party that provides educational programs, marketing, advertising, recruiting, or admissions services to the institution that is false, erroneous or has the likelihood or tendency to deceive or confuse. A substantial misrepresentation is any misrepresentation on which the person to whom it was made could reasonably be expected to rely, or has reasonably relied, to that person s detriment. Considering the breadth of the definition of substantial misrepresentation, it is possible that despite our efforts to prevent such misrepresentations, our employees or service providers may make statements that could be construed as substantial misrepresentations. As a result, we may face complaints from students and prospective students over statements made by us and our agents throughout the enrollment, admissions and financial aid process, as well as throughout attendance at the University, which would expose us to increased risk of enforcement action and applicable sanctions or other penalties and increased risk of private qui tam actions under the Federal False Claims Act. Under the new rules, if the Department of Education determines that an institution has engaged in substantial misrepresentation, the Department of Education may revoke an institution s program participation agreement, impose limitations on the institution s participation in Title IV programs, deny applications from the institution for approval of new programs or locations or other matters, or initiate proceedings to fine the institution or limit, suspend, or terminate its eligibility to participate in Title IV programs. If the Department of Education determines that statements made by us or on our behalf are in violation of the regulations, we could be subject to sanctions and other liability, which could have a material adverse effect on our business.

We are subject to sanctions if we fail to correctly calculate and timely return Title IV program funds for students who withdraw before completing their educational program.

A school participating in the Title IV programs must calculate the amount of unearned Title IV program funds that it has disbursed to students who withdraw from their educational programs before completing such programs and must return those unearned funds to the appropriate lender or the Department of Education in a timely manner, generally within 45 days of the date the school determines that the student has withdrawn. If the unearned funds are not properly calculated and timely returned for a sufficient percentage of students, we may have to post a letter of credit in favor of the Department of Education equal to 25% of the Title IV program funds that should have been returned for such students in the prior fiscal year, we may be liable for repayment of Title IV program funds and related interest and we could be fined or otherwise sanctioned by the Department of Education, which could increase our cost of regulatory compliance and materially adversely affect us. Further, a failure to comply with these regulatory requirements could result in termination of our ability to participate in the Title IV programs, which would materially affect us.

Increased disclosure and recordkeeping requirements could result in lower enrollment or growth rates in a manner that materially and adversely affects our business.

Department of Education rules require that, for each program leading to gainful employment in a recognized occupation, institutions must provide prospective students with information concerning the occupation that the program prepares students to enter, the program s on-time graduation rate, and the tuition and fees it charges a student for completing the program within normal time, as well as the costs of books, supplies, room, and board, and the median loan debt incurred by students who completed the program. Institutions must also provide the Department of Education with information that will allow determination of student debt levels and incomes after program completion. These reporting and disclosure requirements have caused increased administrative burden and costs and may have a negative effect on our growth and enrollments.

A reduction in funding or new restrictions on eligibility for the Federal Pell Grant Program, or the elimination of subsidized Stafford loans, could make college less affordable for certain students at our institution, which could negatively impact our enrollments, revenue and results of operations.

The U.S. Congress must periodically reauthorize the Higher Education Act and annually determine the funding level for each Title IV program. In 2008, the Higher Education Act was reauthorized through September 30, 2013 by the Higher Education Opportunity Act. Changes to the Higher Education Act, including changes in eligibility and funding for Title IV programs, are likely to occur in subsequent reauthorizations, but we cannot predict the scope or substance of any such changes.

In recent years, there has been increased focus by Congress on the role that proprietary educational institutions play in higher education. Any action by Congress that significantly reduces Title IV program funding, whether through across-the-board funding reductions, sequestration or otherwise, or materially impacts the eligibility of our institutions or students to participate in Title IV programs would have a material adverse effect on our enrollment, financial condition, results of operations and cash flows. Congressional action could also require us to modify our practices in ways that could increase our administrative costs and reduce our operating income, which could have a material adverse effect on our financial condition, results of operations and cash flows.

If Congress significantly reduced the amount of available Title IV program funding, we would attempt to arrange for alternative sources of financial aid for our students, which may include lending funds directly to our students, but private sources may not be able to provide as much funding to our students on as favorable terms as is currently provided by Title IV. In addition, private organizations could require us to guarantee all or part of this assistance and we might incur other additional costs. For these reasons, private, alternative sources of student financial aid would only partly offset, if at all, the impact on our business of reduced Title IV program funding.

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We cannot offer new programs, expand our operations into certain states, or acquire additional schools if such actions are not timely approved by the applicable regulatory agencies, and we may have to repay Title IV funds disbursed to students enrolled in any such programs, schools, or states if we do not obtain prior approval.

Our expansion efforts include offering new educational programs. In addition, we may increase our operations in additional states and seek to acquire existing schools from other companies. If we are unable to obtain the necessary approvals for such new programs, operations, or acquisitions from the Department of Education, the Higher Learning Commission, the Arizona State Board for Private Postsecondary Education, or any other applicable state education agency or accrediting commission, or if we are unable to obtain such approvals in a timely manner, our ability to consummate the planned actions and provide Title IV funds to any affected students would be impaired, which could have a material adverse effect on our expansion plans. In addition, if we were to determine erroneously that a new program did not need approval or that we had all required approvals, we could be liable for repayment of the Title IV program funds provided to students in that program or at that location.

If we do not maintain our state authorization in Arizona, we may not operate or participate in the Title IV programs.

A school that grants degrees or certificates must be authorized by the relevant education agency of the state in which it is located. We are located in the state of Arizona and are authorized by the Arizona State Board for Private Postsecondary Education. State authorization is also required for our students to be eligible to receive funding under the Title IV programs. To maintain our state authorization, we must continuously meet standards relating to, among other things, educational programs, facilities, instructional and administrative staff, marketing and recruitment, financial operations, addition of new locations and educational programs, and various operational and administrative procedures. If we fail to satisfy any of these standards, we could lose our authorization by the Arizona State Board for Private Postsecondary Education to offer our educational programs, which would also cause us to lose our eligibility to participate in the Title IV programs and have a material adverse effect on us.

Our failure to comply with the regulatory requirements of states other than Arizona could result in actions taken by those states or the Department of Education that could have a material adverse effect on our enrollments.

Almost every state imposes regulatory requirements on educational institutions that have physical facilities located within the state s boundaries. Individual state laws establish standards in areas such as educational programs, facilities, instructional and administrative staff, marketing and recruitment, financial operations, addition of new locations and educational programs, and various operational and administrative procedures, some of which are different than the standards prescribed by the Department of Education or the Arizona State Board for Private Postsecondary Education. Several states have sought to assert jurisdiction over educational institutions offering online degree programs that have no physical location in the state but that have some activity in the state, such as enrolling or offering educational services to students who reside in the state, employing faculty who reside in the state, or advertising to or recruiting prospective students in the state.

State regulatory requirements for online education have historically varied among the states. To address this issue and to meet new Department of Education requirements we applied and have been approved to be an approved institutional participant in the State Authorization Reciprocity Agreement (SARA). SARA is an agreement among member states, districts and territories that establishes comparable national standards for interstate offering of postsecondary distance education courses and programs. It is intended to make it easier for students to take online courses offered by postsecondary institutions based in another state. SARA is overseen by a national council (NC-SARA) and administered by four regional education compacts, for which Arizona is a W-SARA member. There is a yearly renewal for participating in NC-SARA and AZ-SARA and institutions must agree to meet certain requirements to participate. As of December 31, 2016, 47 states are members of SARA.

Some states that do not participate in SARA impose regulatory requirements on out-of-state educational institutions operating within their boundaries, such as those having a physical facility or conducting certain academic activities within the state. We currently enroll students in all 50 states and the District of Columbia. Although we are currently licensed, authorized, in-process, or exempt in all non-SARA jurisdictions in which we operate, if we fail to comply with state licensing or authorization requirements for a state, or fail to obtain licenses or authorizations when required, we could lose our state license or authorization by that state or be subject to other sanctions, including restrictions on our activities in, and fines and penalties imposed by, that state, as well as fines, penalties, and sanctions imposed by the Department of Education. The loss of licensure or authorization in any non-SARA state could prohibit us from recruiting prospective students or offering services to current students in that state, which could significantly reduce our enrollments.

Laws, regulations, or interpretations related to doing business over the Internet could also increase our cost of doing business and affect our ability to recruit students in particular states, which could, in turn, negatively affect enrollments and revenues and have a material adverse effect on our business.

Additionally, regulatory agencies may sometimes disagree with the way we have interpreted or applied these requirements. Any misinterpretation by us of these regulatory requirements or adverse changes in regulations or interpretations thereof by regulators could materially adversely affect us. If we fail to comply with state licensing or authorization requirements for a state in which we operate, or fail to obtain licenses or authorizations when required, we could lose our state licensure or authorization by that state or be subject to other sanctions, including restrictions on our activities in, and fines and penalties imposed by, that state, as well as fines, penalties, and sanctions imposed by the Department of Education. The loss of licensure or authorization in a state other than Arizona could prohibit us from recruiting prospective students or offering educational services to current students in that state, which could significantly reduce our enrollments.

The inability of our graduates to obtain a professional license or certification in their chosen field of study could reduce our enrollments and revenues, and potentially lead to student claims against us that could be costly to us.

Many of our students, particularly those in our education and healthcare programs, seek a professional license or certification in their chosen fields following graduation. A student s ability to obtain a professional license or certification depends on several factors, including whether the institution and the student s program were accredited by a particular accrediting commission or approved by a professional association or by the state in which the student seeks employment. Additional factors are outside the control of the institution, such as the individual student s own background and qualifications. If one or more states refuse to recognize a significant number of our students for professional licensing or certification based on factors relating to our institution or programs, the potential growth of those programs would be negatively impacted and we could be exposed to claims or litigation by students or graduates based on their inability to obtain their desired professional license or certification, each of which could materially adversely affect us.

Government agencies, regulatory agencies, and third parties may conduct compliance reviews, bring claims, or initiate litigation against us based on alleged violations of the extensive regulatory requirements applicable to us, which could cause us to pay monetary damages, be sanctioned or limited in our operations, and expend significant resources to defend against those claims.

Because we operate in a highly regulated industry, we are subject to program reviews, audits, investigations, claims of non-compliance, and lawsuits by government agencies, regulatory agencies, students, employees, stockholders, and other third parties alleging non-compliance with applicable legal requirements, many of which are imprecise and subject to interpretation. If the result of any such proceeding is unfavorable to us, we may lose or have limitations imposed on our state licensing, accreditation, or Title IV program participation; be required to pay monetary damages (including triple damages in certain whistleblower suits); or be subject to fines, injunctions, or other penalties, any of which could have a material adverse effect on our business, prospects, financial condition, and results of operations. Claims and lawsuits brought against us, even if they are without merit, may also result in adverse publicity, damage our reputation, negatively affect the market price of our stock, adversely affect our student enrollments, and reduce the willingness of third parties to do business with us. Even if we adequately address the issues raised by any such proceeding and successfully defend against it, we may have to devote significant financial and management resources to address these issues, which could harm our business.

If any of the education regulatory agencies that regulate us do not approve or delay their approval of any transaction involving us that constitutes a change in control, our ability to operate or participate in the Title IV programs may be impaired.

If we experience a change in control under the standards of the Department of Education, the Higher Learning Commission, the Arizona State Board for Private Postsecondary Education, or any other applicable state education agency or accrediting commission, we must notify and/or seek the approval of each such agency. These agencies do not have uniform criteria for what constitutes a change in control. Transactions or events that typically constitute a change in control include significant acquisitions or dispositions of the voting stock of an institution or its parent company and significant changes in the composition of the board of directors of an institution or its parent company. With respect to publicly traded corporations, like us, they also may include cases where a corporation has a stockholder that owns, or has voting control over, at least 25% of the total outstanding voting stock of the corporation and is the largest stockholder of the corporation (defined in the regulations as a controlling shareholder), and that controlling shareholder ceases to own, or have voting control over, at least 25% of such stock or ceases to be the largest stockholder, or other transactions or events may be beyond our control. Our failure to obtain, or a delay in receiving, approval of any change in control from the Department of Education, the Higher Learning Commission, or the Arizona State Board for Private Postsecondary Education could impair our ability to operate or participate in the Title IV programs, which could have a material adverse effect on our business, prospects, financial condition, and results of operations. Our failure to obtain, or a delay in receiving, approval of any change in control from any other state in which we are currently licensed or authorized, or from any of our specialized accrediting commissions, could require us to suspend our activities in that state or suspend offering the applicable programs until we receive the required approval, or could otherwise impair our operations. The potential adverse effects of a change in control could influence future decisions by us and our stockholders regarding the sale, purchase, transfer, issuance, or redemption of our stock, which could discourage bids for your shares of our stock and could have an adverse effect on the market price of your shares.

Proposed legislation, additional rulemaking or additional examinations from U.S. Congress may impact general public perception of the industry in a negative manner resulting in a material and adverse impact on our business.

Criticisms of the overall student lending and postsecondary education sectors may impact general public perceptions of educational institutions, including us, in a negative manner. Adverse media coverage regarding other educational institutions or regarding us directly could damage our reputation. The environment surrounding access to and the costs of student loans remains in a state of flux. The uncertainty surrounding these issues, and any resolution of these issues that increases loan costs or reduces students access to Title IV loans or to student extended payment plans such as the ones we make available to our students, could reduce student demand for our programs, adversely impact our revenues and operating profit or result in increased regulatory scrutiny.

Our reputation and our stock price may be negatively affected by adverse publicity or by the actions of other postsecondary educational institutions.

In addition to the Congressional and regulatory activities focused on for-profit educational institutions beginning in 2010 and since, in recent years, regulatory proceedings and litigation have been commenced against various postsecondary educational institutions relating to, among other things, deceptive trade practices, false claims against the government, and non-compliance with Department of Education requirements, state education laws, and state consumer protection laws. These proceedings have been brought by the Department of Education, the U.S. Department of Justice, the SEC, and state governmental agencies, among others. These allegations have attracted adverse media coverage and have been the subject of legislative hearings and regulatory actions at both the federal and state levels, focusing not only on the individual schools but in some cases on the for-profit postsecondary education sector as a whole. Adverse media coverage regarding other for-profit education companies or other educational institutions could damage our reputation, result in lower enrollments, revenues, and operating profit, and have a negative impact on our stock price. Such coverage could also result in increased scrutiny and regulation by the Department of Education, Congress, accrediting commissions, state legislatures, state attorneys general, or other governmental authorities of all educational institutions, including us.

Risks Related to Our Business

Our success depends, in part, on the effectiveness of our marketing and advertising programs in recruiting new students.

Building awareness of Grand Canyon University and the programs we offer is critical to our ability to attract prospective students. It is also critical to our success that we convert prospective students to enrolled students in a cost-effective manner and that these enrolled students remain active in our programs. Some of the factors that could prevent us from successfully recruiting, enrolling, and retaining students in our programs include:

- the reduced availability of, or higher interest rates and other costs associated with, Title IV loan funds or other sources of financial aid;

- the emergence of more successful competitors;

factors related to our marketing, including the costs and effectiveness of Internet advertising and broad-based branding campaigns and recruiting efforts;

performance problems with our online systems;

failure to maintain institutional and specialized accreditations;

the requirements of the education agencies that regulate us which restrict schools initiation of new programs and modification of existing programs;

the requirements of the education agencies that regulate us which restrict the ways schools can compensate their recruitment personnel;

increased regulation of online education, including in states in which we do not have a physical presence;

restrictions that may be imposed on graduates of online programs that seek certification or licensure in certain states;

student dissatisfaction with our services and programs;

damage to our reputation or other adverse effects as a result of negative publicity in the media, in industry or governmental reports, or otherwise, affecting us or other companies in the for-profit postsecondary education sector;

price reductions by competitors that we are unwilling or unable to match;

a decline in the acceptance of online education;

an adverse economic or other development that affects job prospects in our core disciplines; and

a decrease in the perceived or actual economic benefits that students derive from our programs.

If we are unable to continue to develop awareness of Grand Canyon University and the programs we offer, and to recruit, enroll, and retain students, our enrollments would suffer and our ability to increase revenues and maintain profitability would be significantly impaired.

Our failure to keep pace with changing market needs and technology could harm our ability to attract students.

Our success depends to a large extent on the willingness of employers to employ, promote, or increase the pay of our graduates. Increasingly, employers demand that their new employees possess appropriate technical and analytical skills and also appropriate interpersonal skills, such as communication, and teamwork skills. These skills can evolve rapidly in a changing economic and technological environment. Accordingly, it is important that our educational programs evolve in response to those economic and technological changes. The expansion of existing academic programs and the development of new programs may not be accepted by current or prospective students or by the employers of our graduates. Even if we are able to develop acceptable new programs, we may not be able to begin offering those new programs in a timely fashion or as quickly as our competitors offer similar programs. If we are unable to adequately respond to changes in market requirements due to regulatory or financial constraints, unusually rapid technological changes, or other factors, the rates at which our graduates obtain jobs in their fields of study could suffer, our ability to attract and retain students could be impaired, and our business, prospects, financial condition, and results of operations could be adversely affected.

We have invested significant resources to develop and implement features that enhance the online classroom experience, such as delivering course content through streaming video, simulations, and other interactive enhancements. Our information technology systems and tools could become impaired or obsolete due to our action or failure to act. For instance, we could install new information technology without accurately assessing its costs or benefits, or we could experience delayed or ineffective implementation of new information technology. We could fail to respond in a timely manner for future technological developments in our industry. Should our actions or failure to act impair or render our information technology less effective, this could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We may not be able to successfully implement our growth strategy if we are not able to improve the content of our existing academic programs or to develop new programs on a timely basis and in a cost-effective manner, or at all.

We continually seek to improve the content of our existing programs and develop new programs in order to meet changing market needs. The success of any of our programs and courses, both ground and online, depends in part on our ability to expand the content of our existing programs, develop new programs in a cost-effective manner, and meet the needs of existing and prospective students and employers in a timely manner, as well as on the acceptance of our actions by existing or prospective students and employers. Even if we are able to develop acceptable new programs, we may not be able to introduce these new programs in a timely fashion or as quickly as our competitors are able to introduce competing programs. If we do not respond adequately to changes in market conditions, our ability to attract and retain students could be impaired and our business, prospects, financial condition, and results of operations could suffer.

The development and approval of new programs and courses, both ground and online, are subject to requirements and limitations imposed by the Department of Education, state licensing agencies, and the relevant accrediting commissions, and in certain cases, such as with doctoral programs, involves a process that can take several years to complete. The imposition of restrictions on the initiation of new educational programs by any of our regulatory agencies, or delays in obtaining approvals of such programs, may delay our expansion plans. Establishing new academic programs or modifying existing academic programs may also require us to make investments in specialized personnel, increase marketing efforts, and reallocate resources. We may have limited experience with the subject matter of new programs.

If we are unable to expand our existing programs, offer new programs on a timely basis or in a cost-effective manner, or otherwise manage effectively the operations of newly established programs, our business, prospects, financial condition, and results of operations could be adversely affected.

We are subject to rules and regulations as a result of our membership with the National Collegiate Athletic Association (NCAA) and any violations of such rules or regulations could adversely affect our reputation and operations.

Strict observance of rules and regulations contribute to the success of our athletic program. It is the responsibility of the University administration and the Athletic Department to adhere to all regulations created for the governance of intercollegiate athletics as set forth by the Western Athletic Conference (WAC), NCAA, and Grand Canyon University. The move from Division II to Division I was effective July 1, 2013 and demonstrated our commitment to athletic excellence and has enhanced our visibility. Any violations of such rules and regulations could adversely affect our reputation and operations.

A decline in the overall growth of enrollment in postsecondary institutions, or in the number of students seeking degrees online or in our core disciplines, could cause us to experience lower enrollment, which could negatively impact our future growth.

Based on industry analyses, we believe that enrollment growth in degree-granting, postsecondary institutions is slowing and that the number of high school graduates that are eligible to enroll in degree-granting, postsecondary institutions is expected to decrease over the next few years. In order to maintain current growth rates, we will need to attract a larger percentage of students in existing markets and expand our markets by creating new academic programs. In addition, if job growth in the fields related to our core disciplines is weaker than expected, as a result of any regional or national economic downturn or otherwise, fewer students may seek the types of degrees that we offer. Our failure to attract new students, or the decisions by prospective students to seek degrees in other disciplines, would have an adverse impact on our future growth.

If students fail to pay their outstanding balances owed to us, our business may be harmed.

From time to time, students, including former students, may carry balances on portions of their education expense not covered by financial aid programs. These balances are unsecured and not guaranteed. We have historically been successful in collecting our accounts receivable, including those due from former students as a result of the return to Title IV requirement, because the amount owed by a particular student that is in excess of the amount of financial aid that the student earned and that we are entitled to retain is often quite small. We believe that the level of motivation that former students have to pay off their balances due to us, based on such factors as being able to receive transcripts or protecting their credit, has lessened over time. As a result, losses related to unpaid student balances in excess of our allowance for doubtful accounts, or the failure of students to repay their debt obligations, could have a material adverse effect on our business, financial condition and results of operations.

We operate in a highly competitive industry, and competitors with greater resources could harm our business.

The postsecondary education market is highly fragmented and competitive. We compete for students primarily with traditional public and four-year degree-granting regionally accredited colleges and universities and other proprietary degree-granting regionally accredited schools. An increasing number of traditional colleges and universities and community colleges are offering distance learning and other online education programs, including programs that are geared toward the needs of working adult students. This trend has been accelerated by private companies that provide and/or manage online learning platforms for traditional colleges and universities. As the proportion of traditional colleges and universities providing alternative learning modalities increases, we will face increasing competition for students from such institutions, including those with well-established reputations for excellence. In addition, it is likely that we will begin to face competition from various emerging nontraditional, credit-bearing and noncredit-bearing education programs, provided by both proprietary and not-for-profit providers, and other direct-to-consumer education services. Each of these competitors may develop platforms or other technologies, including technologies that allow for greater levels of interactivity between faculty and students and that are superior to the platform and technology we use, and these differences may affect our ability to recruit and retain students. Public institutions receive substantial government subsidies, and public and private non-profit institutions have access to government and foundation grants, tax-deductible contributions, and other financial resources generally not available to for-profit schools. Accordingly, public and private non-profit institutions may have instructional and support resources superior to those in the for-profit sector, and public institutions may be able to offer substantially lower tuition prices. Some of our competitors in both the public and private sectors also have substantially greater financial and other resources than we do. We may not be able to compete successfully against current or future competitors, including with respect to our ability to acquire or compete with technologies being developed by our competitors, and may face competitive pressures that could adversely affect our business, prospects, financial condition, and results of operations. These competitive factors could cause our enrollments, revenues, and profitability to significantly decrease and could render our online delivery format less competitive or obsolete.

If we do not maintain existing, and develop additional, relationships with employers, our future growth may be impaired.

We currently have relationships with large school districts and healthcare systems, primarily in Arizona, and also have relationships with national and international employers, to provide their employees with the opportunity to obtain degrees through us while continuing their employment. These relationships are an important part of our strategy as they provide us with a steady source of potential working adult students for particular programs and also serve to increase our reputation among high-profile employers. A number of employers we work with have reduced the extent to which they reimburse their employees for participating in our programs. If we are unable to develop new relationships, or if our existing relationships deteriorate or end as a result of current or future economic conditions affecting employers or otherwise, our efforts to seek these sources of potential working adult students will be impaired, and this could materially and adversely affect our business, prospects, financial condition, and results of operations.

Our success depends upon our ability to recruit and retain key personnel.

Our success to date has largely depended on, and will continue to depend on, the skills, efforts, and motivation of our executive officers, who generally have significant experience with our University and within the education industry. Our success also largely depends on our ability to attract and retain highly qualified faculty, school administrators, and additional corporate management personnel. We may have difficulties in locating and hiring qualified personnel and in retaining such personnel once hired. In addition, because we operate in a highly competitive industry, our hiring of qualified executives or other personnel may cause us or such persons to be subject to lawsuits alleging misappropriation of trade secrets, improper solicitation of employees, or other claims. Other than non-compete agreements of limited duration that we have with certain executive officers, we have not historically sought non-compete agreements with key personnel and they may leave and subsequently compete against us. The loss of the services of any of our key personnel, many of whom are not party to employment agreements with us, or our failure to attract and retain other qualified and experienced faculty and personnel on acceptable terms, could cause our business to suffer.

The protection of our operations through exclusive proprietary rights and intellectual property is limited, and from time to time we encounter disputes relating to our use of intellectual property of third parties, any of which could harm our operations and prospects.

In the ordinary course of our business we develop intellectual property of many kinds that is or will be the subject of copyright, trademark, service mark, patent, trade secret, or other protections. This intellectual property includes but is not limited to courseware materials and business know-how and internal processes and procedures developed to respond to the requirements of operating our business and to comply with the rules and regulations of various education regulatory agencies. We rely on a combination of copyrights, trademarks, service marks, trade secrets, domain names, and agreements to protect our intellectual property. We rely on service mark and trademark protection in the United States to protect our rights to the mark Grand Canyon University, as well as distinctive logos and other marks associated with our services. We rely on agreements under which we obtain rights to use course content developed by faculty members and other third party content experts, as well as license agreements pursuant to which we license the right to brand certain of our program offerings. We cannot assure you that the measures that we take will be adequate or that we have secured, or will be able to secure, appropriate protections for all of our proprietary rights in the United States or select foreign jurisdictions, or that third parties will not infringe upon or violate our proprietary rights. Unauthorized third parties may attempt to duplicate or copy the proprietary aspects of our curricula, online resource material, and other content, and offer competing programs to ours.

In particular, we license the right to utilize the name of Jerry Colangelo in connection with our business school and our Colangelo School of Sports Business that we operate within our business school, and we have spent significant resources in related branding efforts. Nevertheless, these license agreements may terminate or expire, or otherwise may not necessarily be extended in the future. In addition, third parties may attempt to develop competing programs or copy aspects of our curriculum, online resource material, quality management, and other proprietary content. The termination of this license agreement, or attempts to compete with or duplicate our programs, if successful, could adversely affect our business. Protecting these types of intellectual property rights can be difficult, particularly as it relates to the development by our competitors of competing courses and programs.

We may from time to time encounter disputes over rights and obligations concerning intellectual property, and we may not prevail in these disputes. In certain instances, we may not have obtained sufficient rights in the content of a course. Third parties may raise a claim against us alleging an infringement or violation of the intellectual property of that third party. Some third-party intellectual property rights may be extremely broad, and it may not be possible for us to conduct our operations in such a way as to avoid those intellectual property rights. Any such intellectual property claim could subject us to costly litigation and impose a significant strain on our financial resources and management personnel regardless of whether such claim has merit, and we may be required to alter the content of our classes or pay monetary damages, which may be significant.

Our credit agreement may restrict our operations and our ability to complete certain transactions.

Our credit agreement, which we entered into in December 2012, imposes certain operating restrictions on us, including limitations on our ability to incur additional debt or make certain investments, and requires us to maintain compliance with certain applicable regulatory standards. In addition, the credit agreement requires us to maintain a maximum leverage ratio, a minimum fixed charge coverage ratio and a minimum tangible net worth, in each case as such terms are defined in the credit agreement. We cannot assure you that these covenants will not adversely affect our ability to finance our future operations or capital needs or to pursue available business opportunities. A breach of any of these covenants or our inability to maintain the required financial ratios could result in a default in respect of the related indebtedness. If a default occurs, the affected lenders could elect to declare the indebtedness, together with accrued interest and other fees, to be immediately due and payable.

Our failure to comply with environmental laws and regulations governing our activities could result in financial penalties and other costs.

We use hazardous materials at our ground campus and generate small quantities of waste, such as used oil, antifreeze, paint, car batteries, and laboratory materials. As a result, we are subject to a variety of environmental laws and regulations governing, among other things, the use, storage, and disposal of solid and hazardous substances and waste, and the clean-up of contamination at our facilities or off-site locations to which we send or have sent waste for disposal. In the event we do not maintain compliance with any of these laws and regulations, or are responsible for a spill or release of hazardous materials, we could incur significant costs for clean-up, damages, and fines, or penalties which could adversely impact our business, prospects, financial condition, and results of operations.

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The actions, errors, or instances of regulatory noncompliance of third party vendors upon which our institutions rely may negatively impact our business.

We engage third party vendors to provide, among other services, marketing activities. Although we require that the work done by such third parties maintains quality assurance and compliance with applicable regulations, we may be ultimately responsible for any errors on instances of regulatory noncompliance, some of which could adversely impact our reputation, business, prospects, financial condition, cash flows, and results of operations.

Risks Related to Our Business Technology Infrastructure

We are subject to laws and regulations as a result of our collection and use of personal information, and any violations of such laws or regulations, or any breach, theft, or loss of such information, could adversely affect our reputation and operations.

Possession and use of personal information in our operations subjects us to risks and costs that could harm our business. We collect, use, and retain large amounts of personal information regarding our applicants, students, faculty, staff, and their families, including social security numbers, tax return information, personal and family financial data, and credit card numbers. We also collect and maintain personal information of our employees in the ordinary course of our business. Our services can be accessed globally through the Internet. Therefore, we may be subject to the application of national privacy laws in countries outside the U.S. from which applicants and students access our services. Such privacy laws could impose conditions that limit the way we market and provide our services.

Our computer networks and the networks of certain of our vendors that hold and manage confidential information on our behalf may be vulnerable to unauthorized access, employee theft or misuse, computer hackers, computer viruses, and other security threats. Confidential information may also inadvertently become available to third parties when we integrate systems or migrate data to our servers following an acquisition of a school or in connection with periodic hardware or software upgrades.

Due to the sensitive nature of the personal information stored on our servers, our networks may be targeted by hackers seeking to access this data. A user who circumvents security measures could misappropriate sensitive information or cause interruptions or malfunctions in our operations. Although we use security and business controls to limit access and use of personal information, a third party may be able to circumvent those security and business controls, which could result in a breach of student or employee privacy. In addition, errors in the storage, use, or transmission of personal information could result in a breach of privacy for current or prospective students or employees. Possession and use of personal information in our operations also subjects us to legislative and regulatory burdens that could require us to implement certain policies and procedures, such as the procedures we adopted to comply with the Red Flags Rule that was promulgated by the Federal Trade Commission (FTC) under the federal Fair Credit Reporting Act and that requires the establishment of guidelines and policies regarding identity theft related to student credit accounts, and could require us to make certain notifications of data breaches and restrict our use of personal information. A violation of any laws or regulations relating to the collection or use of personal information could result in the imposition of fines against us. As a result, we may be required to expend significant resources to protect against the threat of these security breaches or to alleviate problems caused by these breaches. A major breach, theft, or loss of personal information regarding our students and their families or our employees that is held by us or our vendors, or a violation of laws or regulations relating to the same, could have a material adverse effect on our reputation and result in further regulation and oversight by federal and state authorities and increased costs of compliance.

Capacity constraints, system disruptions, or security breaches in our online computer networks and phone systems could have a material adverse effect on our ability to attract and retain students.

The performance and reliability of the infrastructure of our computer networks and phone systems, including our online programs, is critical to our operations, reputation and to our ability to attract and retain students. Any computer system disruption or failure, or a sudden and significant increase in traffic on the servers that host our online operations, may result in our online courses and programs being unavailable for a period of time. In addition, any significant failure of our computer networks or servers, whether as a result of third-party actions or in connection with planned upgrades and conversions, could disrupt our on-campus operations. Individual, sustained, or repeated occurrences could significantly damage the reputation of our online operations and result in a loss of potential or existing students. Additionally, our online operations are vulnerable to interruption or malfunction due to events beyond our control, including natural disasters and network and telecommunications failures. Our computer networks may also be vulnerable to unauthorized access, computer hackers, computer viruses, malicious code, organized cyber-attacks and other security problems. A user who circumvents security measures could misappropriate proprietary information or cause interruptions to or malfunctions in operations. As a result, we may be required to expend significant resources to protect against the threat of these security breaches or to alleviate problems caused by these incidents. Any interruption to our online operations could have a material adverse effect on our ability to attract students to our online programs and to retain those students.

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A failure of our information systems to properly store, process and report relevant data may reduce our management s effectiveness, interfere with our regulatory compliance and increase our operating expenses.

We are dependent on the integrity of our data management systems. If these systems do not effectively collect, store and process relevant data for the operation of our business, whether due to equipment malfunctions or constraints, software deficiencies, or human error, our ability to effectively report, plan, forecast and execute our business plan and comply with applicable laws and regulations, including the Higher Education Act, as reauthorized, and the regulations thereunder, will be impaired, perhaps materially. Any such impairment could materially and adversely affect our financial condition, results of operations, and cash flows.

We may incur liability for the unauthorized duplication or distribution of class materials posted online for class discussions.

In some instances, our faculty members or our students may post various articles or other third-party content on class discussion boards. Third parties may raise claims against us for the unauthorized duplication of material posted online for class discussions. Any such claims could subject us to costly litigation and impose a significant strain on our financial resources and management personnel regardless of whether the claims have merit. Our general liability insurance may not cover potential claims of this type adequately or at all, and we may be required to alter the content of our courses or pay monetary damages, which may be significant.

Risks Related to Owning our Common Stock

Provisions in our charter documents and the Delaware General Corporation Law could make it more difficult for a third party to acquire us and could discourage a takeover and adversely affect existing stockholders.

Anti-takeover provisions of our certificate of incorporation, bylaws, the Delaware General Corporation Law, or DGCL, and regulations of state and federal education agencies could diminish the opportunity for stockholders to participate in acquisition proposals at a price above the then-current market price of our common stock. For example, while we have no present plans to issue any preferred stock, our Board of Directors, without further stockholder approval, may issue shares of undesignated preferred stock and fix the powers, preferences, rights, and limitations of such class or series, which could adversely affect the voting power of your shares. In addition, our bylaws provide for an advance notice procedure for nomination of candidates to our Board of Directors that could have the effect of delaying, deterring, or preventing a change in control. Further, as a Delaware corporation, we are subject to provisions of the DGCL regarding business combinations, which can deter attempted takeovers in certain situations. The approval requirements of the Department of Education, our regional accrediting commission, and state education agencies for a change in control transaction could also delay, deter, or prevent a transaction that would result in a change in control. We may, in the future, consider adopting additional anti-takeover measures. The authority of our Board of Directors to issue undesignated preferred or other capital stock and the anti-takeover provisions of the DGCL, as well as other current and any future anti-takeover measures adopted by us, may, in certain circumstances, delay, deter, or prevent takeover attempts and other changes in control of the company not approved by our Board of Directors.

If securities analysts do not publish research or reports about our business or industry or if they downgrade their evaluations of our stock, the price of our stock could decline.

The activity within the trading market for our common stock depends in part on the research and reports that industry or financial analysts publish about us, our business and the for-profit education sector. In recent periods, a number of analysts have dropped coverage of the sector. If analysts cease coverage of us or additional analysts cease coverage of our sector, we could lose visibility in the market for our stock, which in turn could cause our stock price to decline. If one or more of the analysts covering us downgrade their estimates or evaluations of our stock, the price of our stock could decline.

Item 1B. ***Unresolved Staff Comments***

None.

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Item 2. *Properties*

We own our ground campus, which is located on over 260 acres in the center of the Phoenix, Arizona metropolitan area, near downtown Phoenix. Our on-campus facilities currently consist of classroom buildings, lecture halls, a 300-seat theater, a 155,000-volume newly renovated library, a media arts complex that provides communications students with audio and video equipment, a 55,000 square foot recreation center that has state of the art training facilities for our 400 student-athletes plus practice space and locker rooms for men s and women s basketball, a 140,000 square foot/ 7,500 seat basketball and entertainment arena, a stadium that hosts NCAA men s and women s soccer as well as several club sports programs, a basketball practice facility, on-campus tennis courts, beach volleyball courts, and a competition/practice gymnasium, an activity center that contains a food court, a bowling alley and other student services, a student union which was recently remodeled and expanded, residence halls, apartments, campus pools, athletic facilities and parking garages. In order to accommodate the continued growth of our traditional ground population, we completed four additional dormitories, a classroom building for our College of Science, Engineering and Technology and a third parking structure prior to the 2015/2016 school year and prior to the 2016/2017 school year we completed construction on three apartment style residence halls, a 170,000 square foot classroom building for our College of Science, Engineering and Technology, a student service center and a fourth parking structure. In late 2015, we revitalized the Maryvale Golf Course under a partnership agreement with the City of Phoenix and in 2016 the Grand Canyon University Championship Golf Course was opened to the public. Additionally, we have several office buildings used for administration and we recently completed a large student services center and parking garage in close proximity to our ground campus. Employees that worked in two leased office buildings in the Phoenix area were consolidated into this new building upon completion in late 2016.

We lease four facilities in Arizona and one in New Mexico for classroom and labs for our nursing professional studies students. Additionally, we lease five office locations in California and one in Colorado. We may add additional space in Arizona and in other states in the southwest U.S. to accommodate our growth plans in 2017 and beyond.

Item 3. *Legal Proceedings*

From time to time, we are subject to ordinary and routine litigation incidental to our business. While the outcomes of these matters are uncertain, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on our financial position, results of operations or cash flows.

Item 4. *Mine Safety Disclosures*

None.

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PART II

Item 5. *Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

Market Information

Our common stock trades on the Nasdaq Global Market under the symbol LOPE. The holders of our common stock are entitled to one vote per share on any matter to be voted upon by stockholders. All shares of common stock rank equally as to voting and all other matters. The shares of common stock have no preemptive or conversion rights, no redemption or sinking fund provisions, are not liable for further call or assessment and are not entitled to cumulative voting rights.

The table below sets forth the high and low sales prices for our common stock, as reported by the Nasdaq Global Market.

	High	Low
2016		
First Quarter	$ 43.37	$ 31.12
Second Quarter	$ 45.02	$ 37.94
Third Quarter	$ 44.98	$ 38.81
Fourth Quarter	$ 61.80	$ 39.68
2015		
First Quarter	$ 48.29	$ 42.63
Second Quarter	$ 45.82	$ 41.30
Third Quarter	$ 45.17	$ 35.38
Fourth Quarter	$ 42.81	$ 36.18

Holders

As of December 31, 2016, there were approximately 214 registered holders of record of common stock. A substantially greater number of holders of common stock are street name or beneficial holders, whose shares are held of record by banks, brokers and other financial institutions.

Dividends

We currently intend to retain all future earnings for the operation and expansion of our business and do not anticipate paying cash dividends on our common stock in the foreseeable future.

Recent Sales of Unregistered Securities

None.

Securities Authorized for Issuance under Equity Compensation Plans

The information required by Item 201(d) of Regulation S-K is provided under Item 12, *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*, Equity Compensation Plan Information, which is incorporated herein by reference.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Our Board of Directors has authorized the University to repurchase up to $175.0 million in aggregate of common stock, from time to time, depending on market conditions and other considerations. The current expiration date on the repurchase authorization by our Board of Directors is December 31, 2017. Repurchases occur at our discretion. Repurchases may be made in the open market or in privately negotiated transactions, pursuant to the applicable Securities and Exchange Commission rules. The amount and timing of future share repurchases, if any, will be made as market and business conditions warrant. Since the approval of our share repurchase plan, we have purchased 3.5 million shares of common stock at an aggregate cost of $75.8 million, which are recorded at cost in the accompanying December 31, 2016 consolidated balance sheet and statement of stockholders equity. At December 31, 2016, there remained $99.2 million available under our current share repurchase authorization. During the year ended December 31, 2016, we repurchased 415,555 shares of common stock at an aggregate cost of $15.4 million.

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The following table sets forth our share repurchases of common stock and our share repurchases in lieu of taxes, which are not included in the repurchase plan totals as they were effected in conjunction with the vesting of restricted share awards, during each period in the fourth quarter of fiscal 2016:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Dollar Value of Shares That May Yet Be Purchased Under the Program
Share Repurchases				
October 1, 2016 October 31, 2016		$		$ 99,200,000
November 1, 2016 November 30, 2016		$		$ 99,200,000
December 1, 2016 December 31, 2016		$		$ 99,200,000
Total		$		$ 99,200,000
Tax Withholdings				
October 1, 2016 October 31, 2016	1,271	$ 41.70		$
November 1, 2016 November 30, 2016		$		$
December 1, 2016 December 31, 2016		$		$
Total	1,271	$ 41.70		$

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University Stock Performance

The following graph compares the cumulative total return of our common stock with the cumulative total returns of the S&P 500 Index and our selected peer group of five companies that includes: Capella Education Company, American Public Education, Inc., Apollo Education Group Inc., Strayer Education Inc. and Bridgepoint Education, Inc. This chart assumes that an investment of $100 was made in our common stock, in the index, and in the peer group on December 31, 2011 and that all dividends paid by us and such companies were reinvested, and tracks the relative performance of such investments through December 31, 2016.

	12/11	12/12	12/13	12/14	12/15	12/16
Grand Canyon Education, Inc.	**100.00**	**147.06**	**273.18**	**292.36**	**251.38**	**366.23**
S&P 500	**100.00**	**116.00**	**153.58**	**174.60**	**177.01**	**198.18**
Peer Group	**100.00**	**47.28**	**62.63**	**72.82**	**30.21**	**43.69**

The information contained in the performance graph shall not be deemed soliciting material or to be filed with the SEC nor shall such information be deemed incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that we specifically incorporate it by reference into such filing.

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Item 6. *Selected Consolidated Financial and Other Data*

The following selected consolidated financial and other data should be read in conjunction with Item 8, *Consolidated Financial Statements and Supplementary Data*, and Item 7, *Management s Discussion and Analysis of Financial Condition and Results of Operations*, to fully understand the information presented below. The selected consolidated income statement data and other data, excluding period end enrollment, for the years ended December 31, 2016, 2015, and 2014, and the selected consolidated balance sheet data as of December 31, 2016, and 2015, have been derived from our audited consolidated financial statements for such years, which are included herein. The selected consolidated income statement data and other data, excluding period end enrollment, for the years ended December 31, 2013 and 2012, and the selected consolidated balance sheet data as of December 31, 2014, 2013, and 2012, have been derived from our audited consolidated financial statements for such years, which are not included herein. Our historical results are not necessarily indicative of our results for any future period.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(In thousands, except per share data)				
Income Statement Data:					
Net revenue	$ 873,344	$ 778,200	$ 691,055	$ 598,335	$ 511,257
Costs and expenses:					
Instructional costs and services	373,101	329,651	288,791	254,419	220,403
Admissions advisory and related[(1)]	119,286	112,572	108,567	97,077	85,917
Advertising[(1)]	88,152	76,229	65,808	60,985	51,023
Marketing and promotional[(1)]	8,860	7,287	7,439	5,644	4,360
General and administrative	43,219	42,100	39,635	36,934	35,502
Lease termination costs	3,523				
Total costs and expenses	636,141	567,839	510,240	455,059	397,205
Operating income	237,203	210,361	180,815	143,276	114,052
Interest expense	(1,328)	(1,248)	(1,801)	(2,244)	(699)
Interest income and other	249	(106)	684	3,863	71
Income before income taxes	236,124	209,007	179,698	144,895	113,424
Income tax expense	87,610	77,596	68,232	56,184	43,977
Net income	$ 148,514	$ 131,411	$ 111,466	$ 88,711	$ 69,447
Earnings per common share					
Basic	$ 3.22	$ 2.86	$ 2.45	$ 1.98	$ 1.57
Diluted	$ 3.15	$ 2.78	$ 2.37	$ 1.92	$ 1.53
Shares used in computing earnings per common share					
Basic	46,083	45,975	45,538	44,731	44,332
Diluted	47,121	47,281	47,006	46,131	45,251
Other Data:					
Capital expenditures	$ 239,019	$ 218,301	$ 168,646	$ 93,490	$ 104,876
Depreciation and amortization	$ 45,387	$ 35,379	$ 29,177	$ 25,141	$ 21,627

Adjusted EBITDA[2]	$ 304,071	$ 264,988	$ 227,812	$ 185,086	$ 149,593
Period end enrollment[3]					
Online	64,646	59,311	55,060	49,580	44,690
Ground	17,262	15,195	12,746	10,078	7,602
Balance Sheet Data:					
Cash and cash equivalents, marketable securities and investments	$ 108,572	$ 106,400	$ 166,022	$ 164,244	$ 105,111
Restricted cash, cash equivalents and investments	$ 84,931	$ 75,384	$ 67,840	$ 64,368	$ 56,189
Total assets[4]	$ 1,092,493	$ 891,982	$ 749,564	$ 610,941	$ 489,442
Notes payable (including short-term)	$ 98,252	$ 79,877	$ 86,493	$ 93,100	$ 99,701
Total stockholders equity	$ 773,686	$ 610,251	$ 476,232	$ 344,844	$ 234,059

(1) During the first quarter of 2013, the University made changes in its presentation of operating expenses and revised prior periods to conform to the current presentation. All years presented in the five year table were reclassified to conform to the current presentation.
(2) Adjusted EBITDA is defined as net income plus interest expense, less interest income and other gain (loss) recognized on investments, plus income tax expense, plus depreciation and amortization (EBITDA), as adjusted for (i) the amortization of prepaid royalty payments recorded in conjunction with a settlement of a dispute with our former owner; (ii) contributions to Arizona school tuition organizations in lieu of the payment of state income taxes; (iii) share-based compensation; and (iv) one-time, unusual charges or gains, such as litigation and regulatory reserves, impairment charges and asset write-offs, and exit or lease termination costs.
(3) Enrollment represents individual students who attended a course during the last two months of the calendar quarter.
(4) During the first quarter of 2016, the University made changes in its presentation of deferred tax assets and liabilities to comply with a new accounting standard. Accordingly, we reclassified the current deferred taxes to net against noncurrent deferred tax liabilities for all prior periods to conform to the current presentation.

We present Adjusted EBITDA because we consider it to be an important supplemental measure of our operating performance. We also make certain compensation decisions based, in part, on our operating performance, as measured by Adjusted EBITDA, and our credit agreement requires us to comply with covenants that include performance metrics substantially similar to Adjusted EBITDA. All of the adjustments made in our calculation of Adjusted EBITDA are adjustments to items that management does not consider to be reflective of our core operating performance. Management considers our core operating performance to be that which can be affected by our managers in any particular period through their management of the resources that affect our underlying revenue and profit generating operations during that period. Royalty expenses paid to our former owner, contributions to Arizona school tuition organizations in lieu of the payment of state income taxes, share-based compensation, one time unusual charges or gains, such as estimated litigation and regulatory reserves, impairment charges, exit costs, and lease termination fees are not considered reflective of our core performance. We believe Adjusted EBITDA allows us to compare our current operating results with corresponding historical periods and with the operational performance of other companies in our industry because it does not give effect to potential differences caused by variations in capital structures (affecting relative interest expense, including the impact of write-offs of deferred financing costs when companies refinance their indebtedness), tax positions (such as the impact on periods or companies of changes in effective tax rates or net operating losses), the book amortization of intangibles (affecting relative amortization expense), and other items that we do not consider reflective of underlying operating performance. We also present Adjusted EBITDA because we believe it is frequently used by securities analysts, investors, and other interested parties as a measure of performance.

In evaluating Adjusted EBITDA, investors should be aware that in the future we may incur expenses similar to the adjustments described above. Our presentation of Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by expenses that are unusual, non-routine, or non-recurring. Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for net income, operating income, or any other performance measure derived in accordance with and reported under GAAP or as an alternative to cash flow from operating activities or as a measure of our liquidity. Some of these limitations are that it does not reflect:

- cash expenditures for capital expenditures or contractual commitments;

- changes in, or cash requirements for, our working capital requirements;
- interest expense, or the cash required to replace assets that are being depreciated or amortized; and
- the impact on our reported results of earnings or charges resulting from the items for which we make adjustments to our EBITDA, as described above and set forth in the table below.

In addition, other companies, including other companies in our industry, may calculate these measures differently than we do, limiting the usefulness of Adjusted EBITDA as a comparative measure. Because of these limitations, Adjusted EBITDA should not be considered as a substitute for net income, operating income, or any other performance measure derived in accordance with GAAP, or as an alternative to cash flow from operating activities or as a measure of our liquidity. We compensate for these limitations by relying primarily on our GAAP results and use Adjusted EBITDA only as a supplemental performance measure. For more information, see our consolidated financial statements and the notes to those statements included elsewhere in this Annual Report on Form 10-K.

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The following table reconciles Adjusted EBITDA to net income for the periods indicated:

	Year Ended December 31,		
(In thousands)	**2016**	**2015**	**2014**
Net income	$ 148,514	$ 131,411	$ 111,466
Plus: interest expense	1,328	1,248	1,801
Less: interest income and other[(a)]	(249)	106	(684)
Plus: income tax expense	87,610	77,596	68,232
Plus: depreciation and amortization	45,387	35,379	29,177
EBITDA	282,590	245,740	209,992
Plus: royalty to former owner[(b)]	296	296	296
Plus: prepaid royalty impairment and other fixed asset impairments[(c)]	250	2,755	3,441
Plus: contributions made in lieu of state income taxes[(d)]	4,000	2,750	2,750
Plus: transaction expenses[(e)]	1,136	1,861	
Plus: estimated litigation and regulatory reserves[(f)]		328	870
Plus: lease termination costs[(g)]	3,523		518
Plus: share-based compensation[(h)]	12,276	11,257	9,945
Adjusted EBITDA	$ 304,071	$ 264,987	$ 227,812

(a) Represents a loss of $0.9 million in 2015 on a note receivable purchased in December 2012, net of interest income.

(b) Represents the amortization of prepaid royalty payments, as discussed in Note 2 to our consolidated financial statements that are included in Item 8, *Consolidated Financial Statements and Supplementary Data*.

(c) Represents prepaid royalty impairment and other fixed asset impairments. The 2016 and 2015 amounts represents the write-off of the remaining book value of on campus buildings removed to make way for new dormitories and a classroom building as well as internal use software write offs. The 2014 amount relates to the termination during 2014 of our use of the Ken Blanchard name for our College of Business.

(d) Reflects contributions to various Arizona school tuition organizations to assist with funding for education. In connection with such contributions made we received a dollar-for-dollar state income tax credit, which resulted in a reduction in our effective income tax rate to 37.1%, 37.1% and 38.0% for the years ended December 31, 2016, 2015 and 2014, respectively. Had these contributions not been made, our effective tax rate would have been 38.2%, 37.9% and 38.9%, for 2016, 2015 and 2014, respectively. Such contributions are viewed by our management to be made in lieu of payments of state income taxes and are therefore excluded from evaluation of our core operating performance.

(e) Reflects $1.1 million and $1.9 million for expenses incurred in 2016 and 2015, respectively, related to a proposed transaction under which Grand Canyon University would have become a non-profit entity.

(f) Reflects $0.3 million and $0.9 million for estimated litigation reserves in 2015 and 2014, respectively.

(g) Represents lease termination costs incurred related to the early termination of leased space.

(h) Reflects share-based compensation expense relating to restricted stock awards and option grants made to employees and directors.

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Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion and analysis of our financial condition and results of operations for the years ended December 31, 2016 and 2015 should be read in conjunction with our consolidated financial statements and related notes that appear in Item 8, *Consolidated Financial Statements and Supplementary Data*. In addition to historical information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Annual Report on Form 10-K, particularly in Item 1A, *Risk Factors* and *Forward-Looking Statements*.

Executive Overview

We are a comprehensive regionally accredited university that offers over 200 graduate and undergraduate degree programs and certificates across nine colleges both online and on ground at our over 260 acre campus in Phoenix, Arizona, and onsite at facilities we lease and at facilities owned by third party employers. We are committed to providing an academically rigorous educational experience with a focus on professionally relevant programs that meet the objectives of our students. Our undergraduate programs are designed to be innovative and meet the future needs of employers, while providing students with the needed critical thinking and effective communication skills developed through a Christian, liberal arts foundation. We offer master s and doctoral degrees in contemporary fields that are designed to provide students with the capacity for transformational leadership in their chosen industry, emphasizing the immediate relevance of theory, application, and evaluation to promote personal and organizational change. We believe the growing brand of the University and the value proposition for both traditional aged students attending on our campus in Phoenix, Arizona and working adult students attending on our campus or at off-site locations in cohorts (referred to by us as professional studies student) or online, has enabled us to increase enrollment to approximately 81,900 students at December 31, 2016. At December 31, 2016, 78.9% of our students were enrolled in our online programs, and, of our working adult students (online and professional studies students), 49.5% were pursuing master s or doctoral degrees.

Key Trends, Developments and Challenges

The following circumstances and trends present opportunities, challenges and risks.

Evolving Postsecondary Education Market. We believe that there is a large number of traditional-aged students looking for a residential experience at an affordable, private, Christian university. As a result of state funding challenges, most state universities are receiving less state subsidies and therefore have been forced to increase tuition, decrease the number of students they can accept and/or make other changes that impact the student experience. Some private universities also are facing enrollment challenges as a result of their high tuition costs. We also believe the number of non-traditional students who work, are raising a family, or are doing both while trying to earn a college degree continues to grow. The continued economic environment in the U.S., however, has caused an increased number of potential students and/or their parents to consider the cost of education as a primary factor in choosing the school that they will attend. Given these trends, we believe that many individuals will be attracted to our high quality academic programs at affordable tuition rates. We also believe that competition for students continues to increase. We compete primarily with traditional public and four-year degree-granting regionally accredited colleges and universities and other proprietary degree-granting regionally accredited schools. An increasing number of traditional colleges, universities and community colleges are offering distance learning and other online education programs, including programs that are geared towards the needs of working adult students. This trend has been accelerated by private companies that provide and/or manage online learning platforms for traditional colleges and universities. As the proportion of traditional colleges and universities providing alternative learning modalities increases, we face increasing competition for students from such institutions, including those with well-established reputations for excellence.

Regulation and Oversight**.** We are 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 us 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. Recent regulations have imposed new reporting and disclosure requirements that have caused increased administrative burden and costs and may have a negative effect on our growth and enrollments. In addition, in recent years, there has been increased focus by Congress on the role that proprietary educational institutions play in higher education and various proposals to modify the laws to which proprietary educational institutions are subject. We cannot predict what legislation, if any, may result from these Congressional proposals or what impact any such legislation might have on the proprietary education sector generally or our business in particular. To the extent that any laws or regulations are adopted, or other administrative actions are taken, that limit our participation in Title IV programs or the amount of student financial aid for which the students at our institutions are eligible, our enrollments, revenues and results of operation could be materially and adversely affected.

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Fiscal Year 2016 Highlights

We achieved the following in 2016:

Enrollment, Net Revenue, Operating Income Growth with No Increase in Ground Tuition Rates. We achieved enrollment growth of 9.9% during the fiscal year ended December 31, 2016, as ground enrollment increased 13.6% and online enrollment increased 9.0% over the prior year. We attribute the significant growth in our ground enrollment between years to our increasing brand recognition and the value proposition that our ground traditional campus affords to traditional-aged students and their parents. After scholarships, our ground traditional students pay tuition, room, board, and fees in an amount that is often half to a third of what it costs to attend a private, traditional university in another state and an amount comparable to what it costs to attend a public university. Our online students pay tuition and fees in an amount that is often less than the cost of other high service online programs such as ours. For example, our largest local competitor s undergraduate tuition for online programs ranges from $490 to $553 per credit hour and its graduate tuition for online programs ranges from $492 to $1,132 per credit hour while our online tuition per credit hour ranges from $355 to $470 for undergraduate programs and $330 to $640 for graduate programs. There are online programs that are less expensive than ours but those programs generally do not provide the full level of support services that we provide to our students. Although our online enrollment continues to grow, as the proportion of traditional colleges and universities providing alternative learning modalities increases, we will face increasing competition for working adult students from such institutions, including those with well-established reputations for excellence. We did not raise tuition in any of our programs for our 2016-2017 academic year. A tuition increase of approximately 1% was implemented for the majority of online programs for our 2015-2016 academic year. We have not raised our tuition for our traditional ground programs in eight years. Net revenues increased 12.2% over the prior year primarily due to the enrollment growth and due to an increase in ancillary revenues resulting from the increased traditional student enrollment (e.g. housing, food, etc.). Operating income was $237.2 million for the fiscal year ended December 31, 2016, an increase of 12.8% over the $210.4 million in operating income for 2015.

Continued Program Expansion. In the Fall of 2014, the University launched the College of Science, Engineering and Technology, rolling out programs in computer science and information technology. In the Fall of 2015, three engineering programs, Electrical Engineering, Bio-medical Engineering and Mechanical Engineering began. In total the University now offers over 200 graduate and undergraduate degree programs and certificates across nine colleges with over 33 new programs or emphases rolled out in 2016 and another 34 are planned for 2017.

Capital Expenditures. Our capital expenditures in 2016 of $178.3 million were primarily related to the expansion of our over 260 acre physical campus in Phoenix, Arizona and significant investments in technology innovation to support our students and staff. In order to accommodate the continued growth of the traditional ground population, the University completed three more apartment style residence halls, a 170,000 square foot classroom building for its College of Science, Engineering and Technology, a student service center and a fourth parking structure. Included in off-site development during 2016 is $60.7 million primarily related to an off-site student services center and parking garage that is in close proximity to our ground traditional campus. Employees that work in two leased office buildings in the Phoenix area were consolidated into this new building in late 2016.

Revenue and Enrollment

Net revenue consists principally of tuition, room and board charges attributable to students residing on our ground campus, application and graduation fees, and fees from educational resources such as access to online materials, less scholarships. Factors affecting our net revenue include: (i) the number of students who are enrolled and who remain enrolled in our courses; (ii) the number of credit hours per student; (iii) our degree and program mix; (iv) changes in our tuition rates; (v) the timing of our ground traditional campus semesters; (vi) the amount of the scholarships that we offer; and (vii) the number of students housed in, and the rent charged for, our on-campus student apartments and dormitories.

We define enrollment as individual students who attended a course during the last two months of the calendar quarter. We offer three 15-week semesters in a calendar year with one start available per semester for our traditional ground students. Online and professional studies students have more frequent class starts in courses that generally range from five to sixteen weeks through the calendar year. Enrollments are a function of the number of continuing students at the beginning of each period and new enrollments during the period, which are offset by graduations, withdrawals, and inactive students during the period. Inactive students for a particular period include students who are not registered in a class and, therefore, are not generating net revenue for that period, but who have not withdrawn from Grand Canyon University.

We believe that the principal factors that affect our enrollments and net revenue are the number and breadth of the programs we offer; the attractiveness of our program offerings and learning experience, particularly for career-oriented adults who are seeking pay increases or job opportunities that are directly tied to higher educational attainment; the effectiveness of our marketing, recruiting and retention efforts, which is affected by our brand strength and price point; the quality of our academic programs and student services; the convenience and flexibility of our online delivery platform; the availability and cost of federal and other funding for student financial aid; the seasonality of our net revenue, which is enrollment driven and is typically lowest in our second fiscal quarter and highest in our fourth fiscal quarter; and general economic conditions, particularly as they might affect job prospects in our core disciplines.

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The following is a summary of our student enrollment at December 31, 2016, 2015, and 2014 by degree type and by instructional delivery method:

	December 31,					
	2016(1)		2015(1)		2014(1)	
	# of Students	% of Total	# of Students	% of Total	# of Students	% of Total
Graduate degree(2)	33,215	40.6%	29,237	39.2%	26,319	38.8%
Undergraduate degree	48,693	59.4%	45,269	60.8%	41,487	61.2%
Total	81,908	100.0%	74,506	100.0%	67,806	100.0%

	December 31,					
	2016(1)		2015(1)		2014	
	# of Students	% of Total	# of Students	% of Total	# of Students	% of Total
Online(3)	64,646	78.9%	59,311	79.6%	55,060	81.2%
Ground(4)	17,262	21.1%	15,195	20.4%	12,746	18.8%
Total	81,908	100.0%	74,506	100.0%	67,806	100.0%

(1) Enrollment represents individual students who attended a course during the last two months of the calendar quarter. Included in enrollment at December 31, 2016, 2015 and 2014 are students pursuing non-degree certificates of 847, 679, and 585, respectively.

(2) Includes 7,084, 6,302 and 5,570 students pursuing doctoral degrees at December 31, 2016, 2015 and 2014, respectively.

(3) As of December 31, 2016, 2015 and 2014, 49.5%, 47.8% and 46.0%, respectively, of our working adult students (online and professional studies students) were pursuing graduate or doctoral degrees.

(4) Includes our traditional on-campus students, as well as our professional studies students.

For the 2016-17 academic year (the academic year begins in May), our prices per credit hour range from $355 to $470 for undergraduate online and professional studies courses, $330 to $630 for graduate online courses, $640 for doctoral online programs, and $688 for undergraduate courses for ground students. For our active duty and active reserve online and professional studies students, our prices per credit hour are $250 for undergraduate, $400 for graduate courses and $608 for doctoral courses. The overall price of each course varies based upon the number of credit hours per course (with most courses representing four credit hours), the degree level of the program, and the discipline. In addition, we charge a fixed $8,250 block tuition for undergraduate ground students taking between 12 and 18 credit hours per semester, with an additional $688 per credit hour for credits in excess of 18. A traditional undergraduate degree typically requires a minimum of 120 credit hours. The minimum number of credit hours required for a master s degree and overall cost for such a degree varies by program, although such programs typically require approximately 36 credit hours. The doctoral program requires approximately 60 credit hours and on average, doctoral students who graduated during the 2014-2015 academic year required 5.25 dissertation continuation courses to complete their degree.

Based on current tuition rates, tuition for a full program would generally equate to between $15,450 and $37,000 for an online master s program, between $42,600 and $56,400 for a full four-year online bachelor s program, approximately $66,000 for a full four-year bachelor s program taken on our ground campus, and $48,000 for a full doctoral program including five dissertation continuation courses. Students requiring dissertation continuation courses in excess of five are only charged $500 per course. The tuition amounts referred to above assume no reductions for transfer credits or scholarships, which many of our students utilize to reduce their total program costs. For example, the average student on our ground traditional campus will pay approximately $8,600 in tuition in the 2016-17 school year after scholarships. Thus, based on the number of transfer credits and the scholarships they receive it is likely that a student will pay less than $35,000 in tuition for a bachelor s degree on our ground campus. For the years ended December 31, 2016, 2015 and 2014, our revenue was reduced by approximately $179.2 million, $163.9 million and $140.0 million, respectively, as a result of scholarships that we offered to our students. The increase in scholarships reflects our increased revenues and our resulting increased use of scholarships (especially academic scholarships), to attract high performing students to our ground traditional campus.

Revenue per student for the year ended December 31, 2016 increased over 2015 primarily due to our residential traditional campus enrollment growing at a rate higher than our working adult enrollment. When factoring in room, board, and fees, the revenue per student is higher for these students than for our working adult students. We did not raise tuition in any of our programs for our 2016-2017 academic year and have not raised our tuition for our traditional ground program in eight years. A tuition increase of approximately 1% was implemented for the majority of online programs in September 2015. This reflects a concerted effort to control tuition pricing for students so that debt levels assumed by our students are reasonable. Tuition increases have not historically been, and may not in the future be, consistent across our programs due to market conditions and differences in operating costs of individual programs.

We derive a majority of our net revenues from tuition financed by the Title IV programs. For the years ended December 31, 2016, 2015 and 2014, we derived cash receipts equal to approximately 72.3%, 74.8%, and 76.5%, respectively, of our net revenues from Title IV programs. Our students also may rely on scholarships, personal savings, private loans, and employer tuition reimbursements to pay a portion of their tuition and related expenses.

Critical Accounting Policies and Estimates

The discussion of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. During the preparation of these consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions, including those discussed below. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. The results of our analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and the impact of such differences may be material to our consolidated financial statements.

We believe that the following critical accounting policies involve our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue recognition. Net revenues consist primarily of tuition and fees derived from courses taught by us online, at our over 260 acre campus in Phoenix, Arizona, and at facilities we lease or those of employers, as well as from related educational resources such as access to online materials. Tuition revenue and most fees and related educational resources are recognized pro-rata over the applicable period of instruction, net of scholarships awarded by us. Generally, we will refund all or a portion of tuition already paid pursuant to our refund policy, dependent upon length of course and modality and subject to certain state specific refund requirements. If a student withdraws at a time when only a portion, or none of the tuition is refundable, then in accordance with its revenue recognition policy, the University continues to recognize the tuition that was not refunded pro-rata over the applicable period of instruction. However, for students that have taken out financial aid to pay their tuition and for which a return to Title IV is required as a result of his or her withdrawal, the University recognizes revenue after a student withdraws only at the time of cash collection. Sales tax collected from students is excluded from net revenues. We also charge online students an upfront learning management fee, which is deferred and recognized over the average expected term of a student. Costs that are direct and incremental to new online students are also deferred and recognized ratably over the average expected term of a student. Deferred revenue and student deposits in any period represent the excess of tuition, fees and other student payments received as compared to amounts recognized as revenue on the statement of operations and are reflected as current liabilities in the accompanying balance sheet. Our educational programs have starting and ending dates that differ from our quarters. Therefore, at the end of each fiscal quarter, a portion of revenue from these programs is not yet earned. Other revenues may be recognized as sales occur or services are performed.

Allowance for doubtful accounts. We record an allowance for doubtful accounts for estimated losses resulting from the inability, failure or refusal of our students to make required payments, which includes the recovery of financial aid funds advanced to a student for amounts in excess of the student s cost of tuition and related fees that we may have to return under Title IV after a student drops. We determine the adequacy of our allowance for doubtful accounts based on an analysis of our historical bad debt experience, current economic trends, and the aging of the accounts receivable and student status. We apply a reserve to our receivables based upon an estimate of the risk presented by the age of the receivables and student status. We write off accounts receivable balances of active students at the earlier of the time the balance is deemed uncollectible, or one year after the revenue is generated. We reserve for receivables due from inactive students on a more accelerated basis than those due from active students and write off inactive student accounts at 150 days, as amounts due from inactive students are much more difficult to collect than amounts due from active students. We monitor our collections and write-off experience to assess whether adjustments to the estimated reserve are necessary.

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

Income taxes. We recognize the amount of taxes payable or refundable for the current year and deferred tax assets and liabilities for future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expect to be realized. Our deferred tax assets are subject to periodic recoverability assessments. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that more likely than not will be realized. Realization of the deferred tax assets is principally dependent upon achievement of projected future taxable income offset by deferred tax liabilities. We evaluate the realizability of the deferred tax assets annually. Since becoming a taxable corporation in August 2005, we have not recorded any valuation allowances to date on our deferred income tax assets. We evaluate and account for uncertain tax positions using a two-step approach. Recognition occurs when we conclude that a tax position based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement determines the amount of benefit that is greater than 50% likely to be realized upon the ultimate settlement with a taxing authority that has full knowledge of the facts. Derecognition of a tax position that was previously recognized occurs when we determine that a tax position no longer meets the more-likely-than-not threshold of being sustained upon examination. As of December 31, 2016 and 2015, the University has reserved approximately $1,981 and $1,706, respectively, for uncertain tax positions, including interest and penalties. The increase in the reserve in 2015 was attributable to apportionment positions taken on state income tax returns related to the sourcing of receipts from services.

Results of Operations

The following table sets forth statements of operations data as a percentage of net revenue for each of the periods indicated:

	Year Ended December 31,		
	2016	2015	2014
Net revenue	100.0%	100.0%	100.0%
Costs and expenses			
Instructional costs and services	42.7	42.4	41.8
Admissions advisory and related	13.7	14.5	15.7
Advertising	10.1	9.8	9.5
Marketing and promotional	1.0	0.9	1.1
General and administrative	4.9	5.4	5.7
Lease termination costs	0.4	0.0	0.0
Total costs and expenses	72.8	73.0	73.8
Operating income	27.2	27.0	26.2
Interest expense	(0.2)	(0.2)	(0.3)
Interest income and other	0.0	0.0	0.1
Income before income taxes	27.0	26.9	26.0
Income tax expense	10.0	10.0	9.9
Net income	17.0	16.9	16.1

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Net revenue. Our net revenue for the year ended December 31, 2016 was $873.3 million, an increase of $95.1 million, or 12.2%, as compared to net revenue of $778.2 million for the year ended December 31, 2015. This increase was primarily due to an increase in ground and online enrollment and, to a lesser extent, an increase in room and board and other student fees, partially offset by an increase in institutional scholarships. We did not raise tuition in any of our programs for our 2016-17 academic year. A tuition increase of approximately 1% was implemented for the majority of our online programs in September 2015. We have not raised our tuition for our traditional ground program in eight years. End-of-period enrollment increased 9.9% between December 31, 2016 and 2015, as ground enrollment increased 13.6% and online enrollment increased 9.0% over the prior year. The majority of the ground enrollment growth between years was residential students at our ground traditional campus in Phoenix, Arizona. We attribute the significant growth in our ground enrollment between years to our increasing brand recognition and the value proposition that our ground traditional campus affords to traditional-aged students and their parents. After scholarships, our ground traditional students pay for tuition, room, board, and fees, often half to a third of what it costs to attend a private, traditional university in another state and an amount comparable to what it costs to attend a public university. Although our online enrollment continues to grow, as the proportion of traditional colleges and universities providing alternative learning modalities increases, we will face increasing competition for working adult students from such institutions, including those with well-established reputations for excellence. The growth in revenue per student between years is primarily due to our residential traditional campus enrollment growing at a rate higher than our working adult enrollment. When factoring in room, board and fees, the revenue per student is higher for these students than for our working adult students.

Instructional costs and services expenses. Our instructional costs and services expenses for the year ended December 31, 2016 were $373.1 million, an increase of $43.4 million, or 13.2%, as compared to instructional costs and services expenses of $329.7 million for the year ended December 31, 2015. This increase was primarily due to increases in instructional compensation and related expenses including share-based compensation, faculty compensation, occupancy and depreciation and amortization, dues, fees, subscriptions and other instructional supplies, bad debt expense and other miscellaneous instructional costs and services of $10.9 million, $8.9 million, $14.2 million, $5.6 million, $2.0 million and $1.8 million, respectively. The increase in employee compensation and related expenses and faculty compensation are primarily due to the increase in the number of staff to support the increasing number of students attending the University, tenure adjustments, and increased benefit costs between years. In addition, we continue to increase our full-time faculty between years. The increase in occupancy, depreciation and amortization is the result of us placing into service additional buildings to support the growing number of ground traditional students. The increase in dues, fees, subscriptions and other instructional supplies is primarily due to increased licensing fees related to educational resources and increased food costs associated with a higher number of residential students. Our instructional costs and services expenses as a percentage of net revenue increased by 0.3% to 42.7% for the year ended December 31, 2016, as compared to 42.4% for the year ended December 31, 2015 due to an increase in dues, fees, subscriptions and other instructional supplies as a percentage of revenue due to the low profit margin derived on food sales, and occupancy, depreciation and amortization increasing as a percentage of revenue. Bad debt expense stayed flat year over year at 2.1% of net revenue. We anticipate that instructional costs and services will continue to increase as a percentage of revenue due to these factors.

Admissions advisory and related expenses. Our admissions advisory and related expenses for the year ended December 31, 2016 were $119.3 million, an increase of $6.7 million, or 6.0%, as compared to admissions advisory and related expenses of $112.6 million for the year ended December 31, 2015. This increase was primarily due to increases in employee compensation and related expenses, partially offset by decreases in other admissions advisory expenses of $7.0 million and $0.3 million, respectively. Employee compensation and related expenses increased as a result of increasing the number of admissions advisors, tenure adjustments, and increasing benefit costs between years. Our admissions advisory and related expenses as a percentage of net revenue decreased by 0.8% to 13.7% for the year ended December 31, 2016, from 14.5% for the year ended December 31, 2015 primarily due to our ability to leverage our admissions advisory personnel across an increasing revenue base. Although we are hopeful that we will continue to see leverage of our admissions advisory personnel, we do not anticipate the leverage in future years will be as significant as in 2016.

Advertising expenses. Our advertising expenses for the year ended December 31, 2016 were $88.2 million, an increase of $12.0 million, or 15.6%, as compared to advertising expenses of $76.2 million for the year ended December 31, 2015. This increase was primarily due to increased digital media and branding advertising. Our advertising expenses as a percentage of net revenue increased by 0.3% to 10.1% for the year ended December 31, 2016, from 9.8% for the year ended December 31, 2015 as we have increased our advertising spend to increase brand awareness. We plan to continue to increase our advertising spend on brand awareness in 2017 to counter the increased advertising of our competitors.

Marketing and promotional expenses. Our marketing and promotional expenses for the year ended December 31, 2016 were $8.9 million, an increase of $1.6 million, or 21.6%, as compared to marketing and promotional expenses of $7.3 million for the year ended December 31, 2015. Our marketing and promotional expenses as a percentage of net revenue increased slightly by 0.1% to 1.0% for the year ended December 31, 2016, from 0.9% for the year ended December 31, 2015.

General and administrative expenses. Our general and administrative expenses for the year ended December 31, 2016 were $43.2 million, an increase of $1.1 million, or 2.7%, as compared to general and administrative expenses of $42.1

million for the year ended December 31, 2015. This increase was primarily due to increases in employee compensation and related expenses including share-based compensation, and contributions to private school tuition organizations in lieu of state income taxes, partially offset by lower legal, audit and insurance costs and other general administrative expenses of $1.0 million, $1.2 million and $1.2 million respectively. During 2016 and 2015 our contributions to private school tuition organizations in lieu of state income taxes were $4.0 million and $2.8 million, respectively. Our general and administrative expenses as a percentage of net revenue decreased by 0.5% to 4.9% for the year ended December 31, 2016, from 5.4% for the year ended December 31, 2015 due to decreased legal costs and our ability to leverage our general and administrative expenses across an increasing revenue base.

Lease termination costs. In July 2016, we notified a current landlord of our intent to vacate leased space by the fourth quarter of 2016. As a result, we were required to pay a termination fee to terminate the lease resulting in $3.4 million of expense in the third quarter of 2016. Additionally in the fourth quarter of 2016, we completed our relocation of our employees to the new buildings and as a result expensed $0.1 million related to impaired assets from lease space no longer occupied by our employees.

Interest expense. Our interest expense for the year ended December 31, 2016 was $1.3 million, an increase of $0.1 million, as compared to interest expense of $1.2 million for the year ended December 31, 2015. Our interest expense stayed flat as a percentage of net revenue at 0.2% for the years ended December 31, 2016 and 2015.

Interest income and other. Our interest income and other for the year ended December 31, 2016 was a gain of $0.2 million, an increase of $0.3 million, as compared to interest income and other loss of $0.1 million for the year ended December 31, 2015. The increase was primarily due to higher investment returns.

Income tax expense. Income tax expense for the year ended December 31, 2016 was $87.6 million, an increase of $10.0 million from $77.6 million for the year ended December 31, 2015. This increase was primarily attributable to increased income before income taxes. Our effective tax rate was 37.1% for both of the years ended December 31, 2016 and 2015. The tax rate for both periods is less than the annual effective tax rates due to the contributions made in lieu of state income taxes in the third quarter of both years.

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Net income. Our net income for the year ended December 31, 2016 was $148.5 million, an increase of $17.1 million, as compared to $131.4 million for the year ended December 31, 2015, due to the factors discussed above.

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

Net revenue. Our net revenue for the year ended December 31, 2015 was $778.2 million, an increase of $87.1 million, or 12.6%, as compared to net revenue of $691.1 million for the year ended December 31, 2014. This increase was primarily due to an increase in ground and online enrollment and, to a lesser extent, an increase in room and board and other student fees, partially offset by an increase in institutional scholarships. We did not raise tuition in any of our programs for our 2014-15 academic year. A tuition increase of approximately 1% was implemented for the majority of our online programs in September 2015. We have not raised our tuition for our traditional ground program in seven years. End-of-period enrollment increased 9.9% between December 31, 2015 and 2014, as ground enrollment increased 19.2% and online enrollment increased 7.7% over the prior year. The majority of the ground enrollment growth between years was residential students at our ground traditional campus in Phoenix, Arizona. We attribute the significant growth in our ground enrollment between years to our increasing brand recognition and the value proposition that our ground traditional campus affords to traditional-aged students and their parents. After scholarships, our ground traditional students pay for tuition, room, board, and fees, often half to a third of what it costs to attend a private, traditional university in another state and an amount comparable to what it costs to attend a public university. Although our online enrollment continues to grow, as the proportion of traditional colleges and universities providing alternative learning modalities increases, we will face increasing competition for working adult students from such institutions, including those with well-established reputations for excellence. The growth in revenue per student between years is primarily due to our residential traditional campus enrollment growing at a rate higher than our working adult enrollment. When factoring in room, board and fees, the revenue per student is higher for these students than for our working adult students.

Instructional costs and services expenses. Our instructional costs and services expenses for the year ended December 31, 2015 were $329.7 million, an increase of $40.9 million, or 14.1%, as compared to instructional costs and services expenses of $288.8 million for the year ended December 31, 2014. This increase was primarily due to increases in instructional compensation and related expenses including share-based compensation, faculty compensation, occupancy and depreciation and amortization, dues, fees, subscriptions and other instructional supplies, bad debt expense and other miscellaneous instructional costs and services of $15.3 million, $7.3 million, $8.0 million, $7.6 million, $1.6 million and $1.1 million, respectively. The increase in employee compensation and related expenses and faculty compensation are primarily due to the increase in the number of staff to support the increasing number of students attending the University and increased benefit costs between years. In addition, we continue to increase our full-time faculty between years. The increase in occupancy, depreciation and amortization is the result of us placing into service additional buildings to support the growing number of ground traditional students. The increase in dues, fees, subscriptions and other instructional supplies is primarily due to increased licensing fees related to educational resources and increased food costs associated with a higher number of residential students. Our instructional costs and services expenses as a percentage of net revenue increased by 0.6% to 42.4% for the year ended December 31, 2015, as compared to 41.8% for the year ended December 31, 2014 due to an increase in dues, fees, subscriptions and other instructional supplies as a percentage of revenue due to the low profit margin derived on food sales, and occupancy, depreciation and amortization increasing as a percentage of revenue, partially offset by a decrease in bad debt expense from 2.2% of net revenue for the year ended December 31, 2014 to 2.1% of net revenues for the year ended December 31, 2015.

Admissions advisory and related expenses. Our admissions advisory and related expenses for the year ended December 31, 2015 were $112.6 million, an increase of $4.0 million, or 3.7%, as compared to admissions advisory and related expenses of $108.6 million for the year ended December 31, 2014. This increase was primarily due to increases in employee compensation and related expenses, partially offset by decreases in other admissions advisory expenses of $5.1 million and $1.2 million, respectively. Employee compensation and related expenses increased as a result of increasing the number of enrollment counselors and increasing benefit costs between years. Our admissions advisory and related expenses as a percentage of net revenue decreased by 1.2% to 14.5% for the year ended December 31, 2015, from 15.7% for the year ended December 31, 2014 primarily due to our ability to leverage our admissions advisory personnel across an increasing revenue base.

Advertising expenses. Our advertising expenses for the year ended December 31, 2015 were $76.2 million, an increase of $10.4 million, or 15.8%, as compared to advertising expenses of $65.8 million for the year ended December 31, 2014. This increase was primarily due to increased digital media and branding advertising focused on the southwestern United States region. Our advertising expenses as a percentage of net revenue increased by 0.3% to 9.8% for the year ended December 31, 2015, from 9.5% for the year ended December 31, 2014 as we have intentionally increased our advertising spend to increase brand awareness.

Marketing and promotional expenses. Our marketing and promotional expenses for the year ended December 31, 2015 were $7.3 million, a decrease of $0.1 million, or 2.0%, as compared to marketing and promotional expenses of $7.4 million for the year ended December 31, 2014. Our marketing and promotional expenses as a percentage of net revenue decreased slightly by 0.2% to 0.9% for the year ended December 31, 2015, from 1.1% for the year ended December 31, 2014.

General and administrative expenses. Our general and administrative expenses for the year ended December 31, 2015 were $42.1 million, an increase of $2.5 million, or 6.2%, as compared to general and administrative expenses of $39.6 million for the year ended December 31, 2014. This increase was primarily due to increases in legal, audit and insurance costs and employee compensation and related expenses including share-based compensation of $1.7 million and $0.4 million respectively, and our continued increases in contributions to charities, our community and city and state public-private partnerships. During 2015 and 2014 our contributions to private school tuition organizations in lieu of state income taxes were $2.8 million for both years. Our general and administrative expenses as a percentage of net revenue decreased by 0.3% to 5.4% for the year ended December 31, 2015, from 5.7% for the year ended December 31, 2014 due to our ability to leverage our general and administrative expenses across an increasing revenue base.

Interest expense. Our interest expense for the year ended December 31, 2015 was $1.2 million, a decrease of $0.6 million, as compared to interest expense of $1.8 million for the year ended December 31, 2014. This decrease was primarily due to an increase in ongoing construction projects, resulting in higher capitalized interest and a decrease in the average balance of our credit facility between periods due to scheduled monthly principal payments. Our interest expense decreased as a percentage of net revenue by 0.1% to 0.2% for the year ended December 31, 2015, from 0.3% for the year ended December 31, 2014.

Interest income and other. Our interest income and other for the year ended December 31, 2015 was a loss of $0.1 million, a decrease of $0.8 million, as compared to interest income and other of $0.7 million for the year ended December 31, 2014. The decrease was primarily due to the Arizona Court of Appeals reversing an earlier award of late penalty income of $1.0 million from the settlement of a note receivable.

Income tax expense. Income tax expense for the year ended December 31, 2015 was $77.6 million, an increase of $9.4 million from $68.2 million for the year ended December 31, 2014. This increase was primarily attributable to increased income before income taxes. Our effective tax rate was 37.1% and 38.0% for the year ended December 31, 2015 and 2014, respectively. Our effective tax rate in 2015 is lower than the prior year due to state tax apportionment and rate changes. The tax rate for both periods is less than the annual effective tax rates due to the contributions made in lieu of state income taxes in the third quarter of both years.

Net income. Our net income for the year ended December 31, 2015 was $131.4 million, an increase of $19.9 million, as compared to $111.5 million for the year ended December 31, 2014, due to the factors discussed above.

Seasonality

Our net revenue and operating results normally fluctuate as a result of seasonal variations in our business, principally due to changes in enrollment. Student population varies as a result of new enrollments, graduations, and student attrition. The majority of our traditional ground students do not attend courses during the summer months (May through August), which affects our results for our second and third fiscal quarters. Since a significant amount of our campus costs are fixed, the lower revenue resulting from the decreased ground student enrollment has historically contributed to lower operating margins during those periods. We intend to continue to increase, the relative proportion of our students that are ground traditional students. Thus, we expect this summer effect to become more pronounced in future years. Partially offsetting this summer effect in the third quarter has been the sequential quarterly increase in enrollments that has occurred as a result of the traditional fall school start. This increase in enrollments also has occurred in the first quarter, corresponding to calendar year matriculation. In addition, we typically experience higher net revenue in the fourth quarter due to its overlap with the semester encompassing the traditional fall school start and in the first quarter due to its overlap with the first semester of the calendar year. A portion of our expenses do not vary proportionately with these fluctuations in net revenue, resulting in higher operating income in the first and fourth quarters relative to other quarters. We expect quarterly fluctuation in operating results to continue as a result of these seasonal patterns.

Liquidity, Capital Resources, and Financial Position

Liquidity. During 2016, we financed our operating activities and capital expenditures primarily through cash provided by operating activities. Our unrestricted cash, cash equivalents and investments were $108.6 million at December 31, 2016 and our restricted cash, cash equivalents and investments were $84.9 million. In December 2012, we entered into a new credit agreement, which increased our term loan to $100 million with a maturity date of December 2019. Additionally, this facility, as amended in January 2016, provides a revolving line of credit in the amount of $150 million through December 2017 to be utilized for working capital, capital expenditures and other general corporate purposes. Indebtedness under the credit facility is secured by our assets and is guaranteed by certain of our subsidiaries. As of December 31, 2016, $25.0 million was drawn on the revolver.

Based on our current level of operations and anticipated growth, we believe that our cash flow from operations and other sources of liquidity, including cash, and cash equivalents, will provide adequate funds for ongoing operations, planned capital expenditures, and working capital requirements for at least the next 24 months.

Share Repurchase Program

Our Board of Directors has authorized the University to repurchase up to $175.0 million in aggregate of common stock, from time to time, depending on market conditions and other considerations. The current expiration date on the repurchase authorization by our Board of Directors is December 31, 2017. Repurchases occur at the University s discretion.

Under our share purchase authorization, we may purchase shares in the open market or in privately negotiated transactions, pursuant to the applicable Securities and Exchange Commission Rules. The amount and timing of future share repurchases, if any, will be made as market and business conditions warrant.

Since the approval of the initial share repurchase plan, the University has purchased 3.5 million shares of common stock at an aggregate cost of $75.8 million, which includes 415,555 shares of common stock at an aggregate cost of $15.4 million during the year ended December 31, 2016. At December 31, 2016, there remains $99.2 million available under our current share repurchase authorization.

Accounting Pronouncement to be Adopted in 2017

In March 2016, the FASB issued *Compensation Stock Compensation: Improvement to Employee Share-Based Payment Accounting*. This standard is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016 and early adoption is permitted. The University will adopt this standard as of January 1, 2017 using the prospective method.

As part of the new guidance, we will be required to record the income tax impact of the difference between the share-based compensation expense for book purposes and the amount deducted on the income tax return when awards vest or are settled within the income statement as part of income tax expense rather than current practice to record the difference as part of additional paid-in-capital (APIC) and will eliminate the requirement that excess tax benefits be realized on an income tax return prior to recognition in the financial statements. The University will have excess tax benefits after adoption, which will be reflected as a discrete item in the period the award vests or the options are exercised. However, the inclusion of excess tax benefits and deficiencies as a component of our income tax expense will increase volatility within our provision for income taxes as the amount of excess tax benefits or deficiencies from share-based compensation awards are dependent on our stock price at the date the restricted awards vest, our stock price on the date an option is exercised, and the quantity of options exercised. Our restricted stock vests in March each year so the favorable benefit will primarily impact the first quarter each year. Additionally, the guidance requires entities to present excess tax benefits as an operating activity on the statement of cash flows rather than current practice as a financing activity. Accordingly, in the first quarter of 2017, based on the current stock price, we anticipate our operating cash flows will increase and our financing cash flows will decrease upon our adoption of the standard. We will restate our prior period cash flows to be comparable to the required presentation. The University will make an accounting policy election to recognize forfeitures as they occur with no estimate of forfeitures applied to expense recognition. The new standard also simplifies the minimum statutory tax withholding requirements for employers who withhold shares upon settlement of an award on behalf of an employee to cover tax obligations by allowing an entity to withhold an amount up to the employees maximum individual tax rate in the relevant jurisdiction without resulting in liability classification of the award. As a result, the University expects some employees will elect a higher tax withholding and this may slightly increase our shares repurchased in lieu of income taxes in future period.

Finally, as a result of the excess tax benefit changes in the computation of our treasury stock method dilution computations, we are anticipating a higher diluted weighted average shares outstanding subsequent to adoption.

Cash Flows

Operating Activities. Net cash provided by operating activities for the years ended December 31, 2016, 2015 and 2014 was $218.3 million, $173.9 million and $167.0 million, respectively. Cash provided by operations in 2016, 2015 and 2014 resulted from our net income plus non-cash charges for provision for bad debts, depreciation and amortization, timing of income tax and employee related payments and student deposits and changes in other working capital.

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Investing Activities. Net cash used in investing activities was $216.0 million, $200.9 million, and $161.0 million for the years ended December 31, 2016, 2015, and 2014, respectively. Our cash used in investing activities is primarily related to the purchase of short-term investments and capital expenditures, partially offset by proceeds from the sale or maturity of short-term investments. Proceeds from investment, net of purchases of short-term investments, was $20.8 million, $17.4 million, and $7.6 million during the years ended December 31, 2016, 2015 and 2014, respectively. Capital expenditures were $178.3 million, $204.7 million and $168.7 million for the years ended December 31, 2016, 2015, and 2014, respectively. In 2016, capital expenditures primarily consisted of ground campus building projects that started in late 2015 such as three more apartment style residence halls, a 170,000 square foot classroom building for our College of Science, Engineering and Technology, a student service center, and a fourth parking structure, as well as land purchases adjacent to or near our Phoenix campus, and purchases of computer equipment, other internal use software projects and furniture and equipment to support our increasing employee headcount. Included in off-site development during 2016 is $60.7 million primarily related to an off-site student services center and parking garage that is in close proximity to our ground traditional campus. Employees that worked in two leased office buildings in the Phoenix area were relocated to this new building by the end of 2016. In 2015, in order to accommodate the continued growth of our traditional ground population, we completed four additional dormitories, a classroom building for our College of Science, Engineering and Technology, and a third parking structure prior to the 2015/2016 school year and started construction on all the construction projects completed in 2016, as well as land purchases adjacent to or near our Phoenix campus, and purchases of computer equipment, other internal use software projects and furniture and equipment to support our increasing employee headcount. Included in off-site development during 2015 is $10.0 million we spent to revitalize what was formerly known as the Maryvale Golf Course under a partnership agreement with the City of Phoenix. The golf course is now known as Grand Canyon University Championship golf course. Also, in late 2015, we commenced construction on the off-site office building and parking garage that is in close proximity to our ground traditional campus. In 2014, capital expenditures primarily consisted of ground campus building projects such as the construction of an additional classroom building and parking garage, additional residence halls that accommodate another 1,600 students and land purchases adjacent to our Phoenix campus to support our growing traditional student enrollment as well as purchases of computer equipment, other internal use software projects and furniture and equipment to support our increasing employee headcount.

Financing Activities . Net cash provided by financing activities was $20.7 million for the year ended December 31, 2016. Net cash used in financing activities was $15.2 million for the year ended December 31, 2015. Net cash provided by financing activities was $3.4 million for the year ended December 31, 2014. During 2016, net cash provided by financing activities consisted of net proceeds received from the revolving line of credit of $25.0 million, proceeds from the exercise of stock options of $13.2 million and excess tax benefits from share-based compensation of $9.9 million, partially offset by $15.4 million used to purchase treasury stock in accordance with the University s share repurchase program and $4.7 million used to purchase common shares withheld in lieu of income taxes resulting from restricted share awards and principal payments on notes payable, repayments on our notes payable and capital lease payments totaled $7.2 million. During 2015, $11.3 million was used to purchase treasury stock in accordance with the University s share repurchase program and $4.3 million was used to purchase common shares withheld in lieu of income taxes resulting from restricted share awards while principal payments on notes payable and capital leases totaled $6.8 million, partially offset by proceeds from the exercise of stock options of $3.5 million and excess tax benefits from share-based compensation of $3.6 million. During 2014, proceeds from the exercise of stock options of $7.8 million and excess tax benefits from share-based compensation of $7.6 million were partially offset by $3.7 million used to purchase common shares withheld in lieu of income taxes resulting from restricted share awards and $1.6 million used to purchase treasury stock in accordance with the University s share repurchase program and principal payments on notes payable and capital leases totaling $6.7 million.

Contractual Obligations

The following table sets forth, as of December 31, 2016, the aggregate amounts of our significant contractual obligations and commitments with definitive payment terms due in each of the periods presented (in millions):

	Payments Due by Period				
	Total	**Less than 1 Year**	**2-3 Years**	**4-5 Years**	**More than 5 Years**
Long term notes payable[(1)]	$ 98.2	$ 31.6	$ 66.6	$ 0.0	$ 0.0
Capital lease obligations	0.4	0.2	0.2	0.0	0.0
Purchase obligations[(2)]	39.0	29.6	6.1	2.8	0.5
Operating lease obligations[(3)]	3.7	1.5	1.3	0.8	0.1
Total contractual obligations	$ 141.3	$ 62.9	$ 74.2	$ 3.6	$ 0.6

(1) See Note 6, Notes Payable and Other Noncurrent Liabilities, to our consolidated financial statements, included in Item 8, *Consolidated Financial Statements and Supplementary Data*, for a discussion of our long term notes payable and other obligations.

(2) Represents unconditional purchase obligations and other obligations. Amount consists primarily of construction agreements for construction in progress on our ground traditional campus and an off-site office building and parking garage.

(3) See Note 7, Commitments and Contingencies, to our consolidated financial statements, included in Item 8, *Consolidated Financial Statements and Supplementary Data*, for a discussion of our operating lease obligations.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have had or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Non-GAAP Discussion

In addition to our GAAP results, we use Adjusted EBITDA as a supplemental measure of our operating performance and as part of our compensation determinations. Adjusted EBITDA is not required by or presented in accordance with GAAP and should not be considered as an alternative to net income, operating income, or any other performance measure derived in accordance with GAAP, or as an alternative to cash flow from operating activities or as a measure of our liquidity. See Item 6, *Selected Consolidated Financial and Other Data,* for a discussion of our Adjusted EBITDA computation and reconciliation.

Recent Accounting Pronouncements

See Note 2, Summary of Significant Accounting Policies, in Item 8, Consolidated Financial Statements and Supplementary Data

Item 7A. ***Quantitative and Qualitative Disclosures about Market Risk***

Impact of inflation. We believe that inflation has not had a material impact on our results of operations for the years ended December 31, 2016, 2015, or 2014. There can be no assurance that future inflation will not have an adverse impact on our operating results and financial condition.

Market risk. On February 27, 2013 we entered into an interest rate corridor to manage our 30-day LIBOR interest exposure from variable rate debt, which matures in December 2019. The corridor instrument, which hedges variable interest rate risk starting March 1, 2013 through December 20, 2019 with a notional amount of $73.3 million as of December 31, 2016, permits us to hedge our interest rate risk at several thresholds. Under this arrangement, in addition to the credit spread, we will pay variable interest rates based on the 30-day LIBOR rates monthly until that index reaches 1.5%. If 30-day LIBOR is equal to 1.5% through 3.0%, we will continue to pay 1.5%. If the 30-day LIBOR exceeds 3.0%, we will pay actual 30-day LIBOR less 1.5%.

Except with respect to the foregoing, we have no derivative financial instruments or derivative commodity instruments. We invest cash in excess of current operating requirements in short term certificates of deposit and money market instruments, municipal bond portfolios, or municipal mutual funds at multiple financial institutions.

Interest rate risk. We manage interest rate risk through the instruments noted above and by investing excess funds in cash equivalents, BBB or higher rated municipal bonds and municipal mutual funds bearing variable interest rates, which are tied to various market indices or individual bond coupon rates. Our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities before their maturity date that have declined in market value due to changes in interest rates. At December 31, 2016, a 10% increase or decrease in interest rates would not have a material impact on our future earnings, fair values, or cash flows.

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Item 8. *Consolidated Financial Statements and Supplementary Data*

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Grand Canyon Education, Inc.:

We have audited the accompanying consolidated balance sheets of Grand Canyon Education, Inc. and subsidiaries (the Company) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders equity, and cash flows for each of the years in the three-year period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Grand Canyon Education, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Grand Canyon Education, Inc. s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 16, 2017 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Phoenix, Arizona

February 16, 2017

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Grand Canyon Education, Inc.

Consolidated Balance Sheets

(In thousands, except par value)	As of December 31, 2016	2015
ASSETS:		
Current assets		
Cash and cash equivalents	$ 45,976	$ 23,036
Restricted cash, cash equivalents and investments	84,931	75,384
Investments	62,596	83,364
Accounts receivable, net	9,999	8,298
Income taxes receivable	4,686	3,952
Other current assets	21,880	20,863
Total current assets	230,068	214,897
Property and equipment, net	855,528	667,483
Prepaid royalties	3,059	3,355
Goodwill	2,941	2,941
Other assets	897	3,306
Total assets	$ 1,092,493	$ 891,982
LIABILITIES AND STOCKHOLDERS EQUITY:		
Current liabilities		
Accounts payable	$ 24,824	$ 34,149
Accrued compensation and benefits	19,697	17,895
Accrued liabilities	21,163	13,846
Income taxes payable	2,734	29
Student deposits	85,881	76,742
Deferred revenue	40,739	37,876
Due to related parties	120	675
Current portion of capital lease obligations		697
Current portion of notes payable	31,636	6,625
Total current liabilities	226,794	188,534
Capital lease obligations, less current portion		788
Other noncurrent liabilities	1,689	4,302
Deferred income taxes, non-current	23,708	14,855
Notes payable, less current portion	66,616	73,252
Total liabilities	318,807	281,731
Commitments and contingencies		
Stockholders equity		

Preferred stock, $0.01 par value, 10,000 shares authorized; 0 shares issued and outstanding at December 31, 2016 and 2015		
Common stock, $0.01 par value, 100,000 shares authorized; 51,509 and 50,288 shares issued and 47,559 and 46,877 shares outstanding at December 31, 2016 and 2015, respectively	515	503
Treasury stock, at cost, 3,950 and 3,411 shares of common stock at December 31, 2016 and 2015, respectively	(89,394)	(69,332)
Additional paid-in capital	212,559	177,167
Accumulated other comprehensive loss	(910)	(489)
Retained earnings	650,916	502,402
Total stockholders equity	773,686	610,251
Total liabilities and stockholders equity	$ 1,092,493	$ 891,982

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

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Grand Canyon Education, Inc.

Consolidated Income Statements

	Year Ended December 31,		
(In thousands, except per share amounts)	**2016**	**2015**	**2014**
Net revenue	$ 873,344	$ 778,200	$ 691,055
Costs and expenses:			
Instructional costs and services	373,101	329,651	288,791
Admissions advisory and related, including $980 in 2016; $1,575 in 2015; and $2,974 in 2014, respectively, to related parties	119,286	112,572	108,567
Advertising	88,152	76,229	65,808
Marketing and promotional	8,860	7,287	7,439
General and administrative	43,219	42,100	39,635
Lease termination costs	3,523		
Total costs and expenses	636,141	567,839	510,240
Operating income	237,203	210,361	180,815
Interest expense	(1,328)	(1,248)	(1,801)
Interest income and other	249	(106)	684
Income before income taxes	236,124	209,007	179,698
Income tax expense	87,610	77,596	68,232
Net income	$ 148,514	$ 131,411	$ 111,466
Earnings per share:			
Basic income per share	$ 3.22	$ 2.86	$ 2.45
Diluted income per share	$ 3.15	$ 2.78	$ 2.37
Basic weighted average shares outstanding	46,083	45,975	45,538
Diluted weighted average shares outstanding	47,121	47,281	47,006

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

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Grand Canyon Education, Inc.

Consolidated Statements of Comprehensive Income

	Year Ended December 31,		
(In thousands)	**2016**	**2015**	**2014**
Net income	$ 148,514	$ 131,411	$ 111,466
Other comprehensive income (loss), net of tax:			
Unrealized losses on hedging derivatives, net of taxes of $94, $230, and $186 for the years ended December 31, 2016, 2015 and 2014, respectively	(151)	(372)	(300)
Unrealized losses on available for sale securities, net of taxes of $168, $50 and $60 for the years ended December 31, 2016, 2015 and 2014, respectively	(270)	(82)	(93)
Comprehensive income	$ 148,093	$ 130,957	$ 111,073

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

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Grand Canyon Education, Inc.

Consolidated Statements of Stockholders Equity

(In thousands)

	Common Stock		Treasury Stock		Additional Paid-in	Accumulated Other Comprehensive Income	Retained	
	Shares	Amount	Shares	Amount	Capital	(Loss)	Earnings	Total
Balance at December 31, 2013	48,890	$ 489	2,845	$ (48,432)	$ 132,904	$ 358	$ 259,525	$ 344,844
Comprehensive income						(393)	111,466	111,073
Common stock purchased for treasury			38	(1,676)				(1,676)
Share-based compensation	317	3	77	(3,662)	9,941			6,282
Restricted shares forfeited			42					
Exercise of stock options	539	5			7,820			7,825
Excess tax benefits					7,884			7,884
Balance at December 31, 2014	49,746	497	3,002	(53,770)	158,549	(35)	370,991	476,232
Comprehensive income						(454)	131,411	130,957
Common stock purchased for treasury			288	(11,279)				(11,279)
Share-based compensation	324	3	94	(4,283)	11,269			6,989
Restricted shares forfeited			27					
Exercise of stock options	218	3			3,486			3,489
Excess tax benefits					3,863			3,863

Balance at December 31, 2015	50,288	503	3,411	(69,332)		177,167		(489)	502,402	610,251
Comprehensive income								(421)	148,514	148,093
Common stock purchased for treasury			416	(15,367)						(15,367)
Share-based compensation	275	3	114	(4,695)		12,273				7,581
Restricted shares forfeited			9							
Exercise of stock options	946	9			**$ 19,563**		$ 18,594			

Accrued expenses due to affiliates :	**September 30,**	December 31,
	2013	2012
Total accrued expenses due to affiliates	**$ 2,159**	$ 705

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SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

In July 1999, SPAR Marketing Force, Inc. (“SMF”), SBS and SIT entered into a perpetual software ownership agreement providing that each party independently owned an undivided share of and had the right to unilaterally license and exploit their "Business Manager" Internet job scheduling software (which had been jointly developed by such parties), and all related improvements, revisions, developments and documentation from time to time voluntarily made or procured by any of them at its own expense. In addition, SPAR Trademarks, Inc. ("STM"), SBS and SIT entered into separate perpetual trademark licensing agreements whereby STM has granted non-exclusive royalty-free licenses to SIT and SBS (and through them to their commonly controlled subsidiaries and affiliates by sublicenses, including SAS) for their continued use of the name "SPAR" and certain other trademarks and related rights of STM, a wholly owned subsidiary of SGRP. SBS and SAS provide services to the Company, as described above, and SIT no longer provides services to and does not compete with the Company.

Effective August 31, 2013, the Company sold its equity interests and working capital investment in its Romanian subsidiary, SPAR Business Ideas Provider S.R.L. ("BIP"), to a Company affiliate, SPAR InfoTech, Inc. ("SIT"), for a total purchase price of $348,465. The Company received, at closing, $187,767 in cash and the balance is payable over 30 months with interest at 6% per annum. The purchase price was equal to the book value of the Company's interests in BIP, which management believes approximates fair value. The sale to SIT was approved by the Company's Audit Committee and Board of Directors.

Through arrangements with the Company, SBS, SAS and other companies owned by Mr. Brown or Mr. Bartels participate in various benefit plans, insurance policies and similar group purchases by the Company, for which the Company charges them their allocable shares of the costs of those group items and the actual costs of all items paid specifically for them. All such transactions between the Company and the above affiliates are paid and/or collected by the Company in the normal course of business. As an accommodation, the Company also provides certain accounting, human resource and similar administrative services to SIT and certain other affiliates of Robert G. Brown and William H. Bartels, at a nominal cost.

In addition to the above, SAS purchases insurance coverage for worker compensation, casualty and property insurance risk for itself, SBS and (through SBS under contracts with them) it's field merchandising specialists, and the Company from Affinity Insurance, Ltd. ("Affinity"). SAS owns minority (less than 1%) equity interest in Affinity, and Robert G. Brown is a director of Affinity. The Affinity insurance premiums for such coverage are ultimately charged to SAS, SBS (and through SBS to its covered field merchandising specialists) and the Company based on the contractual arrangements of the parties.

In the event of any material dispute in the business relationships between the Company and SBS, SAS, SIT or NRS, it is possible that Mr. Brown, Mr. Bartels or Mr. Burdekin may have one or more conflicts of interest with respect to these relationships and such dispute could have a material adverse effect on the Company.

7. Preferred Stock

SGRP's certificate of incorporation authorizes it to issue 3,000,000 shares of preferred stock with a par value of $0.01 per share (the "SGRP Preferred Stock"), which may have such preferences and priorities over the SGRP Common Stock and other rights, powers and privileges as the Company's Board of Directors may establish in its discretion from time to time. The Company has created and authorized the issuance of a maximum of 3,000,000 shares of Series A Preferred Stock pursuant to SGRP's Certificate of Designation of Series "A" Preferred Stock (the "SGRP Series A Preferred Stock"), which have dividend and liquidation preferences, have a cumulative dividend of 10% per year, are redeemable at the Company's option and are convertible at the holder's option (and without further consideration) on a one-to-one basis into SGRP Common Stock. As of September 30, 2013, there are no shares of SGRP Series A Preferred Stock outstanding, and there are 2,445,598 shares of SGRP Series A Preferred Stock authorized and available for issuance under SGRP's certificate of incorporation and Certificate of Designation of Series "A" Preferred Stock. The number of shares authorized and available by such designation could, however, be reduced by amendment or redemption to facilitate the creation of other SGRP Preferred Series.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

8. Stock-Based Compensation and Other Plans

SGRP currently grants options to its eligible directors, officers and employees and certain consultants (who are employees of its affiliates) to purchase shares of Common Stock issued by SGRP ("SGRP Shares") pursuant to the 2008 Stock Compensation Plan, as amended (the "2008 Plan"). SGRP also has granted stock options that continue to be outstanding under the 2000 Stock Option Plan ("2000 Plan"). The 2000 Plan will continue to govern any remaining outstanding options issued under it for so long as such options are outstanding. As described below, SGRP also has the authority to issue other types of stock-based awards under the 2008 Plan, but to date has only issued restricted stock in addition to such options.

The 2008 Plan increased the number of SGRP Shares that may be covered by awards under all plans to 5.6 million SGRP Shares in the aggregate plus the aggregate number of option shares surrendered (other than in exercise) or expired after May 29, 2008. The stock options issued under the 2008 Plan are typically "nonqualified" (as a tax matter), have a ten (10) year maximum life (term) and vest during the first four years following issuance at the rate of 25% on each anniversary date of their issuance. Stock options are granted at the market price on the grant date, and the Company recognizes compensation expense equal to the fair value of the award, calculated as of the grant date and recognized over the requisite service period (which generally is the vesting period). Fair value is calculated using the Black-Scholes option pricing model.

Based upon the Black-Scholes calculation, share-based compensation expense related to employee and director stock option grants totaled $394,000 and $348,000 for the nine months ended September 30, 2013 and 2012, respectively. The unamortized expense as of September 30, 2013, was approximately $1.4 million for outstanding stock option grants.

On August 6, 2013, 428,000 new stock option grants were issued to employees at an exercise price of $2.14, which represents the fair market value of a share of the Company’s common stock on August 6, 2013, as determined in accordance with the Company’s 2008 Plan. The estimated stock compensation expense is $915,980, which will be recognized ratably over the four year vesting period. The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: dividend yield of 0%; volatility factor of expected market price of common stock of 157%; risk free interest rate of 1.71%; and expected lives of 6 years.

On January 3, 2013 and May 7, 2013, 10,000 and 30,000 new stock option grants were issued to directors at an exercise price of $1.70 and $2.04, respectively which represents the fair market value of a share of the Company’s common stock on January 3, 2013 and May 7, 2013, respectively, as determined in accordance with the Company’s 2008 Plan. The estimated stock compensation expense is $17,000 and $61,200, respectively, which will be recognized ratably over the one year vesting period. The fair value of each option is estimated based on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: dividend yield of 0%; volatility factor of expected market price of common stock of 157%; risk free interest rate of 1.71%; and expected lives of 6 years.

Additionally, during the nine months ended September 30, 2013, new stock option grants covering 28,000 SGRP Shares were awarded to eight new employees of the Company and SAS at an exercise price of $1.69 per share which represents the fair market value of a share of the Company’s common stock on the date of issue, as determined in accordance with the Company’s 2008 Plan. The estimated stock compensation expense is $47,320, which will be recognized ratably over the four year vesting period. The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: dividend yield of 0%; volatility factor of expected market price of common stock of 157%; risk free interest rate of 1.71%; and expected lives of 6 years.

Pursuant to the 2008 Plan, SGRP's Compensation Committee authorized a restricted SGRP common stock award of 100,000 shares on March 10, 2011 (the "2011 RS Award"), and 25,000 shares on August 1, 2012 (the "2012 RS Award"), as additional compensation to Mr. Raymond, the Company's Chief Executive Officer and President. The restricted shares vest in five equal parts on each of the five anniversaries following the award date (20,000 shares a year in the case of the 2011 RS Award, which started to vest on March 10, 2012, and 5,000 shares a year in the case of the 2012 RS Award, which starts to vest on August 1, 2013), so long as Mr. Raymond continues to be so employed by the Company on the applicable vesting date. If Mr. Raymond leaves such employment, he will lose his right to receive any unvested shares. The compensation expense related to each such award will be amortized by the Company over the five (5) year vesting periods, starting on the issuance date of each award (March 10, 2011, and August 1, 2012, respectively). The Company recorded compensation expenses for the nine months ended September 30, 2013, of $36,613 for the 2011 RS Award and $4,266 for the 2012 RS Award. The unamortized expense as of September 30, 2013 was $117,870 for the 2011 RS Award and $21,023 for the 2012 RS Award.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

9. Customer Deposits

Customer deposits at September 30, 2013, were $627,000 ($335,000 from domestic operations and $292,000 from international operations) compared to $263,000 at December 31, 2012 ($176,000 from domestic operations and $87,000 from international operations).

10. Commitments and Contingencies

Legal Matters

The Company is a party to various legal actions and administrative proceedings arising in the normal course of business. In addition, the Company is involved in various other legal actions and administrative proceedings through its contractual obligation to pay SBS's costs (as part of the total costs of SBS borne by the Company - see Note 6 to Consolidated Financial Statements - *Related Party Transactions*). In the opinion of the Company's management, disposition of these matters are not anticipated to have a material adverse effect on the Company or its estimated or desired assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievement, results or condition.

11. Purchases and Sale of Interests in Subsidiaries

The following contains descriptions of the Company's purchases and sale of interests in its operating subsidiaries during the nine month period ended September 30, 2013. In each of the subsidiaries noted below, the Company, through its various agreements with the applicable Local Investor, has provided for appropriate exit strategies that are fair and equitable for each partner.

<u>BIP (Romania)</u>

Effective August 31, 2013, the Company sold its interests in its Romanian joint venture, SPAR Business Ideas Provider S.R.L. ("BIP"), to the Company's affiliate, SIT. See Note 6 to the Consolidated Financial Statements – *Related-Party Transactions*.

NMS (USA)

In September 2012, the Company made a domestic acquisition that also used its international strategy of seeking a minority (*i.e.*, non-controlling) non-affiliated Local Investor for the Company's new consolidated subsidiary in Georgia, U.S.A. As with most of its international counterparts, the Company acquired a 51% interest in National Merchandising Services, LLC, a newly formed Nevada limited liability company ("NMS"), and is providing its usual Global Contributions, and since then NMS has been a part of the Company's consolidated financial reports. NMS provides merchandising services in the U.S.A. to multiple Fortune 500 companies previously supplied by its Local Investor. The Local Investor in this case is National Merchandising of America, Inc., a Georgia corporation ("NMA"), which owns a 49% interest in NMS and will provided field merchandising services to NMS pursuant to a Field Services Agreement with NMS through July 31, 2013. In addition, NMA contributed substantially all of its customers to NMS and is providing the usual Local Contributions.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

The Company's initial investment in NMS was $859,050, which consists of the following (1) $510 in capital, (2) a cash payment of $400,000 to NMA at closing and a $200,000 non-interest bearing promissory note paid to NMA on January 2, 2013, (3) issuance of SPAR common stock worth $165,000 to NMA, and (4) a contingent liability of $93,540 described below.

NMS agreed to pay an incentive consulting fee ("Consulting Fee") to NMA based on NMS achieving certain earnings goals in each of the next three 12 month periods. The Consulting Fee is calculated based on 50% of NMS earnings in excess of the annual base earnings of $500,000. The maximum consideration for the Consulting Fee could be as much as $600,000. The projected consulting fee is approximately $93,540 and has been recorded as a contingent liability at December 31, 2012 and September 30, 2013. The Company has completed its valuation of the fair value and related allocation between identifiable intangibles and goodwill, and recorded the following in 2012. The intangible asset is being amortized over ten years. The amortization expense was $39,474 for the nine months ended September 30, 2013.

Intangible asset	$526,320
Goodwill	332,730
	$859,050

CMR-Meridian (South Africa)

In September 2012, the Company's existing local consolidated subsidiary, SGRP Meridian (Pty) Ltd. ("SGRP Meridian"), acquired a majority (51%) of the equity interests in CMR Meridian (Pty) Ltd. ("CMR-Meridian"). Combined Manufacturers National (Pty) Ltd ("CMR") acquired the remaining minority (49%) non-controlling interest in CMR-Meridian as its Local Investor, contributed substantially all of its customers to CMR-Meridian and provided the usual Local Contributions while the Company is providing its usual Global Contributions. SGRP Meridian and CMR-Meridian are both part of the Company's consolidated financial reports.

CMR-Meridian initiated operations on October 1, 2012 and the Company provided approximately $380,000 in a working capital loan to SGRP Meridian to assist SGRP Meridian in this new joint venture. SGRP Meridian, through the joint venture agreement with CMR, paid approximately $73,000 at closing and recorded a contingent liability in the amount of $154,000 representing the fair value of potential future payments required to be made by SGRP Meridian to CMR provided certain financial conditions are achieved by CMR-Meridian in 2013 and 2014. The required payments based on an exchange rate of Rand to US Dollars at September 30, 2013, are as follows: (a)

$69,000 if CMR-Meridian achieves $228,000 of earnings before interest and taxes for the twelve month period ending December 31, 2013; and (b) $92,000 if CMR-Meridian achieves $228,000 of earnings before interest and taxes for the twelve month period ending December 31, 2014. If during these two periods the earnings before interest and taxes is lower than $228,000 the payment in each year will be reduced proportionately.

In addition to the above payments, CMR-Meridian may be required to pay CMR an Incentive Consulting Fee provided CMR-Meridian meets the following financial criteria. Should CMR-Meridian's earnings before interest and taxes exceed $228,000 in each of the following twelve month periods ending December 31, CMR-Meridian will pay to CMR:

For 2013, the payment will be 50% of the excess earnings up to a maximum of $159,000,

For 2014, the payment will be 25% of the excess earnings up to a maximum of $93,000, and

For 2015, the payment will be 10% of the excess earnings up to a maximum of $44,000.

At the end of the first three full years of operations, an additional bonus of $57,000 will be paid by CMR-Meridian to CMR if the combined cumulative earnings before interest and taxes exceed $684,000 provided that in each year, a minimum $228,000 in earnings is achieved. Based on current projections, the Company does not believe at this time that CMR-Meridian will meet the criteria to earn the Incentive Consulting Fee; therefore no contingent liability has been recorded as of December 31, 2012 or September 30, 2013. However, the Company will continue to evaluate the potential for the Incentive Consulting Fee throughout 2013.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

Preceptor (India)

In March 2013, the Company purchased a majority (51%) of the equity interests in Preceptor Marketing Services Private Limited ("Preceptor"), a recently formed Indian corporation, from Krognos Integrated Marketing Services Private Limited ("Krognos"), and Preceptor became a new consolidated subsidiary of the Company. The Company also is providing the usual Global Contributions to Preceptor, while Krognos as the Local Investor retained the remaining minority (49%) non-controlling interest in Preceptor and is providing the usual Local Contributions. Krognos also is the Local Investor in the Company's existing subsidiary in India, SPAR Krognos Marketing Private Limited. Preceptor will enable the Company to service clients not serviced by its existing Indian subsidiary. The Company paid $21,000 for its interest in Preceptor, and Preceptor became a consolidated subsidiary of the Company on March 1, 2013.

Certain MFI Business (USA)

In March 2013, the Company also purchased general merchandising service and certain in-store audit service businesses from Market Force Information, Inc. ("MFI"), a leading customer intelligence solution provider. The acquired in-store audit services include the price, point of sale, out of stock, intercept and planogram audits managed by MFI's New York office. With this acquisition, the Company entered the growing in-store audit service business and expanded its existing general merchandising service and client base domestically.

The purchase was made pursuant to the Asset Purchase Agreement dated as of March 15, 2013 (the "Purchase Agreement") between MFI, as the seller, and SPAR Marketing Force, Inc. ("SMF"), a consolidated subsidiary of SGRP and its principal domestic operating company. The purchase was completed on March 15, 2013. The Purchase Price under the Purchase Agreement consisted of a cash purchase price of $1,300,000 and the assumption of certain specified liabilities (principally those arising after the closing under the assumed contracts). The Company plans to complete its purchase price valuation analysis during 2013 and record the appropriate intangible assets and or goodwill based on its analysis. Currently, the Company has recorded $1,300,000 as an intangible asset and is amortizing it on a straight line basis for five years. In addition, SMF entered into a Consulting Services Agreement and a Transition Services Agreement with MFI, under which MFI will provide certain services, equipment and facilities for up to one year, and various assignments and other transfer documents.

The following table includes the amount of MFI's revenue and earnings included in the Company's consolidated income statement for the three and nine months ended September 30, 2013 and a *pro forma* calculation of the amounts of MFI's revenue and earnings that would have been included in the Company's consolidated income statement for the three and nine months ended September 30, 2013 and 2012 had the MFI acquisition date been January 1, 2013 and 2012, instead of March 15, 2013 (in thousands):

	Revenue	Net Income (Loss)
Actual MFI from July 1 to September 30, 2013	$ 1,766	$ (150)
2013 consolidated supplemental pro forma from July 1 to September 30, 2013	$ 27,753	$ 331
2012 consolidated supplemental pro forma from July 1 to September 30, 2012	$ 28,179	$ 216
Actual MFI from March 15 to September 30, 2013	$ 4,485	$ 339
2013 consolidated supplemental pro forma from January 1 to September 30, 2013	$ 82,316	$ (106)
2012 consolidated supplemental pro forma from January 1 to September 30, 2012	$ 77,252	$ 736

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

12. Geographic Data

The Company operates in the same single reportable business segment (e.g., merchandising and marketing services) in both its Domestic Merchandising Services Division and its International Merchandising Services Division. The Company uses those divisions to improve its administration and operational and strategic focuses, and it tracks and reports certain financial information separately for each of those divisions. The Company measures the performance of its domestic and international divisions and subsidiaries using the same metrics. The primary measurement utilized by management is operating profits, historically the key indicator of long-term growth and profitability, as the Company is focused on reinvesting the operating profits of each of its international subsidiaries back into its local markets in an effort to improve market share and continued expansion efforts. Set forth below are summaries of the Company's net revenues from its United States subsidiaries (i.e., the Domestic Merchandising Services Division) and from its international (non-U.S.) subsidiaries (i.e., the International Merchandising Services Division), net revenue from certain international subsidiaries as a percent of consolidated net revenue, operating income and long lived assets by geographic area for 2013 and 2012, respectively (in thousands):

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2013	2012	**2013**	2012
Net revenues:				
United States	**$11,327**	$11,016	**$32,390**	$31,182
International	**16,426**	14,341	**47,762**	37,802
Total net revenues	**$27,753**	$25,357	**$80,152**	$68,984

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
	2013		2012		**2013**		2012	
Net revenues international:		% of consolidated		% of consolidated		% of consolidated		% of consolidated

		net revenue		net revenue		net revenue		net revenue
Mexico	**$4,002**	**14.4%**	$4,095	16.1%	**$11,277**	**14.1%**	$10,432	15.1%
South Africa	**3,873**	**14.0**	1,823	7.2	**11,809**	**14.7**	5,590	8.1
Japan	**2,079**	**7.5**	1,733	6.8	**4,680**	**5.8**	4,602	6.7
China	**1,911**	**6.9**	1,458	5.7	**4,956**	**6.2**	2,999	4.3
Canada	**1,545**	**5.6**	1,660	6.5	**4,389**	**5.5**	4,864	7.1
Australia	**1,283**	**4.6**	2,208	8.7	**5,046**	**6.3**	5,056	7.3
India	**1,203**	**4.3**	467	1.8	**3,318**	**4.1**	1,404	2.0
All others	**530**	**1.9**	897	3.5	**2,287**	**2.9**	2,855	4.1
Total international revenues	**$16,426**	**59.2%**	$14,341	56.3%	**$47,762**	**59.6%**	$37,802	54.7%

	Three Months Ended		**Nine Months Ended**	
	September 30,		**September 30,**	
	2013	2012	**2013**	2012
Operating income:				
United States	**$99**	$729	**$383**	$2,049
International	**291**	177	**520**	3
Total operating income	**$390**	$906	**$903**	$2,052

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SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

	September 30, 2013	December 31, 2012
Long lived assets:		
United States	**$ 4,434**	$ 3,145
International	**2,458**	2,129
Total long lived assets	**$ 6,892**	$ 5,274

13. Supplemental Balance Sheet Information (in thousands)

	September 30, 2013	December 31, 2012
Accounts receivable, net, consists of the following:		
Trade	**$ 13,407**	$ 18,011
Unbilled	**5,354**	3,577
Non-trade	**367**	42
	19,128	21,630
Less allowance for doubtful accounts	**91**	216
Accounts receivable, net	**$ 19,037**	$ 21,414

	September 30, 2013	December 31, 2012
Property and equipment, net, consists of the following:		
Equipment	**$ 8,513**	$ 8,366
Furniture and fixtures	**595**	570
Leasehold improvements	**250**	250
Capitalized software development costs	**5,753**	5,044
	15,111	14,230
Less accumulated depreciation and amortization	**13,072**	12,453

Property and equipment, net	**$ 2,039**	$ 1,777

	September 30, 2013	December 31, 2012
Intangible assets consist of the following:		
Customer contracts and lists	**$ 3,069**	$ 1,804
Less accumulated amortization	**659**	336
	$ 2,410	$ 1,468

The Company is amortizing the customer contracts of $3.1 million on a straight line basis between 3 and 10 years. Amortization expense for the nine months ended September 30, 2013 and 2012 was approximately $323,000 and $113,000, respectively. The unamortized expense for each of the following years is as follows:

Year	Amount
2013	$ 454
2014	525
2015	462
2016	382
2017	382
Thereafter	205
Total	$ 2,410

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SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

	September 30, 2013	December 31, 2012
Accrued expenses and other current liabilities consist of the following:		
Accrued salaries payable	**$ 625**	$ 799
Taxes payable	**878**	1,460
Loans from domestic and international partners	**1,167**	1,559
Accrued accounting and legal expense	**358**	358
Final payment for purchase of NMS, LLC	**-**	200
Contingent liabilities, incentive for consulting fees	**689**	689
Short term portion of capital lease obligations	**115**	178
Other	**1,587**	1,486
Accrued expenses and other current liabilities	**$ 5,419**	$ 6,729

14. Foreign Currency Rate Fluctuations

The financial statements of the foreign entities consolidated into SPAR Group, Inc. consolidated financial statements were translated into United States dollar equivalents at exchange rates as follows: balance sheet accounts for assets and liabilities were converted at quarter-end rates, equity at historical rates and income statement accounts at average exchange rates for the quarter. The resulting translation gains and losses are reflected in accumulated other comprehensive gain or loss in the statements of stockholders' equity. Foreign currency transaction gains and losses are reflected in net earnings. The Company has foreign currency exposure with its international subsidiaries. In both 2013 and 2012, these exposures are primarily concentrated in the South African Rand, India Rupee and Canadian Dollar. Total international assets were $12.8 million and total liabilities were $10.1 million based on exchange rates at September 30, 2013. International revenues for the nine months ended September 30, 2013 and 2012 were $47.8 million and $37.8 million, respectively. The international division reported net income of approximately $8,000 and a net loss of $205,000 for the nine months ended September 30, 2013 and 2012, respectively.

15. Discontinued Operations

Effective August 31, 2013, the Company sold its equity interests and working capital investment in its Romanian subsidiary, SPAR Business Ideas Provider S.R.L. ("BIP"), to a Company affiliate, SPAR InfoTech, Inc. ("SIT"), for a total purchase price of $348,465, The Company received, at closing, $187,767 in cash and the balance is payable over 30 months with interest at 6% per annum. The purchase price was equal to the book value of the Company's interests in BIP, which management believes approximates fair value. The sale to SIT was approved by the Company's Audit Committee and Board of Directors.

As a results of the sale, the Romanian operations were reported in the consolidated financial statements of the Company as a discontinued operation. The consolidated statements of cash flows do not separately report the cash flows of the discontinued operations.

SPAR Group, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited) (continued)

The components of the earnings from discontinued operations are presented below (in thousands):

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2013	**2012**	**2013**	**2012**
Net revenues	**$952**	$1,066	**$3,426**	$2,828
Cost of revenues	**733**	858	**2,736**	2,258
Gross profit	**219**	208	**690**	570
Selling, general and administrative expenses	**208**	177	**562**	426
Depreciation and amortization	**–**	1	**1**	9
Operating income	**11**	30	**127**	135
Other (income) expense	**(6)**	12	**29**	40
Income from operations	**$17**	$18	**$98**	$95

16. Taxes

In July 2006, the FASB issued an interpretation, *Accounting for Uncertainty in Income Taxes*, now codified as ASC Topic 740, which detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements. Tax positions must meet a more-likely-than-not recognition threshold and requires that interest and penalties that the tax law requires to be paid on the underpayment of taxes should be accrued on the difference between the amount claimed or expected to be claimed on the return and the tax benefit recognized in the financial statements. The Company's policy is to record this interest and penalties as additional tax expense. The Company's tax reserves at September 30, 2013, and December 31, 2012, totaled $123,000 and $93,000, respectively, for potential domestic state tax and federal tax liabilities.

SGRP and its subsidiaries file numerous consolidated, combined and separate company income tax returns in the U.S. Federal jurisdiction and in many U.S. state and foreign jurisdictions. With few exceptions, SGRP and its domestic subsidiaries are subject to U.S. Federal, state and local income tax examinations for the years 2009 through the present. However, tax authorities have the ability to review years prior to the position taken by the Company to the extent that SPAR Group utilized tax attributes carried forward from those prior years.

17. Subsequent Events

As of October 30, 2013, SGRP and certain of its domestic subsidiaries (as borrowers) entered into the Fifth Agreement of Amendment to Revolving Loan and Security Agreement And Other Documents (the "Fifth Amendment") with Sterling National Bank ("Sterling") as Agent and Lender, a copy of which is attached to this Quarterly Report as Exhibit 10.1. The Fifth Amendment adds SPAR Canada, Inc., SPAR Canada Company ("SCC"), and SPAR Wings & Ink Company ("SWI") as borrowers under the Sterling Credit Facility. See Note 4 to the Consolidated Financial Statements - Credit Facilities: *Sterling Credit Facility*, above. As a result, the receivables of the Company's Canadian subsidiaries, SCC and SWI, are now included in the Company's borrowing base and pledged to Sterling and advances are available to those Canadian borrowers under the Sterling Credit Facility. SCC has retired its existing credit facility with the Royal Bank of Canada and replaced it by becoming a borrower under the Sterling Credit Facility.

SPAR Group, Inc. and Subsidiaries

Item 2. Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources

Forward-Looking Statements

There are "forward-looking statements" contained in this Quarterly Report on Form 10-Q for the quarter and nine months ended September 30, 2013 (this "Quarterly Report"), of SPAR Group, Inc. ("SGRP", and together with its subsidiaries, the "SPAR Group" or the "Company"), in SGRP's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the Securities and Exchange Commission (the "SEC") on April 2, 2013 (the "2012 Annual Report"), in SGRP's Proxy Statement for its 2013 Annual Meeting of Stockholders as filed with the SEC on April 19, 2013 (the "2013 Proxy Statement"), and the Company's other filings under applicable law with the SEC (including this Quarterly Report, the Company's 2012 Annual Report and the 2013 Proxy Statement, each a "SEC Report"). "Forward-looking statements" are defined in Section 27A of the Securities Act of 1933, as amended (the "Securities Act"),Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and other applicable federal and state securities laws, rules and regulations, as amended (together with the Securities Act and Exchange Act, collectively, "Securities Laws"). The Company's forward-looking statements include, in particular and without limitation, the discussions in this Quarterly Report under the heading "Management's Discussion and Analysis of Financial Condition, Results of Operations, Liquidity and Capital Resources" and in the Company's 2012 Annual Report under the headings "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations". You can identify forward-looking statements in such information by the Company's use of terms such as "may", "will", "expect", "intend", "believe", "estimate", "anticipate", "continue" or similar words or variations or negatives of those words.

You should carefully consider all forward-looking statements, risk factors and the other risks, cautions and information noted in this Quarterly Report, the Company's 2012 Annual Report and the Company's other SEC Reports that could cause the Company's actual assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievement, results, risks or condition to differ materially from those anticipated by the Company and described in the information in the Company's forward-looking statements, whether express or implied, as the Company's anticipations are based upon the Company's plans, intentions, expectations and best estimates and (although the Company believe them to be reasonable) involve known and unknown risks, uncertainties and other factors that could cause them to fail to occur or be realized or to be materially and adversely different from those the Company anticipated.

Although the Company believes that its plans, intentions, expectations and estimates reflected or implied in such forward-looking statements are reasonable, the Company cannot assure you that such plans, intentions, expectations or estimates will be achieved in whole or in part, that the Company has identified all potential risks, or that the Company can successfully avoid or mitigate such risks in whole or in part. You should carefully review the risk factors described in Item 1A – "Risk Factors" in the Company's 2012 Annual Report and any other risks, cautions or information contained in or incorporated by reference into any applicable SEC Report. All forward-looking and other statements and information attributable to the Company or persons acting on its behalf are expressly subject to and qualified by all such risk factors and other risks, cautions and information.

You should not place undue reliance on the Company's forward-looking statements and similar information because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond its control. The Company's forward-looking statements, risk factors and other risks, cautions and information (whether contained in this Quarterly Report or other applicable SEC Report) are based on the information currently available to the Company and speak only as of the date specifically referenced, or if no date is referenced, then as of December 31, 2012, in the case of the 2013 Proxy Statement or the last day of the period covered thereby in the case of other applicable SEC Report. New risks and uncertainties arise from time to time, and it is impossible for the Company to predict these matters or how they may arise or affect the Company. Over time, the Company's actual assets, business, capital, cash flow, credit, expenses, financial condition, income, liabilities, liquidity, locations, marketing, operations, prospects, sales, strategies, taxation or other achievements, results, risks or condition will likely differ from those expressed or implied by the Company's forward-looking statements, and such difference could be significant and materially adverse to the Company and the value of your investment in the Company's Common Stock.

SPAR Group, Inc. and Subsidiaries

The Company does not intend or promise, and the Company expressly disclaims any obligation, to publicly update or revise any forward-looking statements, risk factors or other risks, cautions or information statements (in whole or in part), whether as a result of new information, future events or recognition or otherwise, except as and to the extent required by applicable law.

GENERAL

SPAR Group, Inc. ("SGRP"), and its subsidiaries (together with SGRP, the "SPAR Group" or the "Company"), is a diversified international merchandising and marketing services company and provides a broad array of services worldwide to help companies improve their sales, operating efficiency and profits at retail locations. The Company provides its merchandising and other marketing services to manufacturers, distributors and retailers worldwide, primarily in mass merchandisers, office supply, grocery, drug, independent, convenience and electronics stores. The Company also provides furniture and other product assembly services in stores, homes and offices. The Company has supplied these project and product services in the United States since certain of its predecessors were formed in 1979 and internationally since the Company acquired its first international subsidiary in Japan in May of 2001. The Company currently does business in 9 countries that encompass approximately 50% of the total world population through its operations in the United States, Canada, Japan, South Africa, India, China, Australia, Mexico and Turkey.

Merchandising services primarily consist of regularly scheduled, special project and other product services provided at the store level, and the Company may be engaged by either the retailer or the manufacturer. Those services may include restocking and adding new products, removing spoiled or outdated products, resetting categories "on the shelf" in accordance with client or store schematics, confirming and replacing shelf tags, setting new sale or promotional product displays and advertising, replenishing kiosks, providing in-store event staffing, providing in-store audit service, and providing assembly services in stores, homes and offices. Other merchandising services include whole store or departmental product sets or resets, including new store openings, new product launches and in-store demonstrations, special seasonal or promotional merchandising, focused product support and product recalls. The Company continues to seek to expand its merchandising, assembly and marketing services business throughout the world.

An Overview of the Merchandising and Marketing Services Industry

According to industry estimates over two billion dollars are spent annually in the United States alone on retail merchandising and marketing services. The merchandising and marketing services industry includes manufacturers, retailers, food brokers and professional service merchandising companies. The Company believes that merchandising and marketing services add value to retailers, manufacturers and other businesses and enhance sales by making a product more visible and more available to consumers. These services primarily involve placing orders, shelf maintenance, display placement, reconfiguring products on store shelves and replenishing product inventory.

Historically, retailers staffed their stores as needed to provide these services to ensure, that manufacturers' inventory levels, the advantageous display of new items on shelves, and the maintenance of shelf schematics and product placement were properly merchandised. However retailers, in an effort to improve their margins, have decreased their own store personnel and increased their reliance on manufacturers to perform such services. Initially, manufacturers attempted to satisfy the need for merchandising and marketing services in retail stores by utilizing their own sales representatives. Additionally, retailers also used their own employees to merchandise their stores to satisfy their own merchandising needs. However, both the manufacturers and the retailers discovered that using their own sales representatives and employees for this purpose was expensive and inefficient.

Most manufacturers and retailers have been, and SPAR Group believes they will continue outsourcing their merchandising and marketing service needs to third parties capable of operating at a lower cost by (among other things) serving multiple manufacturers simultaneously. The Company also believes that it is well positioned, as a domestic and international merchandising and marketing services company, to more effectively provide these services to retailers, manufacturers and other businesses around the world.

SPAR Group, Inc. and Subsidiaries

Another significant trend impacting the merchandising and marketing services business is the tendency of consumers to make product purchase decisions once inside the store. Accordingly, merchandising and marketing services and in-store product promotions have proliferated and diversified. Retailers are continually re-merchandising and re-modeling entire stores in an effort to respond to new product developments and changes in consumer preferences. We estimate that these activities have increased in frequency over the last five years. Both retailers and manufacturers are seeking third parties to help them meet the increased demand for these labor-intensive services.

In addition, the consolidation of many retailers has created opportunities for third party merchandisers when an acquired retailer's stores are converted to the look and format of the acquiring retailer. In many cases, stores are completely remodeled and re-merchandised after a consolidation.

SPAR Group believes the current trend in business toward globalization fits well with its expansion model. As companies expand into foreign markets they will need assistance in merchandising or marketing their products. As evidenced in the United States, retailer and manufacturer sponsored merchandising and marketing programs are both expensive and inefficient. The Company also believes that the difficulties encountered by these programs are only exacerbated by the logistics of operating in foreign markets. This environment has created an opportunity for the Company to exploit its internet, hand-held computer, tablet and smart phone-based technology and business model worldwide.

The Company's Domestic and International Geographic Divisions:

In order to cultivate and expand the Company's merchandising and marketing services businesses in both domestic and foreign markets and insure a consistent approach to those businesses worldwide, and even though the Company operates globally in the single business segment of merchandising and marketing services, the Company has divided its world focus into two geographic areas, the United States, which is the sales territory for its Domestic Merchandising Services Division, and international (i.e., all locations outside the United States), which are the sales territories for its International Merchandising Services Division. To that end, the Company also (1) provides and requires all of its locations to use its Internet-based operating, scheduling, tracking and reporting systems (including language translations, ongoing client and financial reports and ongoing IT support), (2) provides and requires all of its locations to comply with the Company's financial reporting and disclosure controls and procedures, ethics code and other policies, (3) provides accounting and auditing support and tracks and reports certain financial and other information separately for those two divisions, and (4) has management teams in its corporate offices responsible for supporting and monitoring the management, sales, marketing and operations of each of the Company's international subsidiaries and maintaining consistency with the Company's other subsidiaries worldwide.

Each of the Company's divisions provides merchandising and other marketing services primarily on behalf of consumer product manufacturers and retailers at mass merchandisers, drug store chains, convenience and grocery stores in their respective territories. SPAR Group's clients include the makers and distributors of general merchandise, health and beauty care, consumer goods, home entertainment and food products in their respective territories.

SPAR Group has provided merchandising and other marketing services in the United States since the formation of its predecessor in 1979 and outside the United States since it acquired its first international subsidiary in Japan in May of 2001. The Company currently conducts its business through its domestic and international divisions in 9 territories around the world (listed in the table below) that encompass approximately 50% of the total world population.

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The Company's international business in each territory outside the United States is conducted through a foreign subsidiary incorporated in its primary territory. The primary territory establishment date (which may include predecessors), the percentage of the Company's equity ownership, and the principal office location for its US (domestic) subsidiaries and each of its foreign (international) subsidiaries is as follows:

Primary Territory	Date Established	SGRP Percentage Ownership	Principal Office Location
United States of America	1979	100%	White Plains, New York, United States of America[6]
Japan	May 2001	100%	Tokyo, Japan
Canada	June 2003	100%	Toronto, Canada
South Africa	April 2004	51% [1]	Durban, South Africa
India	April 2004	51% [2]	New Delhi, India
Australia	April 2006	51%	Melbourne, Australia
Romania	July 2009	51% [3]	Bucharest, Romania
China	March 2010	51% [4]	Shanghai, China
Mexico	August 2011	51%	Mexico City, Mexico
Turkey	August 2011	51% [5]	Istanbul, Turkey

1 In September 2012 the Company, through its subsidiary in South Africa (SGRP Meridian), entered into a joint venture agreement to expand its operations in South Africa. SGRP Meridian owns a 51% ownership interest in the new company; CMR Meridian (Pty) Ltd. ("CMR-Meridian").

2 In June 2011, the Company sold 49% of its interest in its Indian subsidiary to KROGNOS Integrated Marketing Services Private Limited. In March 2013, the company purchased a 51% interest in a new subsidiary in India, Preceptor Marketing Services Private Limited, which began operations in March 2013.

3 In August 2013, the Company sold its 51% ownership in Romania in its active Romania subsidiary to SPAR InfoTech, Inc. (see Note 6 to the Consolidated Financial Statements – *Related-Party Transactions*). The Company continues to have one Romanian subsidiary that is 100% owned and is inactive. Also in May of 2012, the Company sold its 51% ownership in one of its other Romania subsidiaries, SPAR City S.R.L, to its original Local Investor.

4 Currently the Company owns two subsidiaries in China. One subsidiary is 100% owned and is inactive, and the second subsidiary, acquired in March 2010 and operational in August 2010, is 51% owned. In July 2011, the Company, through its active subsidiary in China (SPAR Shanghai), entered into a joint venture agreement to expand its operations in China. SPAR Shanghai has a 51% ownership interest in the new company; SPAR DSI Human Resource Company.

5 In August 2011, the Company sold its 51% ownership in its original subsidiary in Turkey to its original Local Investor, and in November 2011 the Company started a new 51% owned subsidiary to compete in this important market.

6 In September 2012, the Company established a new subsidiary, National Merchandising Services, LLC, ("NMS") 51% owned by the Company, with its principal office in Georgia. In March 2013, the Company purchased general merchandising service and certain in-store audit service businesses from Market Force Information, Inc. (“MFI”).

For more information respecting the Company's business and operations, please see Item 1 - *Business and Organization* in the Company's 2012 Annual Report.

The Company operates in the same single business segment (e.g., merchandising and marketing services) in both its domestic and international divisions (as described above), and the Company tracks and reports certain financial information separately for its subsidiaries in each of those divisions using the same metrics. The primary measurement utilized by management is operating profit level, historically the key indicator of long-term growth and profitability, as the Company is focused on reinvesting the operating profits of each of its international subsidiaries back into its local markets in an effort to improve its market share and continued expansion efforts. Certain financial information regarding each of the Company's two geographic divisions, which includes their respective net revenues and operating income for each of the three month and nine month periods ended September 30, 2013, and September 30, 2012, and their respective long-lived assets at September 30, 2013, and December 31, 2012, are provided in Note 12 to the Consolidated Financial Statements – *Geographic Data*, above. See also Item I - *The Company's Business Strategies (including Leveraging and Improving on the Company's Technological Strength* and *Acquisition Strategies and Strategic Acquisitions), Descriptions of the Company's Services, The Company's Sales and Marketing, The Company's Customer Base* and *The Company's Competition*, all in the Company's 2012 Annual Statement.

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Critical Accounting Policies

There were no material changes during the nine months ended September 30, 2013, to the Company's critical accounting policies as reported in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the SEC on April 2, 2013.

Results of Operations

Three months ended September 30, 2013, compared to three months ended September 30, 2012

The following table sets forth selected financial data and data as a percentage of net revenues for the periods indicated (in thousands, except percent data).

	Three Months Ended September 30,			
	2013		2012	
	$	%	$	%
Net revenues	**$27,753**	100.0%	**$25,357**	100.0%
Cost of revenues	**21,228**	76.5	**19,042**	75.1
Selling, general & administrative expense	**5,747**	20.7	**5,112**	20.2
Depreciation & amortization	**388**	1.4	**297**	1.2
Interest expense	**28**	0.1	**32**	0.1
Other income, net.	**(5)**	0.0	**(29)**	(0.1)
Income before income taxes	**367**	1.3	**903**	3.5
Income tax expense (benefits)	**(139)**	(0.5)	**62**	0.2
Income from continuing operations	**506**	1.8	**841**	3.3
Income from discontinued operations	**17**	0.1	**18**	0.1
Net Income	**523**	1.9	**859**	3.4
Net income attributable to non-controlling interest	**(192)**	(0.7)	**(281)**	(1.1)
Net income attributable to Spar Group, Inc.	**$331**	1.2%	**$578**	2.3%

Net Revenues

Net revenues for the three months ended September 30, 2013, were $27.8 million, compared to $25.4 million for the three months ended September 30, 2012, an increase of $2.4 million or 9.4%.

Domestic net revenues totaled $11.3 million in the three months ended September 30, 2013, compared to $11.0 million for the same period in 2012. Domestic net revenues increased by approximately $300,000. The increase was primarily due to incremental revenue from the recent acquisition of general merchandising and certain in-store audit services from Market Force Information (“MFI”) and the September 2012 acquisition of National Merchandising Services, LLC ("NMS"). The increase in revenue from acquisitions was partially offset by a decrease in syndicated services and other project work.

International net revenues totaled $16.4 million for the three months ended September 30, 2013, compared to $14.3 million for the same period in 2012, an increase of $2.1 million or 14.5%. The increase in 2013 international net revenues was primarily due to incremental revenue from the integration of the acquisitions in South Africa and India and increased revenue in China and Japan, partially offset by lower revenue in Australia and Turkey.

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Cost of Revenues

The Company's cost of revenues consists of its on-site labor and field administration fees, travel and other direct labor-related expenses and was 76.5% of its net revenues for the three months ended September 30, 2013, and 75.1% of its net revenues for the three months ended September 30, 2012.

Domestic cost of revenues was 69.6% of net revenues for the three months ended September 30, 2013, and 70.6% of net revenues for the three months ended September 30, 2012. The decrease in cost of revenues as a percentage of net revenues of 1.0% was due primarily to a favorable mix of syndicated and project work compared to last year. For the three months ended September 30, 2013 and 2012, approximately 85% and 80%, respectively, of the Company's domestic cost of revenues resulted from in-store merchandiser specialist, on-site assembly technician and field administration services purchased from certain of the Company's affiliates, SPAR Business Services, Inc. ("SBS"), and SPAR Administrative Services, Inc. ("SAS"), respectively, and approximately 5% of the Company's domestic cost of revenues for both the three months ended September 30, 2013 and 2012 resulted from in-store merchandiser specialist services purchased from certain of the Company's other affiliates, National Retail Source, LLC ("NRS"), and prior to August 1, 2013, National Merchandising of America, Inc. ("NMA") (See Note 6 to the Consolidated Financial Statements - *Related-Party Transactions*).

Internationally, the cost of revenues increased to 81.3% of net revenues for the three months ended September 30, 2013, compared to 78.6% of net revenues for the three months ended September 30, 2012. The cost of revenue percentage increase of 2.7% was primarily due to higher cost margin business in the new market in India and the mix of business in India, Turkey, Mexico and Australia.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of the Company include its corporate overhead, project management, information technology, executive compensation, human resources, legal and accounting expenses.

Selling, general and administrative expenses were approximately $5.7 million and $5.1 million for the three months ended September 30, 2013 and 2012, respectively.

Domestic selling, general and administrative expenses totaled $3.0 million for three months ended September 30, 2013, compared to $2.3 million for the three months ended September 30, 2012. The increase of $700,000 was primarily due to the Market Force Information (“MFI”) and National Merchandising Services, LLC acquisitions.

International selling, general and administrative expenses totaled $2.7 million for the three months ended September 30, 2013, compared to $2.8 million for the same period in 2012. The decrease of approximately $100,000 was primarily attributable to reduced costs in Australia.

Depreciation and Amortization

Depreciation and amortization charges totaled $388,000 for the three months ended September 30, 2013, and $297,000 for the same period in 2012. The increase of $91,000 is primarily attributable to amortization related to intangible assets recorded in valuing recent acquisitions of MFI, NMS and CMR.

Interest Expense

The Company's net interest expense was $28,000 and $32,000 for the three months ended September 30, 2013 and 2012, respectively.

Other Income

Other income totaled $5,000 and $29,000 for the three months ended September 30, 2013 and 2012, respectively.

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Income Taxes

The income tax benefit totaled $139,000 for the three months ended September 30, 2013 and the income tax provision totaled $62,000 for the three months ended September 30, 2012. The favorable income tax is due to an adjustment to bring the domestic tax provision in line with taxable income for the nine months ended September 30, 2013. The tax provision resulted primarily from domestic state taxes and for tax provisions related to certain international profits. The Company recognizes minimum federal tax provisions as the Company anticipates utilizing operating loss carry forwards in 2013.

Non-controlling Interest

Net operating profits from the non-controlling interest, from the Company's 51% owned subsidiaries, resulted in a reduction of net income of $192,000 and $281,000 for the three months ended September 30, 2013 and September 30, 2012, respectively.

Net Income

The Company reported net income of $331,000 for the three months ended September 30, 2013, or $0.02 per diluted share, compared to a net income of $578,000, or $0.03 per diluted share, for the corresponding period last year.

Nine months ended September 30, 2013, compared to nine months ended September 30, 2012

The following table sets forth selected financial data and data as a percentage of net revenues for the periods indicated (in thousands, except percent data).

	Nine Months Ended September 30,			
	2013		2012	
	$	%	$	%

Net revenues	**$80,152**	100.0%	**$68,984**	100.0%
Cost of revenues	**61,252**	76.4	**50,555**	73.3
Selling, general & administrative expense	**16,900**	21.1	**15,518**	22.5
Depreciation & amortization	**1,097**	1.4	**859**	1.2
Interest expense	**80**	-	**95**	0.1
Other income, net.	**(73)**	(0.1)	**(36)**	-
Income before income taxes	**896**	1.2	**1,993**	2.9
Income taxes expense	**200**	0.3	**134**	0.2
Income from continuing operations	**696**	0.9	**1,859**	2.7
Income from discontinued operations	**98**	0.1	**95**	0.1
Net income	**794**	1.0	**1,954**	2.8
Net income attributable to non-controlling interest	**(550)**	(0.7)	**(351)**	(0.5)
Net income attributable to Spar Group, Inc.	**$244**	0.3%	**$1,603**	2.3%

Net Revenues

Net revenues for the nine months ended September 30, 2013, were $80.2 million, compared to $69.0 million for the nine months ended September 30, 2012, an increase of $11.2 million or 16.2%.

Domestic net revenues totaled $32.4 million in the nine months ended September 30, 2013, compared to $31.2 million for the same period in 2012. Domestic net revenues increased by approximately $1.2 million. The increase was primarily due to incremental revenue from the from Market Force and National Merchandising Services acquisitions, partially offset by a decrease syndicated services and other project work.

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International net revenues totaled $47.8 million for the nine months ended September 30, 2013, compared to $37.8 million for the same period in 2012, an increase of $10.0 million or 26%. The increase in 2013 international net revenues was primarily due to incremental revenue from the newly integrated acquisition in South Africa and India and increased revenue in China and Mexico.

Cost of Revenues

The Company's cost of revenues consists of its on-site labor and administration fees, travel and other direct labor-related expenses and was 76.4% of its net revenues for the nine months ended September 30, 2013, and 73.3% of its net revenues for the nine months ended September 30, 2012.

Domestic cost of revenues was 69.4% of net revenues for the nine months ended September 30, 2013, and 68.1% of net revenues for the nine months ended September 30, 2012. The increase in cost of revenues as a percentage of net revenues was 1.3% due primarily to an unfavorable mix of syndicated and project work compared to last year. For the nine months ended September 30, 2013 and 2012, approximately 80% and 86%, respectively, of the Company's domestic cost of revenues resulted from in-store merchandiser specialist, on-site assembly technician and field administration services purchased from certain of the Company's affiliates, SPAR Business Services, Inc. ("SBS"), and SPAR Administrative Services, Inc. ("SAS"), respectively, and approximately 6% and 2%, of the Company's domestic cost of revenues for the nine months ended September 30, 2013 and 2012, respectively, resulted from in-store merchandiser specialist services purchased from certain of the Company's other affiliates, National Retail Source, LLC ("NRS"), and prior to August 1, 2013, National Merchandising of America, Inc. ("NMA") (See Note 6 to the Consolidated Financial Statements- *Related-Party Transactions*).

Internationally, the cost of revenues increased to 81.2% of net revenues for the nine months ended September 30, 2013, compared to 77.6% of net revenues for the nine months ended September 30, 2012. The cost of revenue percentage increase of 3.6% was primarily due to higher cost margin business in the India, Turkey and Mexico markets and the mix of business in Japan, Canada and China.

Selling, General and Administrative Expenses

Selling, general and administrative expenses of the Company include its corporate overhead, project management, information technology, executive compensation, human resources, legal and accounting expenses.

Selling, general and administrative expenses were approximately $16.9 million and $15.5 million for the nine months ended September 30, 2013 and 2012, respectively.

Domestic selling, general and administrative expenses totaled $8.7 million for nine months ended September 30, 2013, compared to $7.2 million for the nine months ended September 30, 2012. The increase of $1.5 million was primarily due to the Market Force acquisition and increased legal expense.

International selling, general and administrative expenses totaled $8.2 million and $8.3 million for the nine months ended September 30, 2013 and 2012, respectively.

Depreciation and Amortization

Depreciation and amortization charges totaled $1.1 million for the nine months ended September 30, 2013, and $859,000 for the same period in 2012. The increase is primarily attributable to amortization related to intangible assets recorded in valuing recent acquisitions of MFI, NMS and CMR.

Interest Expense

The Company's net interest expense was $80,000 and $95,000 for the nine months ended September 30, 2013 and 2012, respectively. The decrease in interest expense is directly attributable to reduced borrowings as well as lower interest rates.

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Other Income

Other income totaled $73,000 for the nine months ended September 30, 2013, and $36,000 for the same period in 2012.

Income Taxes

Income tax provision totaled $200,000 and $134,000 for the nine months ended September 30, 2013 and 2012, respectively. The tax provision resulted primarily from domestic state taxes and for tax provisions related to certain international profits. The Company recognizes minimum federal tax provisions as the Company anticipates utilizing operating loss carry forwards in 2013.

Non-controlling Interest

Net operating profits from the non-controlling interest, from the Company's 51% owned subsidiaries, resulted in a reduction of net income of $550,000 for the nine months ended September 30, 2013, compared to a reduction of net income of $351,000 for the nine months ended September 30, 2012.

Net Income

The Company reported a net income of $244,000 for the nine months ended September 30, 2013, or $0.01 per diluted share, compared to a net income of $1.6 million, or $0.07 per diluted share, for the corresponding period last year.

Liquidity and Capital Resources

In the nine months ended September 30, 2013, the Company had net income before non-controlling interest of $794,000.

Net cash provided by operating activities was $4.8 million and $4.3 million for the nine months ended September 30, 2013 and 2012, respectively. The net cash provided by operating activities was primarily due to a decrease in accounts receivable and an increase accrued expenses.

Net cash used in investing activities for the nine months ended September 30, 2013, and September 30, 2012, was approximately $2.5 million and $1.1 million, respectively. The net cash used in investing activities was primarily a result of the purchase of the MFI business, plus fixed asset additions.

Net cash used in financing activities for the nine months ended September 30, 2013, and September 30, 2012, was approximately $490,000 and $3.0 million, respectively. Net cash used in financing activities was primarily a result of payments on lines of credit, payments on the capital leases, and purchases of treasury shares.

The above activity resulted in an increase in cash and cash equivalents for the nine months ended September 30, 2013 of $1.3 million.

At September 30, 2013, the Company had net working capital of $8.6 million, as compared to net working capital of $9.7 million at December 31, 2012. The Company's current ratio was 1.6 and 1.7 at September 30, 2013, and December 31, 2012, respectively.

Credit Facilities

The Company is a party to various domestic and international credit facilities. See Note 4 to Consolidated Financial Statements – *Credit Facilities*

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Certain Contractual Obligations

The following table contains a summary of certain of the Company's contractual obligations by category as of September 30, 2013 (in thousands):

	Period in which payments are due				
Contractual Obligations	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Credit Facilities	$2,343	$2,243	$58	$42	$–
Capital Lease Obligations	151	128	23	–	–
Contingent Liabilities	689	242	447	–	–
Operating Lease Obligations	3,097	894	1,124	788	291
Total	$6,280	$3,507	$1,652	$830	$291

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company's accounting policies for financial instruments and disclosures relating to financial instruments require that the Company's consolidated balance sheets include the following financial instruments: cash and cash equivalents, accounts receivable, accounts payable and lines of credit. The Company carries current assets and liabilities at their stated or face amounts in its consolidated financial statements, as the Company believes those amounts approximate the fair value for these items because of the relatively short period of time between origination of the asset or liability and their expected realization or payment. The Company monitors the risks associated with asset and liability positions, as well as interest rates. The Company's investment policy objectives require the preservation and safety of the principal, and the maximization of the return on investment based upon its safety and liquidity objectives.

The Company is exposed to market risk related to the variable interest rate on its lines of credit, both in its United States subsidiaries (*i.e.*, the Domestic Merchandising Services Division) and in its International (non-U.S.) subsidiaries (*i.e.*, the International Merchandising Services Division). At September 30, 2013, the Company's outstanding lines of credit and other debt totaled approximately $2.3 million, as noted in the table below (in thousands):

Location	Variable Interest Rate (1)	US Dollars (2)
United States	2.8%	$ 2,214
International	0.1%	129
		$ 2,343

(1) Based on interest rate at September 30, 2013.

(2) Based on exchange rate at September 30, 2013.

The Company has foreign currency exposure with its international subsidiaries. In both 2013 and 2012, these exposures are primarily concentrated in the South African Rand, the India Rupee and the, Canadian Dollar. Total international assets were $12.8 million and total liabilities were $10.1 million based on exchange rates at September 30, 2013. International revenues for the nine months ended September 30, 2013 and 2012 were $47.8 million and $37.8 million, respectively. The international division reported net income of approximately $139,000 and a net loss of $39,000 for the three months ended September 30, 2013 and 2012, respectively and net income of $8,000 and a net loss of $205,000 for the nine months ended September 30, 2013 and 2012, respectively.

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Item 4. Controls and Procedures

Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the registrant, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Management has designed such internal control over financial reporting by the Company to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

The Company's management has evaluated the effectiveness of the Company's internal control over financial reporting using the "Internal Control – Integrated Framework (1992)" created by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework. Based on this evaluation, management has concluded that internal controls over financial reporting were effective as of September 30, 2013.

Management's Evaluation of Disclosure Controls and Procedures

The Company's chief executive officer and chief financial officer have each reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report, as required by Exchange Act Rules 13a-15(b) and Rule 15d-15(b). Based on that evaluation, the chief executive officer and chief financial officer have each concluded that the Company's current disclosure controls and procedures are effective to insure that the information required to be disclosed by the Company in reports it files, or submits under the Exchange Act were recorded, processed, summarized and reported within the time period 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 the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls Over Financial Reporting

There have been no changes in the Company's internal controls over financial reporting that occurred during the Company's third quarter of its 2013 fiscal year that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

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PART II: OTHER INFORMATION

Item 1. Legal Proceedings

The Company is a party to various legal actions and administrative proceedings arising in the normal course of business. See Note 10 to Consolidated Financial Statements – *Commitments and Contingencies.*

Item 1A. Risk Factors

Existing Risk Factors

Various risk factors applicable to the Company and its businesses are described in Item 1A under the caption "Risk Factors" in SGRP's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as filed with the Securities and Exchange Commission (the "SEC") on April 2, 2013 (the "2012 Annual Report"), which risk factors are incorporated by reference into this Quarterly Report. There have been no material changes in the Company's risk factors since those reports.

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

Item 2(a): Not applicable

Item 2(b): Not applicable

Item 2(c):

The following table summarizes the repurchases by SGRP and its "affiliated purchasers" (as defined in SEC Rule §240.10b-18(a)(3)) of its common stock during the three month period that ended on September 30, 2013:

Issuer Purchases of Equity Securities

Period	**(a) Total number of shares purchased**	**(b) Average price paid per share**	**(c) Total number of shares purchased as part of SGRP's publicly announced repurchase plans or programs**	**(d) Maximum number of shares that may yet be purchased**
Balance at June 30, 2013				439,735
July 2013	-	-	-	439,735
August 2013	43,476	$ 1.90	43,476	396,259
September 2013	32,680	$ 1.97	32,680	363,579
Total Quarter	76,156	$ 1.93	76,156	363,579

There were no purchases of SGRP's common stock by such affiliated purchasers during that period.

The repurchases described above were made pursuant to the SPAR Group, Inc., 2012 Stock Repurchase Program (the "Repurchase Program"), as approved by SGRP's Audit Committee and adopted by its Board of Directors on August 8, 2012, and ratified on November 8, 2012. Under the Repurchase Program, SGRP may repurchase shares of its common stock through August 8, 2015, but not more than 500,000 shares in total, and those repurchases would be made from time to time in the open market and through privately-negotiated transactions, subject to general market and other conditions. SGRP does not intend to repurchase any shares in the market during any blackout period in violation of the rules applicable to its officers and directors under the SPAR Group, Inc. Statement of Policy Regarding Personal Securities Transactions in SGRP Stock and Non-Public Information As Adopted, Restated, Effective and Dated as of May 1, 2004, and As Further Amended Through March 10, 2011 (other than purchases that would otherwise be permitted under the circumstances for anyone covered by such policy). The Company anticipates continuing its Repurchase Program throughout 2013.

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Item 3. Defaults upon Senior Securities

Item 3(a): Defaults under Indebtedness: None.

Item 3(b): Defaults under Preferred Stock: None.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

3.1	Amended and Restated By-Laws of SPAR Group, Inc., as adopted on May 18, 2004, and as amended through August 6, 2013 (as filed herewith).
10.1	Master Field Services

	Agreement dated as of August 1, 2013, between National Retail Source, LLC, a Georgia limited liability company and affiliate of SGRP, and National Merchandising Services, LLC, a Nevada limited liability company and consolidated subsidiary of SGRP (as filed herewith).
10.2	Share Purchase Agreement (respecting equity and debt interests in SPAR Business Ideas Provider S.R.L.) dated as of August 31, 2013, between SPAR InfoTech, Inc. ("SIT"), a Nevada corporation and affiliate of SGRP, and SPAR International Ltd. ("SPAR Cayman"), a Cayman Islands corporation and consolidated subsidiary of SGRP (as filed herewith).
10.3	Fifth Agreement of Amendment

to Revolving Loan and Security Agreement And Other Documents, dated and effective as of October 30, 2013, by and among Sterling National Bank, as "Lender" and "Agent", and SPAR Group, Inc., National Assembly Services, Inc., SPAR Group International, Inc., SPAR Acquisition, Inc., SPAR Trademarks, Inc., and SPAR Marketing Force, Inc., each as an original "Borrower", and SPAR Canada, Inc., SPAR Canada Company and SPAR Wings & Ink Company, each as a "Borrower" newly added to such loan agreement by such amendment (as filed herewith).

31.1 Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of

	the Sarbanes-Oxley Act of 2002, as filed herewith.
31.2	Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as filed herewith.
32.1	Certification of the CEO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed herewith.
32.2	Certification of the CFO pursuant to 18 U.S.C. Section 1350 adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as filed herewith.

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101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels
101.PRE*	XBRL Taxonomy Extension Presentation

* XBRL information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SPAR Group, Inc. and Subsidiaries

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.

Date: November 14, 2013 SPAR Group, Inc., Registrant

By: /s/ James R. Segreto
James R. Segreto
Chief Financial Officer, Treasurer, Secretary
and duly authorized signatory

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