Strategic Education, Inc.
Form 10-Q
August 01, 2018

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the

Securities Exchange Act of 1934

For the quarterly period ended June 30, 2018

Commission File No. 0-21039

Strategic Education, Inc.

(Exact name of registrant as specified in this charter)

Maryland	52-1975978
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2303 Dulles Station Boulevard	20171

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 13, 2018, there were outstanding 11,306,527 shares of Common Stock, par value $0.01 per share, of the Registrant.

STRATEGIC EDUCATION, INC.

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STRATEGIC EDUCATION, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	December 31, 2017	June 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 155,933	$ 171,600
Tuition receivable, net	23,122	25,595
Income taxes receivable	—	5,592
Other current assets	11,293	11,385
Total current assets	190,348	214,172
Property and equipment, net	73,763	72,125
Deferred income taxes	24,452	22,851
Goodwill	20,744	17,919
Other assets	11,971	9,698
Total assets	$ 321,278	$ 336,765
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 46,177	$ 46,657
Income taxes payable	1,038	—
Contract liabilities	21,851	22,547
Total current liabilities	69,066	69,204
Other long-term liabilities	43,015	43,721
Total liabilities	112,081	112,925
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value $0.01; 20,000,000 shares authorized; 11,167,425 and 11,306,527 shares issued and outstanding at December 31, 2017 and June 30, 2018, respectively	112	113
Additional paid-in capital	47,079	53,015
Retained earnings	162,006	170,712
Total stockholders' equity	209,197	223,840
Total liabilities and stockholders' equity	$ 321,278	$ 336,765

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

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STRATEGIC EDUCATION, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2018	2017	2018
Revenues	$ 112,720	$ 114,668	$ 227,632	$ 231,137
Costs and expenses:				
Instruction and educational support	63,650	64,690	125,066	128,466
Marketing	19,226	21,113	37,944	41,237
Admissions advisory	4,779	4,609	9,495	9,285
General and administration	13,205	11,063	24,824	22,281
Merger costs	—	2,824	—	8,171
Fair value adjustments	(1,994)	6,185	(1,994)	6,185
Total costs and expenses	98,866	110,484	195,335	215,625
Income from operations	13,854	4,184	32,297	15,512
Investment income	253	608	434	1,056
Interest expense	160	161	319	320
Income before income taxes	13,947	4,631	32,412	16,248
Provision (benefit) for income taxes	3,645	(557)	11,532	1,593
Net income	$ 10,302	$ 5,188	$ 20,880	$ 14,655
Earnings per share:				
Basic	$ 0.96	$ 0.48	$ 1.96	$ 1.36
Diluted	$ 0.92	$ 0.46	$ 1.87	$ 1.29
Weighted average shares outstanding:				
Basic	10,680	10,879	10,655	10,812
Diluted	11,190	11,380	11,155	11,346

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

STRATEGIC EDUCATION, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS’ EQUITY

(in thousands, except share data)

	Common Stock Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Total
Balance at December 31, 2016	11,093,489	$ 111	$ 35,453	$ 152,810	$ 188,374
Restricted stock grants, net of forfeitures	73,936	1	(1)	—	—
Stock-based compensation	—	—	5,654	—	5,654
Common stock dividends	—	—	—	(5,707)	(5,707)
Net income	—	—	—	20,880	20,880
Balance at June 30, 2017	11,167,425	$ 112	$ 41,106	$ 167,983	$ 209,201

	Common Stock Shares	Par Value	Additional Paid-in Capital	Retained Earnings	Total
Balance at December 31, 2017	11,167,425	$ 112	$ 47,079	$ 162,006	$ 209,197
Impact of adoption of new accounting standard	—	—	—	(171)	(171)
Restricted stock grants, net of forfeitures	139,102	1	(1)	—	—
Stock-based compensation	—	—	5,937	—	5,937
Common stock dividends	—	—	—	(5,778)	(5,778)
Net income	—	—	—	14,655	14,655
Balance at June 30, 2018	11,306,527	$ 113	$ 53,015	$ 170,712	$ 223,840

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

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STRATEGIC EDUCATION, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Six Months Ended June 30, 2017	2018
Cash flows from operating activities:		
Net income	$ 20,880	$ 14,655
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of gain on sale of assets	(133)	—
Amortization of deferred rent	(859)	(909)
Amortization of deferred financing costs	131	131
Depreciation and amortization	8,975	9,915
Deferred income taxes	(1,560)	(1,581)
Stock-based compensation	5,654	5,937
Fair value adjustments	(1,994)	6,185
Changes in assets and liabilities:		
Tuition receivable, net	(137)	(2,916)
Other current assets	411	96
Other assets	829	(824)
Accounts payable and accrued expenses	559	1,363
Income taxes payable and income taxes receivable	(3,153)	(3,447)
Contract liabilities	4,356	2,768
Other long-term liabilities	(1,193)	(1,347)
Net cash provided by operating activities	32,766	30,026
Cash flows from investing activities:		
Purchases of property and equipment	(8,435)	(8,596)
Net cash used in investing activities	(8,435)	(8,596)
Cash flows from financing activities:		
Common dividends paid	(5,707)	(5,778)
Net cash used in financing activities	(5,707)	(5,778)
Net increase in cash, cash equivalents, and restricted cash	18,624	15,652
Cash, cash equivalents, and restricted cash — beginning of period	129,758	156,448
Cash, cash equivalents, and restricted cash — end of period	$ 148,382	$ 172,100
Noncash transactions:		
Purchases of property and equipment included in accounts payable	$ 469	$ 1,252

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

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STRATEGIC EDUCATION, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. Nature of Operations

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

2. Merger with Capella Education Company

On October 29, 2017, the Company entered into a merger agreement with Capella Education Company (“Capella”). Capella provides post-secondary education and job-skills programs primarily through its subsidiary Capella University. The merger was approved by the Company’s stockholders and by Capella’s shareholders on January 19, 2018. Upon consummation of the merger, Capella became a wholly-owned subsidiary of the Company and will continue to offer its education programs through Capella University.

Pursuant to the merger, the Company issued 0.875 shares of the Company’s Common Stock for each issued and outstanding share of Capella Common Stock. Outstanding equity awards held by current Capella employees and certain non-employee directors of Capella were assumed by the Company and converted into comparable Company awards at the exchange ratio. Outstanding equity awards held by Capella non-employee directors who will not serve as directors of the Company after completion of the merger and by former Capella employees were settled upon completion of the merger in exchange for cash payments as specified in the merger agreement. Following the merger, stockholders of the Company and Capella own approximately 52% and 48%, respectively, of the outstanding combined company shares on a fully diluted basis, based on the number of shares outstanding immediately prior to the effective time of the merger.

Also, in connection with the completion of the merger, and as approved by the Company’s shareholders on January 19, 2018, the Company changed its name to Strategic Education, Inc. and increased the number of shares of authorized Common Stock to 32,000,000. The merger was completed on August 1, 2018.

During the three and six months ended June 30, 2018, the Company incurred $2.8 million and $8.2 million of merger costs, respectively. These costs were primarily attributable to legal, accounting, and integration support services incurred by the Company in connection with the merger, and are included in merger costs in the accompanying unaudited condensed consolidated statement of income for the three and six months ended June 30, 2018.

3. Significant Accounting Policies

Financial Statement Presentation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in the consolidated financial statements.

All information as of December 31, 2017 and June 30, 2017 and 2018, and for the three and six months ended June 30, 2017 and 2018 is unaudited but, in the opinion of management, contains all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the condensed consolidated financial position, results of operations, and cash flows of the Company. Certain amounts in the prior period financial statements have been reclassified to conform to the current period’s presentation. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States of America have been condensed or omitted. In addition, the Company had no items of other comprehensive income in the periods presented and accordingly comprehensive income is equal to net income. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results to be expected for the full fiscal year.

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New accounting standard for revenue recognition

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”) which supersedes the prior revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. During 2016 and 2017, the FASB issued additional ASUs amending certain aspects of ASU 2014-09. On January 1, 2018, the Company adopted the new accounting standard and all the related amendments (“ASC 606”) using the modified retrospective method. The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company expects the impact of the adoption of the new standard to be immaterial to the Company’s net income on an ongoing basis. Refer to Note 4 for further discussion.

Restricted Cash

A significant portion of the Company’s revenues are funded by various federal and state government programs. The Company generally does not receive funds from these programs prior to the start of the corresponding academic term. The Company may be required to return certain funds for students who withdraw from the University during the academic term. The Company had approximately $15,000 as of December 31, 2017 of these unpaid obligations, which are recorded as restricted cash and included in other current assets in the unaudited condensed consolidated balance sheets. There were no amounts payable for these obligations at June 30, 2018.

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

The following table illustrates the reconciliation of cash, cash equivalents, and restricted cash shown in the unaudited condensed consolidated statements of cash flows as of June 30, 2017 and 2018 (in thousands):

	For the six months ended June 30,	
	2017	2018
Cash and cash equivalents	$ 147,867	$ 171,600
Restricted cash included in other current assets	15	—
Restricted cash included in other long-term assets	500	500

Total cash, cash equivalents, and restricted cash shown in the statement of cash flows	$ 148,382	$ 172,100

Tuition Receivable and Allowance for Doubtful Accounts

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

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The Company’s tuition receivable and allowance for doubtful accounts were as follows as of December 31, 2017 and June 30, 2018 (in thousands):

	December 31, 2017	June 30, 2018
Tuition receivable	$ 35,809	$ 40,643
Allowance for doubtful accounts	(12,687)	(15,048)
Tuition receivable, net	$ 23,122	$ 25,595

Approximately $2.9 million and $3.4 million of tuition receivable are included in other assets as of December 31, 2017 and June 30, 2018, respectively, because these amounts are expected to be collected after 12 months.

The following table illustrates changes in the Company’s allowance for doubtful accounts for the three and six months ended June 30, 2017 and 2018 (in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2018	2017	2018
Allowance for doubtful accounts, beginning of period	$ 10,820	$ 13,775	$ 10,201	$ 12,687
Additions charged to expense	5,090	6,596	9,472	12,987
Write-offs, net of recoveries	(4,150)	(5,323)	(7,913)	(10,626)
Allowance for doubtful accounts, end of period	$ 11,760	$ 15,048	$ 11,760	$ 15,048

Fair Value

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

- Level 1 assets or liabilities use quoted prices in active markets for identical assets or liabilities as of the measurement date;

- Level 2 assets or liabilities use observable inputs, other than quoted market prices, that are either directly or indirectly observable in the marketplace for identical or similar assets and liabilities; and

- Level 3 assets or liabilities use unobservable inputs that are supported by little or no market activity.

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

Goodwill and Indefinite-Lived Intangible Assets

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

Goodwill and the indefinite-lived intangible assets are assessed at least annually for impairment during the fourth quarter, or more frequently if events occur or circumstances change between annual tests that would more likely than not reduce the fair value of the respective reporting unit below its carrying amount. In the three months ended June 30, 2018, we recorded a goodwill impairment loss of $2.8 million and an intangible asset impairment loss of $3.4 million based on an impairment analysis performed during the period. Refer to Footnote 7 – Goodwill and Intangible Assets of the Footnotes to the Unaudited Consolidated Financial Statements for further discussion of these impairment charges.

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Authorized Stock

The Company has authorized 20,000,000 shares of common stock, par value $.01, of which 11,167,425 and 11,306,527 shares were issued and outstanding as of December 31, 2017 and June 30, 2018, respectively. The Company also has authorized 8,000,000 shares of preferred stock, none of which is issued or outstanding. Before any preferred stock may be issued in the future, the Board of Directors would need to establish the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, and the terms or conditions of the redemption of the preferred stock.

In May 2018, the Company’s Board of Directors declared a regular, quarterly cash dividend of $0.25 per share of common stock. The dividend was paid on June 18, 2018.

Stock-Based Compensation

As required by the Stock Compensation Topic, ASC 718, the Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors, including employee stock options, restricted stock, restricted stock units, and employee stock purchases related to the Company’s Employee Stock Purchase Plan, based on estimated fair values. Stock-based compensation expense recognized in the unaudited condensed consolidated statements of income for each of the three and six months ended June 30, 2017 and 2018 is based on awards ultimately expected to vest and, therefore, has been adjusted for estimated forfeitures. The Company estimates forfeitures at the time of grant and revises the estimate, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The forfeiture rate used is based on historical experience. The Company also assesses the likelihood that performance criteria associated with performance-based awards will be met. If it is determined that it is more likely than not that performance criteria will not be achieved, the Company revises its estimate of the number of shares it believes will ultimately vest. See Footnote 7 for additional information.

Net Income Per Share

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

During the three and six months ended June 30, 2017 and 2018, the Company had no issued and outstanding stock options that were excluded from the calculation. Set forth below is a reconciliation of shares used to calculate basic and diluted earnings per share for the three and six months ended June 30, 2017 and 2018 (in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2018	2017	2018
Weighted average shares outstanding used to compute basic earnings per share	10,680	10,879	10,655	10,812
Incremental shares issuable upon the assumed exercise of stock options	41	51	38	48
Unvested restricted stock and restricted stock units	469	450	462	486
Shares used to compute diluted earnings per share	11,190	11,380	11,155	11,346

Income Taxes

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

The Income Taxes Topic, ASC 740, requires the company to determine whether uncertain tax positions should be recognized within the Company’s financial statements. The Company recognizes interest and penalties, if any, related to uncertain tax positions in income tax expense. Uncertain tax positions are recognized when a tax position, based solely on its technical merits, is determined more likely than not to be sustained upon examination. Upon determination, uncertain tax positions are measured to determine the amount of benefit that is greater than 50% likely to be realized upon ultimate settlement with a taxing authority

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that has full knowledge of all relevant information. A tax position is derecognized if it no longer meets the more likely than not threshold of being sustained.

The tax years since 2014 remain open for Federal tax examination and the tax years since 2013 remain open to examination by state and local taxing jurisdictions in which the Company is subject.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the period reported. The most significant management estimates include allowances for doubtful accounts, useful lives of property and equipment, fair value of future contractual operating lease obligations, potential sublease income and vacancy periods, accrued expenses, forfeiture rates and the likelihood of achieving performance criteria for stock-based awards, value of free courses earned by students that will be redeemed in the future, valuation of goodwill, intangible assets, fair value of contingent consideration, and the provision for income taxes. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (“ASU 2016-02”). The new guidance requires the recognition of right-of-use assets and lease liabilities on the balance sheet for most leases. Under current guidance, operating leases are off-balance sheet. ASU 2016-02 also requires more extensive quantitative and qualitative disclosures about leasing arrangements. ASU 2016-02 applies to fiscal periods beginning after December 15, 2018, using the modified retrospective method, with early adoption permitted. The Company will adopt the new standard effective January 1, 2019 and is currently evaluating the provisions of the standard, including optional practical expedients, and assessing the existing lease portfolio to determine the appropriate changes to the Company’s accounting and lease systems, processes and internal controls. The Company anticipates that the impact of ASU 2016-02 on its consolidated balance sheet will be material as the Company will record significant asset and corresponding liability balances in connection with its leased properties. The Company is still assessing the expected impact on its consolidated statements of income and cash flows.

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

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). ASU 2016-15 is intended to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the Statement of Cash Flows by providing guidance on eight specific cash flow issues. The Company adopted the standard retrospectively on January 1, 2018 with no material impact on its unaudited condensed consolidated statements of cash flows.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows: Restricted Cash (Topic 230) ("ASU 2016-18"). Under ASU 2016-18, an entity should include in its cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. On January 1, 2018, the Company adopted ASU 2016-18 with no material impact on its unaudited condensed consolidated statements of cash flows.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment, which simplifies the subsequent measurement of goodwill only in the event that an impairment is recognized. The amendments in this update should be adopted on a prospective basis for the annual or any interim goodwill impairment tests beginning after December 15, 2019, though early adoption is permitted. The Company adopted this guidance effective as of January 1, 2018 and applied it in the measurement of goodwill in the three months ended June 30, 2018.

In June 2018, the FASB issued ASU No. 2018-07, Improvements to Nonemployee Share-Based Payment Accounting ("ASU 2018-07"), which simplifies the accounting for share-based payments granted to non-employees for goods and services. Under

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ASU 2018-07, most of the current guidance on such payments to non-employees would be aligned with the requirements for share-based payments granted to employees, including determination of measurement date and accounting for performance conditions and for share-based payments after vesting. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company does not expect this guidance to have a material impact on its consolidated financial statements.

Other ASUs issued by the FASB but not yet effective are not expected to have a material effect on the Company's consolidated financial statements.

4. Revenue Recognition

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606. The comparative information has not been restated and continues to be reported under the accounting standards in effect in those reporting periods.

The Company recorded an adjustment to reduce opening retained earnings by $0.2 million, net of tax, due to the impact of adopting ASC 606, primarily related to the allocation of tuition revenue across various performance obligations involved in certain student contract arrangements. In accordance with ASC 606, the disclosure of the impact of adoption on the Company's unaudited condensed consolidated income statement and balance sheet as of and for the three and six months ended June 30, 2018 was as follows (in thousands):

	For the Three Months Ended June 30, 2018		
	As Reported	Balances without Adoption of ASC 606	Effect of Change Higher/(Lower)
Income Statement			
Revenues	$ 114,668	$ 114,549	$ 119
Instruction and educational support expense	64,690	64,535	155
Provision (benefit) for income taxes	(557)	(547)	(10)
Net income	5,188	5,214	(26)

	For the Six Months Ended June 30, 2018		
	As Reported	Balances without Adoption of ASC 606	Effect of Change Higher/(Lower)
Income Statement			
Revenues	$ 231,137	$ 230,887	$ 250

Instruction and educational support expense	128,466	128,119	347
Provision for income taxes	1,593	1,620	(27)
Net income	14,655	14,725	(70)

	As of June 30, 2018		
	As Reported	Balances without Adoption of ASC 606	Effect of Change Higher/(Lower)
Balance Sheet			
Tuition receivable – net	$ 25,595	$ 24,248	$ 1,347
Other current assets	11,385	13,067	(1,682)
Income taxes payable	—	93	(93)
Retained earnings	170,712	170,954	(242)

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Revenue Recognition

The Company’s educational programs typically are offered on a quarterly basis and such periods coincide with the Company’s quarterly financial reporting periods.

Revenues are recognized when control of the promised goods or services is transferred to customers in an amount that reflects the consideration the Company expects to be entitled to receive in exchange for those goods and services. The Company applies the five-step revenue model under ASC 606 to determine when revenue is earned and recognized.

Arrangements with students may have multiple performance obligations. For such arrangements, the Company allocates net tuition revenue to each performance obligation based on its relative standalone selling price. The Company generally determines standalone selling prices based on the prices charged to customers and observable market prices. The standalone selling price of material rights to receive free classes in the future is estimated based on class tuition price and likelihood of redemption based on historical student attendance and completion behavior.

During the quarter ended June 30, 2018, the Company derived approximately $110.3 million of its revenues from tuition revenue net of discounts, grants, and scholarships, which will continue to be recognized in the quarter of instruction. The Company also recognized approximately $3.0 million of revenues from academic fees, $0.8 million for textbook-related sales, and $0.6 million from other revenue streams. For the six months ended June 30, 2018, the Company derived approximately $222.3 million of its revenues from tuition revenue net of discounts, grants, and scholarships, $6.0 million of revenues from academic fees, $1.7 million for textbook-related sales, and $1.1 million from other revenue streams. For the quarter and six months ended June 30, 2018, net tuition revenue was 96% of total revenue.

At the start of each academic term or program, a liability (contract liability) is recorded for academic services to be provided and a tuition receivable is recorded for the portion of the tuition not paid in advance. Any cash received prior to the start of an academic term or program is recorded as a contract liability. Some students may be eligible for scholarship awards, the estimated value of which will be realized in the future and is deducted from revenue when earned, based on historical student attendance and completion behavior. Contract liabilities are recorded as a current or long-term liability in the unaudited condensed consolidated balance sheets based on when the benefit is expected to be realized.

Textbook-related income is recognized upon sale of the course material. Revenues also include certain academic fees recognized within the quarter of instruction, and certificate revenue and licensing revenue which are recognized as the services are provided.

Contract Liabilities – Graduation Fund

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

Revenue from students participating in the Graduation Fund is recorded in accordance with ASC 606. The Company defers the value of the related performance obligation associated with the credits estimated to be redeemed in the future based on the underlying revenue transactions that result in progress by the student toward earning the benefit. The Company's estimate of the benefits that will be redeemed in the future is based on its historical experience of student persistence toward completion of a course of study within this program and similar programs. Each quarter, the Company assesses its methodologies and assumptions underlying these estimates and, to date, any adjustments to the estimates have not been material. The amount estimated to be redeemed in the next 12 months is $20.0 million and is included as a current contract liability in the unaudited condensed consolidated balance sheets. The remainder is expected to be redeemed within two to four years.

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The table below presents activity in the contract liability related to the Graduation Fund for the six months ended June 30, 2017 and 2018 (in thousands):

	June 30, 2017	June 30, 2018
Balance at beginning of period	$ 29,499	$ 37,400
Revenue deferred	11,982	12,917
Benefit redeemed	(7,719)	(10,497)
Balance at end of period	$ 33,762	$ 39,820

Unbilled receivables – Student tuition

Academic materials may be shipped to certain new undergraduate students in advance of the term of enrollment. Under ASC 606, the materials represent a performance obligation to which the Company allocates revenue based on the fair value of the materials relative to the total fair value of all the performance obligations in the arrangement with the student. When control of the materials passes to the student in advance of the term of enrollment, an unbilled receivable and related revenue is recorded. Following adoption of ASC 606 on January 1, 2018, the balance of unbilled receivables related to such materials was $1.3 million as of June 30, 2018, and is included in tuition receivable.

5. Restructuring and Related Charges

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

The following details the changes in the Company's restructuring liability for lease and related costs during the six months ended June 30, 2017 and 2018 (in thousands):

	2017	2018
Balance at beginning of period(1)	$ 11,985	$ 8,781
Adjustments(2)	388	74
Payments	(2,091)	(1,401)
Balance at end of period(1)	$ 10,282	$ 7,454

(1) The current portion of restructuring liabilities was $3.1 million and $2.7 million as of December 31, 2017 and June 30, 2018, respectively, which are included in accounts payable and accrued expenses. The long-term portion is included in other long-term liabilities.

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

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6. Fair Value Measurement

Assets and liabilities measured at fair value on a recurring basis consist of the following as of June 30, 2018 (in thousands):

		Fair Value Measurements at Reporting Date Using		
	June 30, 2018	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$ 102	$ 102	$ —	$ —
Liabilities:				
Deferred payments	$ 4,596	$ —	$ —	$ 4,596

Assets and liabilities measured at fair value on a recurring basis consist of the following as of December 31, 2017 (in thousands):

		Fair Value Measurements at Reporting Date Using		
	December 31, 2017	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds	$ 113	$ 113	$ —	$ —
Liabilities:				
Deferred payments	$ 4,514	$ —	$ —	$ 4,514

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

· Money market funds – Classified in Level 1 is excess cash the Company holds in both taxable and tax-exempt money market funds and that is included in cash and cash equivalents in the accompanying unaudited condensed consolidated balance sheets. The Company records any net unrealized gains and losses for changes in fair value as a component of accumulated other comprehensive income in stockholders' equity. The Company's cash and cash equivalents held at December 31, 2017 and June 30, 2018 approximate fair value and are not disclosed in the above tables because of the short-term nature of the financial instruments.

· Deferred payments – The Company acquired certain assets and entered into deferred payment arrangements with the sellers in transactions that occurred in 2011 and 2016. The deferred payments are classified within Level 3 as there is no liquid market for similarly priced instruments and are valued using models that encompass significant unobservable inputs to estimate the operating results of the acquired assets. The assumptions used to prepare the discounted cash flows include estimates for interest rates, enrollment growth, retention rates, obtaining regulatory approvals for expansion into new markets, and pricing strategies. These assumptions are subject to change as the underlying data sources evolve and the programs mature. The short-term portion of deferred payments was $0.8 million as of June 30, 2018 and is included in accounts payable and accrued expense.

The Company did not change its valuation techniques associated with recurring fair value measurements from prior periods and did not transfer assets or liabilities between levels of the fair value hierarchy during the six months ended June 30, 2017 or 2018.

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Changes in the fair value of the Company’s Level 3 liabilities during the six months ended June 30, 2018 are as follows (in thousands):

	June 30, 2017	June 30, 2018
Balance as of the beginning of period	$ 11,741	$ 4,514
Amounts paid	(511)	(656)
Other adjustments to fair value	(1,260)	738
Balance at end of period	$ 9,970	$ 4,596

7. Goodwill and Intangible Assets

In 2016, the Company completed the acquisition of NYCDA for $13.5 million in cash, with up to an additional $11.5 million payable to the sellers as contingent consideration based on NYCDA’s future operating results. In connection with the acquisition, the Company recorded $13.9 million in goodwill, representing the excess of the purchase price over the fair value of identifiable assets acquired.

The Company regularly monitors the results of NYCDA in relation to the assumptions utilized in the impairment assessment at December 31, 2017. At June 30, 2018, the Company determined that the rate of growth reflected the actual operating results, in relation to the prior impairment assessment, represented a triggering event which warranted an interim re-assessment. Accordingly, the Company performed the quantitative goodwill impairment test using an income-based approach to determine fair value. The income approach consisted of a discounted cash flow model that included projections of future cash flows for NYCDA, calculating a terminal value, and discounting such cash flows by a risk-adjusted rate of return. The determination of fair value consists of using unobservable inputs under the fair value measurement standards.

The Company believes that the most critical assumptions and estimates used in determining the estimated fair value of NYCDA include, but are not limited to, the amounts and timing of expected future cash flows, the discount rate, and the terminal growth rate. The assumptions used in determining the expected future cash flows consider various factors such as historical operating trends, particularly in student enrollment and pricing, anticipated economic and regulatory conditions, reasonable expectations for planned business expansion opportunities, and long-term operating strategies and initiatives. The discount rate is based on the Company's assumption of a prudent investor's required rate of return for assuming the risk of investing in a particular company. The terminal growth rate reflects the sustainable operating income a reporting unit could generate in a perpetual state as a function of revenue growth, inflation, and future margin expectations. The Company also believes that these assumptions are consistent with a reasonable market participant view while employing the concept of highest and best use of the asset. However, the valuation is significantly impacted by the revenue growth assumptions. If the reporting unit does not achieve the growth currently expected, future impairments could be required.

Based on the results of the quantitative goodwill impairment analysis performed, the Company recorded a $2.8 million goodwill impairment charge during the three months ended June 30, 2018, which is reflected within the Fair value adjustments line in the unaudited consolidated statements of income. The goodwill impairment charge represents the excess of the carrying value of the net assets of NYCDA over its estimated fair value. There was no goodwill impairment charge recorded during the period ended June 30, 2017.

The following table presents a rollforward of goodwill balances for the six months ended June 30, 2017 and 2018 (in thousands):

	For the six months ended June 30,	
	2017	2018
Balance, beginning of period	$ 20,744	$ 20,744
Impairment of goodwill	—	(2,825)
Balance, end of period	$ 20,744	$ 17,919

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Intangible Assets

In connection with the purchase price allocations arising from the acquisition of NYCDA in 2016, the Company identified the trade name to be an intangible asset. The Company assigned an indefinite useful life to the trade name intangible asset, as it is believed this asset has the ability to generate cash flows indefinitely. In addition, there are no legal, regulatory, contractual, economic or other factors to limit the useful life of the trade name intangible.

The Company regularly monitors the results of NYCDA in relation to the assumptions utilized in the impairment assessment at December 31, 2017. At June 30, 2018, the Company determined that the rate of growth reflected the actual operating results, in relation to the prior impairment assessment, represented a triggering event which warranted an interim re-assessment. Accordingly, the Company performed a quantitative impairment assessment using the last day of the second quarter of 2018 as the assessment date.

The Company performed the quantitative indefinite-lived intangible asset impairment test using an income-based approach to determine fair value. The income approach consisted of a discounted cash flow model, using the relief from royalty method, which included a projection of future revenues for NYCDA, identifying a royalty rate, calculating a terminal value, and discounting such cash flows by a risk adjusted rate of return. The determination of fair value of the NYCDA trade name primarily consists of using unobservable inputs under the fair value measurement standards.

The Company believes that the most critical assumptions and estimates used in determining the estimated fair value of the NYCDA trade name include, but are not limited to, the amounts and timing of expected future revenues, the royalty rate, the discount rate, and the terminal growth rate. The assumptions used in determining the expected future revenues consider various factors such as historical operating trends, particularly in student enrollment and pricing, anticipated economic and regulatory conditions, reasonable expectations for planned business expansion opportunities, and long-term operating strategies and initiatives. The royalty rate is based on the Company’s assumption of what a reasonable market participant would pay to license the NYCDA trade name, expressed as a percentage of revenues. The discount rate is based on the Company's assumption of a prudent investor's required rate of return for assuming the risk of investing in a particular company. The terminal growth rate reflects the sustainable revenue growth the business could generate in a perpetual state as a function of inflationary expectations. The Company believes that the assumptions used in the indefinite-lived intangible asset impairment tests are consistent with a reasonable market participant view while employing the concept of highest and best use of the asset. However, the valuation is significantly impacted by the revenue growth assumptions. If the reporting unit does not achieve the growth currently expected, future impairments could be required.

Based on the results of the quantitative indefinite-lived intangible asset impairment assessment performed, the Company recorded a $3.4 million impairment charge during the three months ended June 30, 2018, which is reflected within the Fair value adjustments line in the unaudited consolidated statements of income. The indefinite-lived intangible asset impairment charge represents the excess of the carrying value of the NYCDA trade name over its respective estimated fair value calculated as part of the indefinite-lived intangible asset impairment assessment. There was no impairment charge related to indefinite-lived intangible assets recorded during the period ended June 30, 2017.

The following table presents a rollforward of indefinite-lived intangible assets for the six months ended June 30, 2017 and 2018 (in thousands):

	For the six months ended June 30,	
	2017	2018
Balance, beginning of period	$ 7,260	$ 7,260
Impairment of intangible asset	—	(3,360)
Balance, end of period	$ 7,260	$ 3,900

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8. Other Long-Term Liabilities

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

	December 31, 2017	June 30, 2018
Contract liabilities, net of current portion	$ 21,033	$ 23,275
Deferred rent and other facility costs	7,113	6,722
Deferred payments related to acquisitions	6,385	6,397
Loss on facilities not in use	5,652	4,709
Lease incentives	2,832	2,618
Other long-term liabilities	$ 43,015	$ 43,721

Contract Liabilities

As discussed in Note 4, in connection with its student tuition contracts, the Company has an obligation to provide free classes in the future should certain eligibility conditions be maintained (the Graduation Fund). In addition, the Company also has licensed certain of its non-credit bearing course content to a third party for which the Company received an upfront cash payment. Long-term contract liabilities represent the amount of revenue under these arrangements that the Company expects will be realized after one year.

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

The Company records a liability for lease costs of campuses and non-campus facilities that are not currently in use (see Note 5). For facilities still in use, the Company records rent expense on a straight-line basis over the initial term of a lease. The difference between the rent payment and the straight-line rent expense is recorded as a liability.

Deferred Payments Related to Acquisitions

In connection with previous acquisitions, the Company acquired certain assets and entered into deferred payment arrangements with the sellers. The deferred payment arrangements are valued at approximately $3.6 million as of December 31, 2017 and June 30, 2018. In addition, one of the sellers contributed $2.8 million to the Company representing the seller's continuing interest in the assets acquired.

Lease Incentives

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

9. Stock Options, Restricted Stock and Restricted Stock Units

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

In February 2018, the Company’s Board of Directors approved grants of 144,577 shares of restricted stock to certain individuals. These shares, which vest over a four-year period, were granted pursuant to the 2015 Plan. The Company’s stock price closed at $90.99 on the date of these grants.

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In May 2018, the Company's Board of Directors approved grants of 5,856 shares of restricted stock. These shares, which vest annually over a three-year period, were awarded to non-employee members of the Company's Board of Directors, as part of the Company's annual director compensation program and the 2015 Plan. The Company's stock price closed at $103.37 on the date of these grants.

Dividends paid on unvested restricted stock are reimbursed to the Company if the recipient forfeits his or her shares as a result of termination of employment prior to vesting in the award, other than as a result of the recipient's death, disability, or certain qualifying terminations in connection with a change in control of the Company, unless waived by the Company.

Restricted Stock and Restricted Stock Units

The table below sets forth the restricted stock and restricted stock units activity for the six months ended June 30, 2018:

	Number of shares or units	Weighted-average Grant price
Balance, December 31, 2017	716,128	$ 99.65
Grants	150,433	91.47
Vested shares	(198,104)	69.12
Forfeitures	(11,331)	57.37
Balance, June 30, 2018	657,126	$ 112.86

Stock Options

The table below sets forth the stock option activity and other stock option information as of and for the six months ended June 30, 2018:

Weighted-

	Number of shares	Weighted-average exercise price	Weighted-average remaining contractual life (years)	Aggregate intrinsic value(1) (in thousands)
Balance, December 31, 2017	100,000	$ 51.95	3.1	$ 3,763
Grants	—	—		
Exercises	—	—		
Forfeitures/Expirations	—	—		
Balance, June 30, 2018	100,000	$ 51.95	2.6	$ 6,106
Exercisable, June 30, 2018	100,000	$ 51.95	2.6	$ 6,106

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

Valuation and Expense Information under Stock Compensation Topic ASC 718

At June 30, 2018, total stock-based compensation cost which has not yet been recognized was $22.3 million for unvested restricted stock, restricted stock units, and stock option awards. This cost is expected to be recognized over the next 32 months on a weighted-average basis. Awards of approximately 552,000 shares of restricted stock and restricted stock units are subject to performance conditions. The accrual for stock-based compensation for performance awards is based on the Company's estimates that such performance criteria are probable of being achieved over the respective vesting periods. Such a determination involves judgment surrounding the Company's ability to maintain regulatory compliance. If the performance targets are not reached during the respective vesting period, or it is determined it is more likely than not that the performance criteria will not be achieved, related compensation expense is adjusted.

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The following table sets forth the amount of stock-based compensation expense recorded in each of the expense line items for the three and six months ended June 30, 2017 and 2018 (in thousands):

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2018	2017	2018
Instruction and educational support	$ 645	$ 499	$ 814	$ 1,118
Marketing	—	—	—	—
Admissions advisory	—	—	—	—
General and administration	2,583	2,751	4,840	4,819
Stock-based compensation expense included in operating expense	3,228	3,250	5,654	5,937
Tax benefit	1,275	894	2,233	1,646
Stock-based compensation expense, net of tax	$ 1,953	$ 2,356	$ 3,421	$ 4,291

During the three months ended June 30, 2017 and 2018, the Company recognized a tax windfall related to share-based payment arrangements of approximately $0.6 million and $2.0 million, respectively, which was recorded as an adjustment to the provision for income taxes. No stock options were exercised during the six months ended June 30, 2017 or 2018.

10. Income Taxes

The Tax Cuts and Jobs Act (the “2017 Act”) was signed into law on December 22, 2017. The 2017 Act includes a broad range of tax reform legislation affecting businesses, including lowering corporate tax rates, among other provisions. Under accounting principles generally accepted in the United States of America, changes in tax rates and tax law are accounted for in the period of enactment. The Company recognized the income tax effects of the 2017 Act in accordance with Staff Accounting Bulletin No. 118, which provides SEC staff guidance for the application of ASC Topic 740, Income Taxes.

The 2017 Act reduced the federal corporate tax rate from 35% to 21% for tax years beginning after December 31, 2017. ASC 740 requires deferred tax assets and liabilities to be valued using enacted tax rates in effect in the year in which the differences are expected to reverse. Thus, the Company revalued its federal deferred taxes based upon the new 21% tax rate as of December 31, 2017.

The 2017 Act also allows for immediate full expensing for property placed in service after September 27, 2017 and before January 1, 2023. The Company has made the election to accelerate these deductions for the year ended

December 31, 2017 tax returns. At this time, it is uncertain which states will follow federal rules regarding accelerated depreciation and, as such, the Company has not been able to make a reasonable estimate on the impact of deferred taxes related to state depreciation and continues to account for this based on the provisions of the tax laws that were in effect prior to enactment. In addition, the 2017 Act places limitations on the deductibility of certain executive compensation awards in the future, although the Company's existing awards remain eligible for deductibility pursuant to the 2017 Act. The Company is still analyzing the 2017 Act and refining its calculations, which could potentially impact the measurement of the Company's tax balances.

The Company had no unrecognized tax benefits as of June 30, 2018, as compared to $0.3 million of unrecognized tax benefits at June 30, 2017. Interest and penalties, including any related to uncertain tax positions, would be included in the provision for income taxes in the unaudited condensed consolidated statements of income. The Company incurred no expense related to interest and penalties during the six months ended June 30, 2017 and 2018, respectively.

The Company paid $16.2 million and $6.7 million in income taxes during the six months ended June 30, 2017 and 2018, respectively.

11. Litigation

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

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12. Regulation

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

Gainful Employment

Under the Higher Education Act, a proprietary institution offering programs of study other than a baccalaureate degree in liberal arts (for which there is a limited statutory exception) must prepare students for gainful employment in a recognized occupation. On October 31, 2014, the U.S. Department of Education (the "Department") published final regulations related to gainful employment. The regulations went into effect on July 1, 2015, with the exception of new disclosure requirements that were originally scheduled to go into effect January 1, 2017, but which have now been delayed, to some extent, until July 1, 2019. Additionally, the Department announced, on June 16, 2017, its intention to conduct negotiated rulemaking proceedings to revise the gainful employment regulations. Those proceedings began in December 2017 and concluded in March 2018. The negotiating committee did not reach a consensus, and as a result the Department may propose its own regulatory language with no obligation to use the language negotiated or agreed-upon during the committee meetings. If final regulations are published by November 1, 2018, they could become effective as early as July 1, 2019.

The current gainful employment regulations include two debt-to-earnings measures, consisting of an annual income rate and a discretionary income rate. The annual income rate measures student debt in relation to earnings, and the discretionary income rate measures student debt in relation to discretionary income. A program passes if the program's graduates:

- have an annual income rate that does not exceed 8%; or
- have a discretionary income rate that does not exceed 20%.

In addition, a program that does not pass either of the debt-to-earnings metrics, and that has an annual income rate between 8% and 12%, or a discretionary income rate between 20% and 30%, is considered to be in a warning zone. A program fails if the program's graduates have an annual income rate of 12% or greater and a discretionary income rate of 30% or greater. A program would become Title IV-ineligible for three years if it fails both metrics for two out of three consecutive years, or fails to pass at least one metric for four consecutive award years. The regulations provide a means by which an institution may challenge the Department's calculation of any of the debt metrics prior to loss of Title IV eligibility. On January 8, 2017, the University received its final 2015 debt-to-earnings measures and none of its programs failed the debt-to-earnings metrics. Two active programs, the Associate in Arts in Accounting and Associate in Arts in Business Administration, are "in the zone," which means each program remains fully eligible unless

(1) either program has a combination of zone and failing designations for four consecutive years, in which case it would become Title IV-ineligible in the fifth year; or (2) either program fails the metrics for two out of three consecutive years, in which case the program could become ineligible for the following award year.

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.

The current regulations also require institutions annually to report student- and program-level data to the Department, and comply with additional disclosure requirements. Final regulations adopted by the Department, which generally became effective on July 1, 2011, require an institution to use a template designed by the Department to disclose to prospective students, with respect to each gainful employment program, occupations that the program prepares students to enter, total cost of the program, on-time graduation rate, job placement rate, if applicable, and the median loan debt of program completers for the most recently completed award year. On January 19, 2018, the Department announced the release of the 2018 template and gave institutions until April 6, 2018 to update their disclosures for each gainful employment program. The University is in compliance with that requirement. On June 18, 2018, the Department further delayed, until July 1, 2019, the requirements that an institution include the disclosure template, or a link thereto, in its gainful employment program promotional materials and directly distribute the disclosure templates to prospective students.

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

Under the gainful employment regulations, an institution may establish a new program's Title IV eligibility by updating the list of the institution's programs maintained by the Department. However, an institution may not update its list of eligible programs to include a failing or zone program that the institution voluntarily discontinued or that became ineligible, or a gainful employment program that is substantially similar to such a program, until three years after the loss of eligibility or discontinuance.

The requirements associated with the gainful employment regulations may substantially increase the Company's administrative burdens and could affect the University's program offerings, student enrollment, persistence, and retention. Further, although the regulations provide opportunities for an institution to correct any potential deficiencies in a program prior to the loss of Title IV eligibility, the continuing eligibility of the University's academic programs will be affected by factors beyond management's control such as changes in the University's graduates' income levels, changes in student borrowing levels, increases in interest rates, changes in the percentage of former students who are current in the repayment of their student loans, and various other factors. Even if the University were able to correct any deficiency in the gainful employment metrics in a timely manner, the disclosure requirements associated with a program's failure to meet at least one metric may adversely affect student enrollments in that program and may adversely affect the reputation of the University.

Borrower Defenses to Repayment

Pursuant to the Higher Education Act and following negotiated rulemaking, on November 1, 2016, the Department published final regulations that, inter alia, would have specified the acts or omissions of an institution that a borrower may assert as a defense to repayment of a loan made under the Direct Loan Program. Although the regulations were scheduled to become effective on July 1, 2017, on June 16, 2017, the Department delayed indefinitely the effective date of selected provisions of the regulations and announced its intention to conduct negotiated rulemaking proceedings to revise the regulations. On October 24, 2017, the Department published an interim final rule to delay until July 1, 2018 the effective date of the selected provisions. Then, on February 14, 2018, the Department published a final rule to delay until July 1, 2019 the effective date of the selected provisions. With respect to the negotiated rulemaking proceedings to revise the regulations, those proceedings began in November 2017 and concluded in February 2018. The negotiating committee did not reach a consensus, and as a result the Department was able to propose its own regulatory language with no obligation to use language negotiated or agreed-upon during the committee meetings.

On July 31, 2018, the Department published a notice of proposed rulemaking that, among other things, would establish a new federal standard for evaluating and a process for adjudicating borrower defenses to repayment of loans made under the Direct Loan Program on or after July 1, 2019. Under the proposed standard, an individual borrower could assert a defense to repayment based on the institution's statement, act, or omission that is false, misleading, or deceptive. To be eligible for relief, the borrower would be required to demonstrate that the misrepresentation (1) was made with knowledge of its false, misleading, or deceptive nature or with a reckless disregard for the truth, (2) was relied upon by the borrower in making an enrollment decision, and (3) caused the student financial harm. The Department would have discretion to determine the appropriate amount of relief. The proposed regulations would make changes to the Department's eligibility requirements for granting loan discharges to students who had enrolled at institutions or locations that subsequently close. The proposed regulations also would require that institutions that require students to enter into pre-dispute arbitration agreements or class action waivers as a condition of enrollment disclose those requirements in an easily accessible format.

In addition, the proposed regulations would amend the Department's financial responsibility provisions in several respects. The proposed rules would identify certain conditions or events that have or may have an adverse material effect on the institution's financial condition, in response to which the Department would or could require that the institution submit some form of financial protection for the Department. The proposed rules would also update the Department's composite score calculations to reflect recent changes in FASB accounting standards and provide a phase-in process to enable the Department to update its composite score regulations through additional negotiated rulemaking. The Department is accepting public comments on the notice of proposed rulemaking until August 30, 2018. If final regulations are published by November 1, 2018, they could become effective as early as July 1, 2019.

State Education Licensure – Licensure of Online Programs

The increasing popularity and use of the internet and other technology for the delivery of education has led, and may continue to lead, to the adoption of new laws and regulatory practices in the United States or foreign countries or to the interpretation of existing laws and regulations to apply to such services. These new laws and interpretations may relate to issues such as the requirement that online education institutions be licensed as a school in one or more jurisdictions even where they have no physical location. New laws, regulations, or interpretations related to doing business over the internet could increase Strayer University's cost of doing business, affect its ability to increase enrollments and revenues, or otherwise have a material adverse effect on our business.

In April 2013, the Department announced that it would address state authorization of distance education through negotiated rulemaking. While four negotiated rulemaking sessions were conducted from February through May 2014, no consensus was reached.

In June 2016, despite the lack of consensus at the negotiated rulemaking sessions, but as permitted by federal law, the Department issued a Notice of Proposed Rulemaking for public comment on the issue of state authorization for online programs. On December 19, 2016, the Department issued final regulations, which are described below and were scheduled to become effective on July 1, 2018. On May 25, 2018, the Department issued a Notice of Proposed Rulemaking to delay until July 1, 2020 the effective date of the state authorization of distance education provisions of those final regulations based on concerns that were recently raised by regulated parties and to provide adequate time to conduct negotiated rulemaking to reconsider those provisions and, as necessary, develop revised regulations. On July 3, 2018, the Department published a final rule, which was made effective retroactively to June 29, 2018, to delay until July 1, 2020 the effective date of the state authorization of distance education provisions. Certain other portions of the 2016 final regulations, which relate to authorization of foreign locations, went into effect on July 1, 2018.

The 2016 final regulations, among other things, would require an institution offering Title IV-eligible distance education or correspondence courses to be authorized by each state in which the institution enrolls students, if such authorization is required by the state. Institutions can obtain such authorization directly from the state or through a state authorization reciprocity agreement. A state authorization reciprocity agreement is defined as an agreement between two or more states that authorizes an institution located and legally authorized in a state covered by the agreement to provide post-secondary education through distance education or correspondence courses to students in other states covered by the agreement and does not prohibit a participating state from enforcing its own laws with respect to higher education. On December 2, 2016, the University became a participant in the State Authorization Reciprocity Agreement ("SARA"). As a participant in SARA, the University may offer online courses and other forms of distance education to students in any participating SARA state in which it does not have a physical location or a physical presence as defined by the state without having to seek any new state institutional approval beyond its home state (Washington, D.C.). The 2016 final regulations also require institutions to document the state process for resolving complaints from students enrolled in programs offered through distance education or correspondence courses for each state in which such students reside.

In addition, the 2016 final regulations would require an institution to provide public and individualized disclosures to enrolled and prospective students regarding its programs offered solely through distance education or correspondence courses. The public disclosures would include state authorization for the program or course, the process for submitting complaints to relevant states, any adverse actions by a state or accrediting agency related to the distance education program or correspondence course within the past five years, refund policies specific to the state, and applicable licensure or certification requirements for a career that the program prepares a student to enter. An institution would be required to disclose directly to all prospective students if a distance education or correspondence course does not meet the licensure or certification requirements for a state. An institution would be required to disclose to each current and prospective student an adverse action taken against a distance education or correspondence program and any determination that a program ceases to meet licensure or certification requirements.

Under the 2016 final regulations, if an institution does not obtain or maintain state authorization for distance education or correspondence courses in any particular state that has authorization requirements, the institution would lose its ability to award Title IV funds for students in those programs who are residing in that state.

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The Clery Act

The University must comply with the campus safety and security reporting requirements as well as other requirements in the Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act (the "Clery Act") including changes made to the Clery Act by the Violence Against Women Reauthorization Act of 2013. On October 20, 2014, the Department promulgated regulations, effective July 1, 2015, implementing amendments to the Clery Act. In addition, the Department has interpreted Title IX to categorize sexual violence as a form of prohibited sex discrimination and to require institutions to follow certain disciplinary procedures with respect to such offenses. On September 22, 2017, the Department withdrew the statements of policy and guidance reflected in two guidance documents issued under the Obama administration and issued interim guidance about campus sexual misconduct. In the interim guidance, the Department announced that it intends to conduct negotiated rulemaking proceedings to revise its regulations related to institutions' Title IX responsibilities. Failure by the University to comply with the Clery Act or Title IX requirements or regulations thereunder could result in action by the Department fining the University or limiting or suspending its participation in Title IV programs, could lead to litigation, and could harm the University's reputation. The Company believes that the University is in compliance with these requirements.

Compliance Reviews

The University is subject to announced and unannounced compliance reviews and audits by various external agencies, including the Department, its Office of Inspector General, state licensing agencies, guaranty agencies, and accrediting agencies. In 2014, the Department conducted four campus-based program reviews of University locations in three states and the District of Columbia. The reviews covered federal financial aid years 2012-2013 and 2013-2014, and two of the reviews also covered compliance with the Clery Act, the Drug-Free Schools and Communities Act, and regulations related thereto. For three of the program reviews, the University received correspondence from the Department in 2015 closing the program reviews with no further action required by the University. For the other program review, in 2016, the University received a Final Program Review Determination Letter identifying a payment of less than $500 due to the Department based on an underpayment on a return to Title IV calculation, and otherwise closing the review. The University remitted payment, and received a letter from the Department indicating that no further action was required and that the matter was closed.

Program Participation Agreement

Each institution participating in Title IV programs must enter into a Program Participation Agreement with the Department. Under the agreement, the institution agrees to follow the Department's rules and regulations governing Title IV programs. On October 13, 2017, the Department informed the University that it was approved to participate in Title IV programs with full certification through June 30, 2021.

NYCDA

NYCDA currently provides on-ground courses in New York, Pennsylvania, Utah, and the District of Columbia, but is not accredited, does not participate in state or federal student financial aid programs, and is not subject to the regulatory requirements applicable to accredited schools and schools that participate in financial aid programs such as those described above. Programs such as those offered by NYCDA are regulated by each individual state.

13. Subsequent Events

On August 1, 2018, the Company completed the previously announced merger with Capella in accordance with the terms of the Agreement and Plan of Merger dated as of October 29, 2017, and changed its name from Strayer Education, Inc. to Strategic Education, Inc. Pursuant to the merger, Capella is a wholly-owned subsidiary of the Company.

In addition, on August 1, 2018, the Company amended its existing credit facility to extend the maturity date of the revolving credit facility from July 2, 2020 to August 1, 2023, and to increase available borrowings from $150 million to $250 million, with an option to increase the commitments under the revolving facility by an additional $150 million. Borrowings under this new amended credit facility will bear interest at LIBOR or a base rate plus a margin ranging from 1.50% to 2.00%, depending on the Company's leverage ratio; the quarterly unused commitment fee ranges from 0.20% to 0.30% per annum depending on the Company's leverage ratio. Other terms are substantially similar to the Company's existing credit facility. As of August 1, 2018, there are no outstanding borrowings under the amended credit facility. These events had no impact on the unaudited condensed consolidated financial statements as of June 30, 2018.

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

Cautionary Notice Regarding Forward-Looking Statements

Certain of the statements included in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as elsewhere in this Quarterly Report on Form 10-Q are forward-looking statements made pursuant to the Private Securities Litigation Reform Act of 1995 ("Reform Act"). Such statements may be identified by the use of words such as "expect," "estimate," "assume," "believe," "anticipate," "will," "forecast," "outlook," "plan," "project words, and include, without limitation, statements relating to future enrollment, revenues, revenues per student, earnings growth, operating expenses and capital expenditures. These statements are based on the Company's current expectations and are subject to a number of assumptions, risks and uncertainties. In accordance with the Safe Harbor provisions of the Reform Act, the Company has identified important factors that could cause the actual results to differ materially from those expressed in or implied by such statements. The assumptions, risks and uncertainties include the pace of growth of student enrollment, our continued compliance with Title IV of the Higher Education Act, and the regulations thereunder, as well as regional accreditation standards and state regulatory requirements, rulemaking by the Department of Education and increased focus by the U. S. Congress on for-profit education institutions, competitive factors, risks associated with the opening of new campuses, risks associated with the offering of new educational programs and adapting to other changes, risks associated with the acquisition of existing educational institutions, risks relating to the timing of regulatory approvals, our ability to implement our growth strategy, risks associated with the ability of our students to finance their education in a timely manner, and general economic and market conditions. Further information about these and other relevant risks and uncertainties may be found in Part I, "Item 1A. Risk Factors" of the Company's Annual Report on Form 10-K and in the Company's other filings with the Securities and Exchange Commission. The Company undertakes no obligation to update or revise forward-looking statements.

Additional Information

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

Background and Overview

We are an education services holding company that owns Strayer University (the "University") and the New York Code and Design Academy ("NYCDA"). The University is an institution of higher education which offers undergraduate and graduate degree programs at physical campuses, predominantly located in the eastern United States, and online. NYCDA provides non-degree courses in web and application software development, primarily at campuses in New York City and Philadelphia, PA.

In October 2017, we entered into a merger agreement with Capella Education Company ("Capella"). Capella provides post-secondary education and job-skills programs primarily through its subsidiary Capella University. Capella had approximately 37,500 students at December 31, 2017, its revenue for 2017 was $440.4 million, and its net income from continuing operations in 2017 was $23.4 million. The merger was approved by our stockholders and by Capella's shareholders on January 19, 2018. The merger was completed August 1, 2018, whereby Capella became our wholly-owned subsidiary and will continue to offer its education programs through Capella University. We continue to evaluate potential acquisitions and other business initiatives.

Most of our revenue comes from the University, which derives approximately 96% of its revenue from tuition for educational programs, whether delivered online or delivered in person at a physical campus. The academic year of the University is divided into four quarters, each of which is within the four quarters of the calendar year. Students at the University and at NYCDA make payment arrangements for the tuition for each course at the time of enrollment. Tuition revenue is recognized ratably over the course of instruction. If a student withdraws from a course prior to completion, the University refunds a portion of the tuition depending on when the withdrawal occurs. Tuition revenue is shown net of any refunds, withdrawals, corporate discounts, employee tuition discounts, and scholarships. The University also derives revenue from other sources such as textbook-related income which is recognized upon sale, and certificate revenue, certain academic fees, licensing revenue, and other income, which are recognized as the services are provided.

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Tuition receivable and contract liabilities for our students are recorded upon the start of the course, which for the University, is the start of the academic term. Because the University's academic quarters coincide with the calendar quarters, at the end of the fiscal quarter (and academic term), tuition receivable generally represents amounts due from students for educational services already provided and contract liabilities generally represent advance payments for academic services to be provided in the future. Based upon past experience and judgment, the University establishes an allowance for doubtful accounts with respect to accounts receivable. Any uncollected account more than one year past due is charged against the allowance. Accounts less than one year past due are reserved according to the length of time the balance has been outstanding. In establishing reserve amounts, we also consider the status of students as to whether or not they are currently enrolled for the next term, as well as the likelihood of recovering balances that have previously been written off, based on historical experience. Bad debt expense as a percentage of revenues for the second quarter of 2017 and 2018 was 4.5% and 5.8%, respectively.

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

· Instruction and educational support expenses generally contain items of expense directly attributable to educational activities. This expense category includes salaries and benefits of faculty and academic administrators, as well as administrative personnel who support faculty and students. Instruction and educational support expenses also include costs of educational supplies and facilities, including rent for campus facilities, certain costs of establishing and maintaining computer laboratories, and all other physical plant and occupancy costs, with the exception of costs attributable to the corporate offices. Bad debt expense incurred on delinquent student account balances is also included in instruction and educational support expenses.

· Marketing expenses include the costs of advertising and production of marketing materials and related personnel costs.

· Admissions advisory expenses include salaries, benefits, and related costs of personnel engaged in admissions.

· General and administration expenses include salaries and benefits of management and employees engaged in accounting, human resources, legal, regulatory compliance, and other corporate functions, along with the occupancy and other related costs attributable to such functions.

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

Critical Accounting Policies and Estimates

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

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

Revenue recognition — Like many traditional institutions, the University offers its educational programs on a quarter system having four academic terms, which coincide with our quarterly financial reporting periods. NYCDA's revenues are recognized as services are provided, generally ratably over the length of a course. Beginning January 1, 2018, in accordance with our adoption of new revenue recognition standards under ASC 606, materials provided to students in connection with their enrollment in a course are recognized as revenue when control of those materials transfers to the student. Approximately 96% of our revenues during the six months ended June 30, 2018 consisted of tuition revenue. Tuition revenue is recognized ratably over the course of instruction as the University provides academic services in a given term, whether delivered in person at a physical campus or online. Tuition revenue is shown net of any refunds, withdrawals, corporate discounts, scholarships, and employee tuition discounts. The University also derives revenue from other sources such as textbook-related income, certificate revenue, certain academic fees, licensing revenue, and other income, which are all recognized when earned. At the start of each academic term or program, a liability (contract liability) is recorded for academic services to be provided, and a tuition receivable is recorded for the portion of the tuition not paid in advance. Any cash received prior to the start of an academic term or program is recorded as a contract liability.

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

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

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

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

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

New students registering in credit-bearing courses in any undergraduate program for the summer 2013 term (fiscal third quarter) and subsequent terms qualify for the Graduation Fund, whereby qualifying students earn tuition credits that are redeemable in the final year of a student's course of study if he or she successfully remains in the program. Students must meet all of the University's admission requirements and not be eligible for any previously offered scholarship program. Our employees and their dependents are not eligible for the program. To maintain eligibility, students must be enrolled in a bachelor's degree program. Students who have more than one consecutive term of non-attendance lose any Graduation Fund credits earned to date, but may earn and accumulate new credits if the student is reinstated or readmitted by the University in the future. In their final academic year, qualifying students will receive one free course for every three courses that were successfully completed. The performance obligation associated with free courses that may be redeemed in the future is valued based on a systematic and rational allocation of the cost of honoring the benefit earned to each of the underlying revenue transactions that result in progress by the student toward earning the benefit. The estimated value of awards under the Graduation Fund that will be recognized in the future is based on historical experience of students' persistence in completing their course of study and earning a degree and the tuition rate in effect at the time it was associated with the transaction. Estimated redemption rates of eligible students vary based on their term of enrollment. As of June 30, 2018, we had deferred $39.8 million for estimated redemptions earned under the Graduation Fund, as compared to $37.4 million at December 31, 2017. Each quarter, we assess our methodologies and assumptions underlying our estimates for persistence and estimated redemptions based on actual experience. To date, any adjustments to our

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estimates have not been material. However, if actual persistence or redemption rates change, adjustments to the reserve may be necessary and could be material.

Tuition receivable — We record estimates for our allowance for doubtful accounts for tuition receivable from students primarily based on our historical collection rates by age of receivable, net of recoveries, and consideration of other relevant factors. Our experience is that payment of outstanding balances is influenced by whether the student returns to the institution as we require students to make payment arrangements for their outstanding balances prior to enrollment. Therefore, we monitor outstanding tuition receivable balances through subsequent terms, increasing the reserve on such balances over time as the likelihood of returning to the institution diminishes and our historical experience indicates collection is less likely. We periodically assess our methodologies for estimating bad debts in consideration of actual experience. If the financial condition of our students were to deteriorate, resulting in evidence of impairment of their ability to make required payments for tuition payable to us, additional allowances or write-offs may be required. For the second quarter of 2018, our bad debt expense was 5.8% of revenue, compared to 4.5% for the same period in 2017. Our bad debt has been negatively impacted by the continued shift in student mix to less experienced undergraduate students, as well as by delays in the processing of Title IV financial aid. We believe the financial aid processing delays are a short-term condition that, by the end of 2018, will be resolved. A change in our allowance for doubtful accounts of 1% of gross tuition receivable as of June 30, 2018 would have changed our income from operations by approximately $0.4 million.

Goodwill and indefinite-lived intangible assets — Goodwill represents the excess of the purchase price of an acquired business over the amount assigned to the assets acquired and liabilities assumed. Indefinite-lived intangible assets, which include trade names, are recorded at fair market value on their acquisition date. Goodwill and the indefinite-lived intangible assets are assessed at least annually for impairment. In connection with the goodwill in our JWMI reporting unit and the indefinite-lived intangible asset associated with the JWMI trade name, we utilized a qualitative assessment, consistent with ASC 350, to evaluate the recoverability of the related amounts. A qualitative assessment was performed based on the excess fair value noted in prior years. The qualitative factors considered included macroeconomic conditions, industry/market factors, cost considerations, and overall financial performance, among others. Based on our qualitative assessment, we concluded that it was not more likely than not that the fair value was less than the carrying value; as such, no impairments had been incurred.

In connection with the goodwill in our NYCDA reporting unit and the indefinite-lived intangible asset associated with the NYCDA tradename, we determined the change in the rate of growth within the current operating results represented a triggering event and performed a quantitative assessment consistent with ASC 350 during the period ended June 30, 2018. The assessment considered both an income approach and a market approach, whereas the tradename valuation utilized a relief from royalty method. We updated our revenue and cash flow forecasts in the second quarter to determine fair values using the following key assumptions: revenue growth rates ranging from 5% to 51% through 2024 and 3% thereafter, operating margins ranging from -33% to 25% during the same period, and a discount rate of 19%. As a result, during the three months ended June 30, 2018, we recorded impairment charges of $6.2 million based on the results of the goodwill and intangible asset impairment analysis. We have made investments in NYCDA since its acquisition to position it for scalable growth and, while the acquisition has had a positive impact on our revenue growth, NYCDA has not achieved the degree of revenue growth initially anticipated or met operating performance expectations. Refer to Footnote 7 - Goodwill and Intangible Assets - within the footnotes to the unaudited condensed consolidated financial statements for additional information related to the goodwill and intangible asset impairment charges recorded.

Contingent Consideration — In connection with the acquisition of NYCDA, the Company agreed that the purchase price would include contingent cash payments (contingent consideration) of up to $12.5 million payable based on NYCDA's results of operations over a five-year period (the "Earnout"). Generally accepted accounting principles require that contingent consideration be recorded at its estimated fair value at the date of acquisition and then adjusted to fair value each period thereafter until it is settled.

The fair value of the Earnout was originally measured by applying a probability weighted discounted cash flow model based on significant inputs not observable in the market. Based on its original projections, the Company expected the full amount of the Earnout would be paid and initially measured the liability at its fair value of $9.0 million. Following its initial recognition, the Company reassessed and adjusted the carrying value of the Earnout to fair value with fair value reflecting revisions to the business plan, expectations relative to achieving the performance targets over the earnout period, and the impact of the discount rate. As of June 30, 2018, the Company estimates that no amounts under the Earnout will be paid and the related liability has been recorded at zero. The Company will continue to update its forecasts each period and record any fair value adjustments, as necessary.

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In the three months ended June 30, 2017, we recorded a benefit of $2.3 million to reduce the value of contingent consideration payable to the sellers of NYCDA, offset by a charge of $0.3 million to increase our liability for leases on facilities no longer in use.

Accrued lease and related costs — We estimate potential sublease income and vacancy periods for space that is not in use, adjusting our estimates when circumstances change. If our estimates change or if we enter into subleases at rates that are substantially different than our current estimates, we will adjust our liability for lease and related costs. During the six months ended June 30, 2018, we had no reduction to our liability for leases and in the six months ended June 30, 2017 we incurred $0.3 million to increase our liability for leases on facilities no longer in use.

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

Results of Operations

In the second quarter of 2018, we generated $114.7 million in revenue, a 2% increase compared to 2017, principally due to a 8% increase in total enrollment, partially offset by a 6% decline in revenue per student. Income from operations was $4.2 million for the second quarter of 2018 compared to $13.9 million for the second quarter of 2017. Net income in the second quarter of 2018 was $5.2 million compared to $10.3 million for the same period in 2017. Diluted earnings per share was $0.46 compared to $0.92 for the same period in 2017.

In the accompanying analysis of financial information for 2018, we use financial measures, Adjusted Income from Operations, Adjusted Net Income, and Adjusted Diluted Earnings per Share, that are not required by or prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). These measures, which are considered “non-GAAP financial measures” under SEC rules, are defined by us to exclude charges associated with our previously announced merger with Capella Education Company and fair value adjustments primarily related to our acquisition of NYCDA. When considered together with GAAP financial results, we believe these measures provide management and investors with an additional understanding of our business and operating results, including underlying trends.

Non-GAAP financial measures are not defined in the same manner by all companies and may not be comparable with other similarly titled measures of other companies. Non-GAAP financial measures may be considered in addition to, but not as a substitute for or superior to, GAAP results. A reconciliation of these measures to the most directly comparable GAAP measures is provided below.

Adjusted income from operations was $13.2 million in the second quarter of 2018 compared to $11.9 million in 2017. Adjusted net income was $9.9 million in the second quarter of 2018 compared to $7.2 million in 2017, and adjusted diluted earnings per share was $0.87 in the second quarter of 2018 compared to $0.65 in 2017. Adjusted income from operations was $29.9 million in the six months ended June 30, 2018 compared to $30.3 million for the same period in 2017. Adjusted net income was $22.2 million in the six months ended June 30, 2018 compared to $18.4 million for the same period in 2017, and adjusted diluted earnings per share was $1.96 in the six months ended June 30, 2018 compared to $1.65 for the same period in 2017.

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The tables below reconcile our reported results of operations to adjusted results (amounts in thousands, except per share data):

Reconciliation of Reported to Adjusted Results of Operations for the three months ended June 30, 2017

	As Reported (GAAP)	Non-GAAP Adjustment Merger Costs (1)	Fair Value Adjustments (2)	Other Tax Adjustments (3)	As Adjusted (Non-GAAP)
Income from operations	$ 13,854	$ —	$ (1,994)	$ —	$ 11,860
Investment income	253	—	—	—	253
Interest expense	160	—	—	—	160
Income before income taxes	13,947	—	(1,994)	—	11,953
Provision for income taxes	3,645	—	104	972	4,721
Net income	$ 10,302	$ —	$ (2,098)	$ (972)	$ 7,232
Earnings per share:					
Basic **	$ 0.96	$ —	$ (0.20)	$ (0.09)	$ 0.68
Diluted **	$ 0.92	$ —	$ (0.19)	$ (0.09)	$ 0.65
Weighted average shares outstanding:					
Basic	10,680	—	—	—	10,680
Diluted	11,190	—	—	—	11,190

Reconciliation of Reported to Adjusted Results of Operations for the three months ended June 30, 2018

	As Reported (GAAP)	Non-GAAP Adjustment Merger Costs (1)	Fair Value Adjustments (2)	Other Tax Adjustments (3)	As Adjusted (Non-GAAP)
Income from operations	$ 4,184	$ 2,824	$ 6,185	$ —	$ 13,193
Investment income	608	—	—	—	608
Interest expense	161	—	—	—	161
Income before income taxes	4,631	2,824	6,185	—	13,640
Provision (benefit) for income taxes	(557)	624	924	2,760	3,751
Net income	$ 5,188	$ 2,200	$ 5,261	$ (2,760)	$ 9,889
Earnings per share:					
Basic	$ 0.48	$ 0.20	$ 0.48	$ (0.25)	$ 0.91
Diluted	$ 0.46	$ 0.19	$ 0.46	$ (0.24)	$ 0.87
Weighted average shares outstanding:					
Basic	10,879	—	—	—	10,879
Diluted	11,380	—	—	—	11,380

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Reconciliation of Reported to Adjusted Results of Operations for the six months ended June 30, 2017

	As Reported (GAAP)	Non-GAAP Adjustment Merger Costs (1)	Fair Value Adjustments (2)	Other Tax Adjustments (3)	As Adjusted (Non-GAAP)
Income from operations	$ 32,297	$ —	$ (1,994)	$ —	$ 30,303
Investment income	434	—	—	—	434
Interest expense	319	—	—	—	319
Income before income taxes	32,412	—	(1,994)	—	30,418
Provision for income taxes	11,532	—	104	379	12,015
Net income	$ 20,880	$ —	$ (2,098)	$ (379)	$ 18,403
Earnings per share:					
Basic **	$ 1.96	$ —	$ (0.20)	$ (0.04)	$ 1.73
Diluted	$ 1.87	$ —	$ (0.19)	$ (0.03)	$ 1.65
Weighted average shares outstanding:					
Basic	10,655	—	—	—	10,655
Diluted	11,155	—	—	—	11,155

Reconciliation of Reported to Adjusted Results of Operations for the six months ended June 30, 2018

	As Reported (GAAP)	Non-GAAP Adjustment Merger Costs (1)	Fair Value Adjustments (2)	Other Tax Adjustments (3)	As Adjusted (Non-GAAP)
Income from operations	$ 15,512	$ 8,171	$ 6,185	$ —	$ 29,868
Investment income	1,056	—	—	—	1,056
Interest expense	320	—	—	—	320
Income before income taxes	16,248	8,171	6,185	—	30,604
Provision for income taxes	1,593	1,538	924	4,361	8,416
Net income	$ 14,655	$ 6,633	$ 5,261	$ (4,361)	$ 22,188
Earnings per share:					
Basic **	$ 1.36	$ 0.61	$ 0.49	$ (0.40)	$ 2.05
Diluted **	$ 1.29	$ 0.58	$ 0.46	$ (0.38)	$ 1.96
Weighted average shares outstanding:					
Basic	10,812	—	—	—	10,812
Diluted	11,346	—	—	—	11,346

** Earnings per share data may not foot due to rounding

(1) Reflect charges associated with the Company's previously announced merger with Capella Education Company.
(2) Reflects adjustments to the value of contingent consideration, and impairment of goodwill and intangible assets related to the Company's acquisition of the New York Code + Design Academy and the related tax effects, and adjustments to the Company's reserve for leases on facilities no longer in use.
(3) Reflects discrete tax adjustments related to the vesting of stock awards and other adjustments, reflecting an annual effective tax rate of 27.5%.

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

Enrollment

% Change vs Prior Year

Since 2013, we have introduced a number of initiatives in response to the variability in demand for our programs. Recognizing that affordability is an important factor in a prospective student's decision to seek a college degree, we reduced Strayer University undergraduate tuition for new students by 20% beginning in our 2014 winter academic term. We also introduced the Graduation Fund in mid-2013, whereby qualifying students can receive one free course for every three courses successfully completed. The free courses are redeemable in the student's final academic year. In 2015, we increased our investment in resources focused on helping Fortune 1000 companies to structure customized education and training programs for their employees, often with significant discounts to our published tuition rates. In 2017, we introduced several new scholarship programs aimed at specific demographics, geographies, and student profiles. We also began testing significantly reduced tuition for select graduate degree programs. These initiatives have had a negative impact on Strayer University revenue per student, which declined 3% in 2017, and is expected to decrease in 2018 by 4% to 5%, not including any impact from our pending merger with Capella.

As a result of these and other initiatives, average total enrollment grew approximately 6% in 2017. Should the 2017 full-year enrollment growth continue in 2018, we would expect revenue for the full year 2018 to increase at the rate of enrollment growth, less the decline in revenue per student, and would expect operating expenses in 2018 to increase slightly, not including any impact from our pending merger with Capella.

Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Enrollment. Total enrollments at the University for the spring term 2018 increased to 46,868 students, from 43,411 for the spring term 2017. New student enrollments increased by 7%, and continuing student enrollments increased by 8%.

Revenues. Revenues increased 2% to $114.7 million in the second quarter of 2018 from $112.7 million in the second quarter of 2017, principally due to total enrollment growth of 8%, partially offset by a decline in revenue per student of 6%. The decline in revenue per student is largely attributable to students continuing on scholarship programs offered in fall 2017 and growth in lower priced graduate degree programs. Revenues for undergraduate students increased 7% in the three months ended June 30, 2018, driven by an increase in total undergraduate enrollment of 11%, partially offset by a decline in revenue per student of 4%. We expect this decline in revenue per student to continue at the undergraduate level as we enroll more new undergraduate students. For graduate students, revenues decreased 11% in 2018, driven by a decline in total graduate enrollment of 1% and a decline in revenue per student of

10%.

Instruction and educational support expenses. Instruction and educational support expenses increased $1.0 million, or 2%, to $64.7 million in the second quarter of 2018 from $63.7 million in the second quarter of 2017, principally due to increases in student materials costs, depreciation expense following recent infrastructure investments, and bad debt expense. Instruction and educational support expenses as a percentage of revenues increased to 56.4% in the second quarter of 2018 from 56.5% in the second quarter of 2017.

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Marketing expenses. Marketing expenses increased $1.9 million, or 10%, to $21.1 million in the second quarter of 2018 from $19.2 million in the second quarter of 2017, principally due to increased investments in branding initiatives. Marketing expenses as a percentage of revenues increased to 18.4% in the second quarter of 2018 from 17.1% in the second quarter of 2017.

Admissions advisory expenses. Admissions advisory expenses decreased $0.2 million, or 4%, to $4.6 million in the second quarter of 2018, from $4.8 million in the second quarter of 2017. Admissions advisory expenses as a percentage of revenues decreased to 4.0% in the second quarter of 2018 from 4.2% in the second quarter of 2017.

General and administration expenses. General and administration expenses decreased $2.1 million to $11.1 million in the second quarter of 2018 from $13.2 million in the second quarter of 2017. General and administration expenses as a percentage of revenues decreased to 9.6% in the second quarter of 2018 from 11.7% in the second quarter of 2017.

Merger costs. Merger costs were $2.8 million in the second quarter of 2018 and reflect expenses for legal, accounting, and integration support services incurred by the Company in connection with its merger with Capella.

Fair value adjustments. In the three months ended June 30, 2018, we recorded a goodwill impairment loss of $2.8 million and an intangible asset impairment loss of $3.4 million based on an analysis performed during the period. Refer to Footnote 7 – Goodwill and Intangible Assets of the footnotes to the unaudited consolidated financial statements for further discussion of these impairment charges. In the three months ended June 30, 2017, we recorded a benefit of $2.3 million to reduce the value of contingent consideration payable to the sellers of NYCDA, offset by a charge of $0.3 million to increase our liability for leases on facilities no longer in use.

Income from operations. Income from operations was $4.2 million in the second quarter of 2018 compared to $13.9 million in the second quarter of 2017. The decline was primarily due to the merger costs and fair value adjustments to the NYCDA trade name and goodwill incurred in the period.

Investment income and interest expense. Investment income increased to $0.6 million in the second quarter of 2018 compared to $0.3 million in the second quarter of 2017 as a result of higher yields and an increase in our cash balances. Interest expense was $0.2 million in the second quarter of both 2018 and 2017. We had $150.0 million available under our revolving credit facility and no borrowings outstanding as of June 30, 2018.

(Benefit) provision for income taxes. We recorded a benefit for income taxes of $0.6 million in the second quarter of 2018, compared to a provision for income taxes of $3.6 million in the second quarter of 2017. The benefit for income taxes in 2018 reflects the lower federal income tax rate in effect in 2018, accelerated deductions enabled by the 2017 tax law, and the tax benefits associated with the vesting of restricted stock. We expect our effective tax rate, excluding the effect of tax benefits associated with the vesting of restricted stock, the effect of certain nondeductible merger costs, and other discrete tax adjustments, to be between 27%-28% for 2018.

Net income. Net income decreased to $5.2 million in the second quarter of 2018 from $10.3 million in the second quarter of 2017 due to the factors discussed above.

Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017

Enrollment. Average enrollments at the University increased 7% to 46,526 students for the six months ended June 30, 2018 compared to 43,399 students for the same period in 2017.

Revenues. Revenues increased 2% to $231.1 million in the six months ended June 30, 2018 from $227.6 million in the six months ended June 30, 2017, principally due to total enrollment growth of 7%, partially offset by a decline in revenue per student of 5%. The decline in revenue per student is largely attributable to students continuing on scholarship programs offered in fall 2017 and growth in lower priced graduate degree programs. Revenues for undergraduate students increased 6% in the six months ended June 30, 2018, driven by an increase in total undergraduate enrollment of 10%, partially offset by a decline in revenue per student of 4%. We expect this decline in revenue per student to continue at the undergraduate level as we enroll more new undergraduate students. For graduate students, revenues decreased 10% in 2018, driven by a decline in total graduate enrollment of 1% and a decline in revenue per student of 8%.

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Instruction and educational support expenses. Instruction and educational support expenses increased $3.4 million, or 3%, to $128.5 million in the six months ended June 30, 2018 from $125.1 million in the six months ended June 30, 2017, principally due to increases in student materials costs, depreciation expense following recent infrastructure investments, and bad debt expense. Instruction and educational support expenses as a percentage of revenues increased to 55.6% in the six months ended June 30, 2018 from 54.9% in the six months ended June 30, 2017.

Marketing expenses. Marketing expenses increased $3.3 million, or 9%, to $41.2 million in the six months ended June 30, 2018 from $37.9 million in the six months ended June 30 2017, principally due to increased investments in branding initiatives. Marketing expenses as a percentage of revenues increased to 17.8% in the six months ended June 30, 3018 from 16.7% in the six months ended June 30, 2017.

Admissions advisory expenses. Admissions advisory expenses decreased $0.2 million, or 2%, to $9.3 million in the six months ended June 30, 2018 from $9.5 million in the six months ended June 30, 2017, primarily due to decreased personnel costs. Admissions advisory expenses as a percentage of revenues decreased to 4.0% in the six months ended June 30, 2018 from 4.2% in the six months ended June 30, 2017.

General and administration expenses. General and administration expenses decreased $2.5 million, or 10%, to $22.3 million in the six months ended June 30, 2018 from $24.8 million in the six months ended June 30, 2017. General and administration expenses as a percentage of revenues decreased to 9.6% in the six months ended June 30, 2018 from 10.9% in the six months ended June 30, 2017.

Merger costs. Merger costs were $8.2 million in the six months ended June 30, 2018 and reflect expenses for legal, accounting, and integration support services incurred by the Company in connection with its merger with Capella.

Fair value adjustments. In the six months ended June 30, 2018, we recorded a goodwill impairment loss of $2.8 million and an intangible asset impairment loss of $3.4 million based on an impairment analysis performed during the period. Refer to Footnote 7 – Goodwill and Intangible Assets of the footnotes to the unaudited consolidated financial statements for further discussion of these impairment charges. In the six months ended June 30, 2017, we recorded a benefit of $2.3 million to reduce the value of contingent consideration payable to the sellers of NYCDA, offset by a charge of $0.3 million to increase our liability for leases on facilities no longer in use.

Income from operations. Income from operations was $15.5 million in the six months ended June 30, 2018 compared to $32.3 million in the six months ended June 30, 2017, primarily due to the merger costs and fair value adjustments to the NYCDA trade name and goodwill incurred in the period.

Investment income and interest expense. Investment income increased to $1.1 million in the six months ended June 30, 2018 compared to $0.4 million in the six months ended June 30, 2017 as a result of higher yields and an increase in our cash balances. Interest expense was $0.3 million in both of the six months ended June 30, 2018 and 2017. We had $150.0 million available under our revolving credit facility and no borrowings outstanding as of June 30, 2018.

Provision for income taxes. Income tax expense decreased to $1.6 million in the six months ended June 30, 2018 from $11.5 million in the six months ended June 30, 2017. Our effective tax rate for the six months ended June 30, 2018 was 9.8% and was favorably impacted by the lower federal income tax rate in effect in 2018, accelerated deductions enabled by the 2017 tax law, and by tax benefits associated with the vesting of restricted stock. Our effective tax rate excluding these adjustments and the effect of certain nondeductible merger costs and the reduction of goodwill related to NYCDA was 27.5% for the six months ended June 30, 2018, compared to 39.5% for the same period in 2017.

Net income. Net income decreased $6.2 million to $14.7 million in the six months ended June 30, 2018 from $20.9 million in the six months ended June 30, 2017 due to factors discussed above.

Liquidity and Capital Resources

At June 30, 2018, we had cash and cash equivalents of $171.6 million compared to $155.9 million at December 31, 2017 and $147.9 million at June 30, 2017. At June 30, 2018, most of our cash was held in demand deposit accounts at high credit quality financial institutions.

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We are party to a credit agreement which provides for a $150 million revolving credit facility and an option to establish incremental term loans under certain conditions. The credit agreement has a maturity date of July 2, 2020. We had no borrowings outstanding under the revolving credit facility during each of the six months ended June 30, 2017 and 2018.

Borrowings under the revolving credit facility bear interest at LIBOR or a base rate, plus a margin ranging from 1.75% to 2.25%, depending on our leverage ratio. An unused commitment fee ranging from 0.25% to 0.35%, depending on our leverage ratio, accrues on unused amounts under the revolving credit facility. During the three months ended June 30, 2018 and 2017, we paid unused commitment fees of $0.2 million and $0.3 million, respectively. We were in compliance with all applicable covenants related to the credit agreement as of June 30, 2018.

Our net cash from operating activities for the six months ended June 30, 2018 decreased slightly to $30.0 million, as compared to $32.8 million for the same period in 2017. The decrease in net cash from operating activities was largely due to the decline in net income in the period.

Capital expenditures were $8.6 million for the six months ended June 30, 2018, compared to $8.4 million for the same period in 2017.

The Board of Directors declared a quarterly dividend of $0.25 per common share for each of the first two quarters of 2018. During the six months ended June 30, 2018, we paid a total of $5.8 million in cash dividends on our common stock. For the six months ended June 30, 2018, we did not repurchase any shares of common stock and, at June 30, 2018, had $70 million in repurchase authorization to use through December 31, 2018.

For the second quarter of 2018, bad debt expense as a percentage of revenue was 5.8% compared to 4.5% for the second quarter of 2017.

We believe that existing cash and cash equivalents, cash generated from operating activities, and if necessary, cash borrowed under our revolving credit facility, will be sufficient to meet our requirements for at least the next 12 months. Currently, we maintain our cash in mostly demand deposit bank accounts and money market funds, which is included in cash and cash equivalents at June 30, 2018 and 2017. During the six months ended June 30, 2018 and 2017, we earned interest income of $1.1 million and $0.4 million, respectively.

The table below sets forth our contractual commitments associated with operating leases, excluding subleases as of June 30, 2018 (in thousands):

	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating leases	$ 101,291	$ 29,627	$ 44,334	$ 18,198	$ 9,132

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ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to the impact of interest rate changes and may be subject to changes in the market values of our future investments. We invest our excess cash in bank overnight deposits, money market funds and marketable securities. We have not used derivative financial instruments in our investment portfolio. Earnings from investments in bank overnight deposits, money market mutual funds, and marketable securities may be adversely affected in the future should interest rates decline, although such a decline may reduce the interest rate payable on any borrowings under our revolving credit facility. Our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities that have declined in market value due to changes in interest rates. As of June 30, 2018, a 1% increase or decrease in interest rates would not have a material impact on our future earnings, fair values, or cash flows related to investments in cash equivalents or interest earning marketable securities.

Changing interest rates could also have a negative impact on the amount of interest expense we incur. On July 2, 2015, we used approximately $116 million of our existing cash and cash equivalents to prepay our term loan and terminate an interest rate swap as part of an amendment to our credit and term loan agreement. The credit agreement provides for a $150 million revolving credit facility and an option to establish incremental term loans under certain conditions. The credit agreement has a maturity date of July 2, 2020. We had no borrowings outstanding under the revolving credit facility after prepayment of the term loan facility, and as of June 30, 2018. Borrowings under the revolving credit facility bear interest at LIBOR or a base rate, plus a margin ranging from 1.75% to 2.25%, depending on our leverage ratio. An unused commitment fee ranging from 0.25% to 0.35%, depending on our leverage ratio, accrues on unused amounts under the revolving credit facility. An increase in LIBOR would affect interest expense on any outstanding balance of the revolving credit facility. For every 100 basis points increase in LIBOR, we would incur an incremental $1.5 million in interest expense per year assuming the entire $150 million revolving credit facility was utilized.

ITEM 4: CONTROLS AND PROCEDURES

a) Disclosure Controls and Procedures. The Company’s management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company’s disclosure controls and procedures as of June 30, 2018. Based upon such review, the Chief Executive Officer and Chief Financial Officer have concluded that the Company had in place, as of June 30, 2018, effective disclosure controls and procedures designed to ensure that information required to be disclosed by the Company (including consolidated subsidiaries) in the reports it files or submits under the Securities Exchange Act of 1934, as amended, and the rules thereunder, is recorded, processed, summarized and reported within the time periods specified in the Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in reports it files or submits under the Securities Exchange Act is accumulated and communicated to the Company’s management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

b) Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

You should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017, which could materially affect our business, adversely affect the market price of our common stock and could cause you to suffer a partial or complete loss of your investment. There have been no material changes to the risk factors previously described in Part I, "Item 1A. Risk Factors" included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The risks described in our Annual Report on Form 10-K, are not the only risks facing the Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also could materially adversely affect our business. See "Cautionary Notice Regarding Forward-Looking Statements."

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

During the three months ended June 30, 2018, we did not repurchase any shares of common stock under our repurchase program. The remaining authorization for our common stock repurchases was $70.0 million as of June 30, 2018, and is available for use through December 31, 2018.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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Item 6. Exhibits

2.1	Agreement and Plan of Merger, dated as of October 29, 2018, by and among Capella Education, Company, Strayer Education, Inc. and Sarg Sub Inc. (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K (File No. 000-21039) filed with the Commission on October 30, 2017).
3.1	Articles of Amendment and Restatement of the Company, filed with the State Department of Assessments and Taxation of the State of Maryland on July 31, 2018 and effective on August 1, 2018 (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K (File No. 000-21039) filed with the Commission on August 1, 2018).
3.2	Amended and Restated Bylaws of the Company, as effective on August 1, 2018 (incorporated by reference to Exhibit 3.2 of the Company's Current Report on Form 8-K (File No. 000-21039) filed with the Commission on August 1, 2018).
10.1	Employment Agreement, dated as of February 28, 2018, between Strayer University, LLC and Brian W. Jones. (incorporated by reference to Exhibit 10.1 of the Company's Quarterly Report on Form 10-Q (File No. 000-21039) filed with the Commission on May 3, 2018).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.	INS XBRL Instance Document
101.	SCH XBRL Schema Document
101.	CAL XBRL Calculation Linkbase Document
101.	DEF XBRL Definition Linkbase Document
101.	LAB XBRL Label Linkbase Document
101.	PRE XBRL Presentation Linkbase Document

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SIGNATURES

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

STRATEGIC
EDUCATION, INC.

By: /s/ Daniel W. Jackson
Daniel W. Jackson
Executive Vice President
and Chief Financial Officer
Date: August 1, 2018