CAPELLA EDUCATION CO
Form 10-Q
July 28, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015
or

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

For the transition period from to
Commission File Number: 001-33140

CAPELLA EDUCATION COMPANY
(Exact name of registrant as specified in its charter)

Minnesota (State or other jurisdiction of incorporation or organization)	41-1717955 (I.R.S. Employer Identification No.)
Capella Tower 225 South Sixth Street, 9th Floor Minneapolis, Minnesota (Address of principal executive offices)	55402 (Zip Code)

(888) 227-3552
(Registrant’s telephone number, including area code)

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

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 x No o

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

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

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

The total number of shares of common stock outstanding as of July 23, 2015 was 12,067,097.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CAPELLA EDUCATION COMPANY
Consolidated Balance Sheets
(In thousands, except par value)

	As of June 30, 2015 (Unaudited)	As of December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$102,654	$94,003
Marketable securities, current	27,661	29,619
Accounts receivable, net of allowance of $5,886 at June 30, 2015 and $6,558 at December 31, 2014	16,224	17,902
Prepaid expenses and other current assets	13,289	9,007
Deferred income taxes	2,822	2,809
Total current assets	162,650	153,340
Marketable securities, non-current	46,009	43,430
Property and equipment, net	38,300	37,246
Goodwill	16,865	16,961
Intangibles, net	1,658	1,927
Other assets	1,508	1,453
Total assets	$266,990	$254,357
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$5,276	$6,832
Accrued liabilities	35,123	23,410
Dividends payable	4,667	4,622
Income taxes payable	—	709
Deferred revenue	12,163	11,718
Total current liabilities	57,229	47,291
Deferred rent	2,083	2,440
Other liabilities	2,909	3,698
Deferred income taxes	5,473	5,894
Total liabilities	67,694	59,323
Shareholders' equity:		
Common stock, $0.01 par value: Authorized shares — 100,000; Issued and Outstanding shares — 12,117 at June 30, 2015 and 12,243 at December 31, 2014	121	122
Additional paid-in capital	114,687	112,417
Accumulated other comprehensive loss	(269)	(335)
Retained earnings	84,757	82,830
Total shareholders' equity	199,296	195,034
Total liabilities and shareholders' equity	$266,990	$254,357

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

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CAPELLA EDUCATION COMPANY
Consolidated Statements of Income
(In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(Unaudited)			
Revenues	$108,007	$104,832	$217,081	$210,428
Costs and expenses:				
Instructional costs and services	47,369	45,530	94,430	92,830
Marketing and promotional	25,798	23,113	53,298	48,874
Admissions advisory	7,353	7,146	14,557	14,073
General and administrative	10,372	10,889	20,901	21,354
Lease amendment charges	—	2,690	—	2,690
Total costs and expenses	90,892	89,368	183,186	179,821
Operating income	17,115	15,464	33,895	30,607
Other income (expense), net	54	(171)	(92)	(513)
Income before income taxes	17,169	15,293	33,803	30,094
Income tax expense	6,838	6,249	13,435	12,233
Net income	$10,331	$9,044	$20,368	$17,861
Net income per common share:				
Basic	$0.85	$0.74	$1.67	$1.45
Diluted	$0.83	$0.72	$1.64	$1.42
Weighted average number of common shares outstanding:				
Basic	12,187	12,293	12,207	12,317
Diluted	12,400	12,518	12,442	12,564
Cash dividends declared per common share	$0.37	$0.35	$0.74	$0.70

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

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CAPELLA EDUCATION COMPANY
Consolidated Statements of Comprehensive Income
(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	(Unaudited)			
Net income	$10,331	$9,044	$20,368	$17,861
Other comprehensive income (loss):				
Foreign currency translation gain (loss)	(42)	(228)	71	(504)
Unrealized gains (losses) on available for sale securities, net of tax	(39)	44	(5)	17
Comprehensive income	$10,250	$8,860	$20,434	$17,374

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

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CAPELLA EDUCATION COMPANY
Consolidated Statements of Cash Flows
(In thousands)

	Six Months Ended June 30, 2015 (Unaudited)	2014
Operating activities		
Net income	$20,368	$17,861
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for bad debts	6,311	6,900
Depreciation and amortization	11,233	12,056
Amortization of investment discount/premium, net	1,134	817
Impairment of property and equipment	—	277
Loss on disposal of property and equipment	27	70
Share-based compensation	3,894	2,758
Excess tax benefits from share-based compensation	(400)	(392)
Deferred income taxes	(460)	(574)
Payment of contingent consideration	—	(906)
Changes in operating assets and liabilities:		
Accounts receivable	(4,674)	(4,550)
Prepaid expenses and other current assets	(2,918)	(235)
Accounts payable and accrued liabilities	8,290	(60)
Income taxes payable	(2,116)	605
Deferred rent	(357)	(505)
Deferred revenue	585	(273)
Net cash provided by operating activities	40,917	33,849
Investing activities		
Capital expenditures	(12,343)	(10,814)
Investment in partnership interest	(57)	(1,063)
Purchases of marketable securities	(18,246)	(42,093)
Maturities of marketable securities	16,485	6,975
Net cash used in investing activities	(14,161)	(46,995)
Financing activities		
Excess tax benefits from share-based compensation	400	392
Net proceeds from exercise of stock options	1,087	1,638
Payment of dividends	(9,065)	(8,659)
Repurchases of common stock	(10,493)	(9,926)
Payment of contingent consideration	—	(5,945)
Net cash used in financing activities	(18,071)	(22,500)
Effect of foreign exchange rates on cash	(34)	4
Net increase (decrease) in cash and cash equivalents	8,651	(35,642)
Cash and cash equivalents at beginning of period	94,003	124,097
Cash and cash equivalents at end of period	$102,654	$88,455
Supplemental disclosures of cash flow information		
Income taxes paid	$15,987	$12,539
Noncash transactions:		
Purchase of equipment included in accounts payable and accrued liabilities	$585	$1,988
Declaration of cash dividend to be paid	$4,561	$4,354
Repurchases of common stock included in accrued liabilities	$499	$—

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

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CAPELLA EDUCATION COMPANY
Notes to Consolidated Financial Statements
(Unaudited)

1. Nature of Business

Capella Education Company (the Company) was incorporated on December 27, 1991, and is the parent company of its wholly owned subsidiaries, Capella University (the University), Resource Development International Limited (RDI), Sophia Learning, LLC (Sophia), and Capella Learning Solutions (CLS). The University, founded in 1993, is an online postsecondary education services company offering a variety of bachelor's, master's and doctoral degree programs primarily delivered to working adults. The University is accredited by the Higher Learning Commission and is a member of the North Central Association of Colleges and Schools. In 2011, the Company acquired RDI, which is an independent provider of United Kingdom (UK) university distance learning qualifications that markets, develops and delivers programs worldwide via its offices and partners across Asia, North America, Africa and Europe. Sophia is an innovative learning platform leveraging technology to support self-paced learning, including credits eligible for transfer to nearly 2,000 colleges and universities. CLS provides online training solutions and services to corporate partners which are delivered through the Company's online learning platform. With the Company's focus on academic quality in an online delivery format, it has one reporting segment.

2. Summary of Significant Accounting Policies

Consolidation
The consolidated financial statements include the accounts of the Company, the University, CLS, RDI and its subsidiaries, and Sophia, after elimination of intercompany accounts and transactions. RDI operates on a fiscal year ending October 31, which is also the date used for consolidation.

Unaudited Interim Financial Information
The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, these statements include all adjustments (consisting of normal recurring adjustments) considered necessary to present a fair statement of the Company's consolidated results of operations, financial position and cash flows. Operating results for any interim period are not necessarily indicative of the results that may be expected for the full year. Preparation of the Company’s financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and footnotes. Actual results could differ from those estimates. This Quarterly Report on Form 10-Q should be read in conjunction with the Company’s consolidated financial statements and footnotes included in its Annual Report on Form
10-K for the fiscal year ended December 31, 2014 (2014 Annual Report on Form 10-K).

Refer to the Company’s “Summary of Significant Accounting Policies” footnote included within the 2014 Annual Report on Form 10-K for a complete summary of the Company’s significant accounting policies.

3. Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-03, Simplifying the Presentation of Debt Issuance Costs, which is included in Accounting Standards Codification (ASC) 470, Debt. The guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The guidance will be effective for the Company's annual reporting period beginning January 1, 2016, and applied on a retrospective basis; early adoption is also permitted. The Company does not expect adoption of this guidance to have a material impact on its financial condition, results of operations, or disclosures.

In February 2015, the FASB issued ASU No. 2015-02, Amendments to the Consolidation Analysis, which is included in ASC 810, Consolidation. This update changes the guidance with respect to the analyses that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The new guidance affects the following areas: (1) limited partnerships and similar legal entities, (2) evaluating fees paid to a decision maker or a service provider as a variable interest, (3) the effect of fee arrangements on the primary beneficiary determination, (4) the effect of related parties on the primary beneficiary determination, and (5) certain

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investment funds. The guidance will be effective for the Company's interim and annual reporting periods beginning January 1, 2016. The standard allows the Company to transition to the new model using either a full or modified retrospective approach, and early adoption is permitted. The Company is currently evaluating the impact this standard will have on its business practices, financial condition, results of operations, and disclosures.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entities Ability to Continue as a Going Concern, which is included in ASC 205, Presentation of Financial Statements. This update provides an explicit requirement for management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosure in certain circumstances. The guidance will be effective for the Company's annual reporting period beginning January 1, 2017, and applied prospectively; early adoption is also permitted. The Company does not expect adoption of this guidance to have a material impact on its financial condition, results of operations, or disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which is included in ASC 606, Revenue from Contracts with Customers. This ASU is a comprehensive new revenue recognition model that creates a single source of revenue guidance for all companies in all industries. The model is more principles-based than current guidance, and is primarily based on recognizing revenue at an amount that reflects consideration to which the entity expects to be entitled to in exchange for transferring goods or services to a customer. The standard allows the Company to transition to the new model using either a full or modified retrospective approach. Under the original ASU, the guidance was effective for the Company's interim and annual reporting periods beginning January 1, 2017, and early adoption was not permitted. In July 2015, the FASB voted to defer the effective date of the new revenue standard for public entities by one year. As a result, the guidance will be effective for the Company's interim and annual reporting periods beginning January 1, 2018, and early adoption is permitted as of the original effective date contained within the original standard. The Company is still evaluating the impact this standard will have on its business practices, financial condition, results of operations, and disclosures.

The Company has reviewed and considered all other recent accounting pronouncements and believes there are none that could potentially have a material impact on its business practices, financial condition, results of operations, or disclosures.

4. Net Income per Common Share

Basic net income per common share is based on the weighted average number of shares of common stock outstanding during the period. Dilutive shares are computed using the Treasury Stock method and include the incremental effect of shares that would be issued upon the assumed exercise of stock options, settlement of restricted stock, and satisfaction of service conditions for market stock units.
The following table presents a reconciliation of the numerator and denominator in the basic and diluted net income per common share calculation, in thousands, except per share data:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Numerator:				
Net income	$10,331	$9,044	$20,368	$17,861
Denominator:				
Denominator for basic net income per common share— weighted average shares outstanding	12,187	12,293	12,207	12,317
Effect of dilutive stock options, restricted stock, and market stock units	213	225	235	247
Denominator for diluted net income per common share— weighted average shares outstanding	12,400	12,518	12,442	12,564
Basic net income per common share	$0.85	$0.74	$1.67	$1.45

Diluted net income per common share	$0.83	$0.72	$1.64	$1.42

Options to purchase common shares were outstanding, but not included in the computation of diluted net income per common share, because their effect would be anti-dilutive. The following table summarizes these securities, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Anti-dilutive securities excluded from diluted earnings per share calculation	311	239	272	204

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5. Marketable Securities

The following is a summary of available-for-sale securities, in thousands:

	As of June 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Tax-exempt municipal securities	$66,341	$16	$(60)	$66,297
Corporate debt securities	7,372	4	(3)	7,373
Total	$73,713	$20	$(63)	$73,670

	As of December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Tax-exempt municipal securities	$65,708	$31	$(71)	$65,668
Corporate debt securities	7,379	4	(2)	7,381
Total	$73,087	$35	$(73)	$73,049

The unrealized gains and losses on the Company’s investments in municipal and corporate debt securities as of June 30, 2015 and December 31, 2014 were caused by changes in market values primarily due to interest rate changes. All of the Company's securities which were in an unrealized loss position as of June 30, 2015 had been in an unrealized loss position for less than twelve months. The Company does not intend to sell these securities, and it is not more likely than not that the Company will be required to sell these securities prior to the recovery of their amortized cost basis, which may be maturity. No other-than-temporary impairment charges were recorded during the three and six months ended June 30, 2015 and 2014.
The following table summarizes the remaining contractual maturities of the Company’s marketable securities, in thousands:

	As of June 30, 2015	As of December 31, 2014
Due within one year	$27,661	$29,619
Due after one year through five years	46,009	43,430
Total	$73,670	$73,049

The following table summarizes the proceeds from the maturities of available-for-sale securities, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Maturities of marketable securities	$9,505	$4,175	$16,485	$6,975
Total	$9,505	$4,175	$16,485	$6,975

The Company did not record any gross realized gains or gross realized losses in net income during the three and six months ended June 30, 2015 and 2014. Additionally, there were no proceeds from sales of marketable securities prior to maturity during the three and six months ended June 30, 2015 and 2014.

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6. Fair Value Measurements

The following tables summarize certain information for assets and liabilities measured at fair value on a recurring basis, in thousands:

	Fair Value Measurements as of June 30, 2015 Using			
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents:				
Cash	$52,745	$ 52,745	$—	$—
Money market funds	49,909	49,909	—	—
Marketable securities:				
Tax-exempt municipal securities	66,297	—	66,297	—
Corporate debt securities	7,373	—	7,373	—
Total assets at fair value on a recurring basis	$176,324	$ 102,654	$73,670	$—

	Fair Value Measurements as of December 31, 2014 Using			
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents:				
Cash	$64,004	$64,004	$—	$—
Money market funds	29,999	29,999	—	—
Marketable securities:				
Tax-exempt municipal securities	65,668	—	65,668	—
Corporate debt securities	7,381	—	7,381	—
Total assets at fair value on a recurring basis	$167,052	$94,003	$73,049	$—

The Company measures cash and cash equivalents at fair value primarily using real-time quotes for transactions in active exchange markets involving identical assets. The Company’s marketable securities are classified within Level 2 and are valued using readily available pricing sources for comparable instruments utilizing market observable inputs. The Company does not hold securities in inactive markets. The Company did not have any transfers of assets between Level 1 and Level 2 of the fair value measurement hierarchy during the three and six months ended June 30, 2015 and 2014.

The Company did not have any liabilities requiring fair value measurement as of June 30, 2015.

Level 3 Measurements

RDI Contingent Consideration

In connection with the acquisition of RDI, the Company was required to make an additional payment to the former shareholders of RDI when RDI was awarded Taught Degree Awarding Powers (TDAP) by the British government.

On April 14, 2014, RDI received notice from the British government that it had successfully been awarded TDAP. TDAP enables RDI to independently validate its own degrees under the auspices of the Quality Assurance Agency, a government body that reviews the standards and quality of all UK universities. Pursuant to the terms of the acquisition agreement in 2011, the Company made an additional payment of £4.0 million (approximately $6.9 million) to the former shareholders of RDI on May 12, 2014.

Prior to payment, the contingent consideration was classified as a liability under ASC 805, Business Combinations (ASC 805), which required the Company to re-measure the liability at fair value at each reporting date until it was extinguished. The

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Company classified the RDI contingent consideration liability within Level 3 of the fair value measurement hierarchy as its fair value was determined using inputs not readily observable in the market.

The following table presents a reconciliation of the fair value of the RDI contingent consideration, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Balance, beginning of period	$—	$6,629	$—	$6,304
Increase in RDI contingent consideration liability	—	222	—	547
Payment of RDI contingent consideration liability	—	(6,851)	—	(6,851)
Balance, end of period	$—	$—	$—	$—

The change in the fair value of the RDI contingent consideration liability was recorded in other expense, net in the consolidated statements of income during the three and six months ended June 30, 2014.

7. Accrued Liabilities

Accrued liabilities consist of the following, in thousands:

	As of June 30, 2015	As of December 31, 2014
Accrued compensation and benefits	$11,072	$7,482
Accrued instructional	5,644	4,361
Accrued vacation	2,045	1,234
Accrued invoices	13,318	8,238
Other(1)	3,044	2,095
Total	$35,123	$23,410

(1) "Other" consists primarily of the current portion of deferred rent, customer deposits, and other miscellaneous accruals.

8. Commitments and Contingencies

Operating Leases

The Company leases its office facilities and certain office equipment under various noncancelable operating leases. Effective August 29, 2011, the Company entered into an amendment of its lease with Minneapolis 225 Holdings, LLC pursuant to which the Company renewed and extended its existing lease for premises at 225 South Sixth Street in Minneapolis, Minnesota through October 31, 2018. Renewal terms under this lease allow the Company to extend the lease for up to two additional five-year terms.

On April 3, 2014, the Company accepted notice to activate an amendment to this lease. Pursuant to the amendment, in June 2014, the Company returned 54,940 square feet of its previously leased space of 426,165 square feet. Employees located in this area were relocated to other areas within the Company's remaining space. The Company recorded a charge of approximately $2.6 million during the three and six months ended June 30, 2014 in connection with this amendment, which is included within the lease amendment charge line item of the consolidated statements of income.

The Company also consolidated certain of its other leased office space resulting in an additional charge of $0.1 million during the six months ended June 30, 2014. This amount is included within the lease amendment charge line item of the consolidated statements of income.

The following presents the Company's future minimum lease commitments as of June 30, 2015, in thousands:

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2015	$3,114
2016	6,172
2017	5,945
2018	4,876
2019	—
2020 and thereafter	—
Total	$20,107

The Company recognizes rent expense on a straight-line basis over the term of the lease, although the lease may include escalation clauses providing for lower payments at the beginning of the lease term and higher payments at the end of the lease term. Cash or lease incentives received from lessors are recognized on a straight-line basis as a reduction of rent expense from the date the Company takes possession of the property through the end of the lease term. The Company records the unamortized portion of the incentive as a component of deferred rent, in accrued liabilities or long-term liabilities, as appropriate.

Revolving Credit Facility

On September 30, 2011, the Company entered into an unsecured revolving credit agreement (the Credit Agreement) with Bank of America, N.A., and certain other lenders. The Credit Agreement provides $100.0 million of borrowing capacity (the credit facility), with an increase option of an additional $50.0 million. The Credit Agreement expires on September 30, 2016.

Borrowings under the Credit Agreement bear interest at a rate equal to the London Interbank Offered Rate (LIBOR) plus an applicable rate of 1.75% to 2.25% based on the Company’s consolidated leverage ratio or, at the Company’s option, an alternative base rate (defined as the higher of (a) the federal funds rate plus 0.5%; (b) Bank of America’s prime rate; or (c) the one-month LIBOR plus 1.0%) plus an applicable rate of 0.75% to 1.25% based on the Company’s consolidated leverage ratio. The Credit Agreement requires payment of a commitment fee, based on the Company’s consolidated leverage ratio, charged on the unused credit facility. The Company recorded commitment fee expenses of $0.1 million and $0.2 million in other income (expense), net, for the three months ended June 30, 2015 and 2014, and the six months ended June 30, 2015 and 2014, respectively. Outstanding letters of credit are also charged a fee, based on the Company’s consolidated leverage ratio. The Company capitalized approximately $0.5 million of debt issuance costs related to the credit facility, which are being amortized on a straight-line basis over a period of five years. The remaining unamortized portion of debt issuance costs are not significant. Interest expense for the amortization of debt issuance costs is recorded in other expense, net.

The Credit Agreement contains certain covenants that, among other things, require maintenance of certain financial ratios, as defined in the agreement. Failure to comply with the covenants contained in the Credit Agreement will constitute an event of default and could result in termination of the agreement and require payment of all outstanding borrowings. As of June 30, 2015, there were no borrowings under the credit facility, and the Company was in compliance with all debt covenants.

Litigation

In the ordinary conduct of business, the Company is subject to various lawsuits and claims covering a wide range of matters including, but not limited to, claims involving learners or graduates and routine employment matters. While the outcome of these matters is uncertain, the Company does not believe there are any significant matters as of June 30, 2015 that are probable or estimable, for which the outcome could have a material adverse impact on its consolidated financial position or results of operations.

9. Share Repurchase Program and Dividends

Share Repurchase Program

The Company announced its current share repurchase program in July 2008. The Board of Directors authorizes repurchases of outstanding shares of common stock from time to time depending on market conditions and other considerations. A summary of the Company’s comprehensive share repurchase activity from the program's commencement through June 30, 2015, all of which was part of its publicly announced program, is presented below, in thousands:

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Board authorizations:	
July 2008	$60,000
August 2010	60,662
February 2011	65,000
December 2011	50,000
August 2013	50,000
Total amount authorized	285,662
Total value of shares repurchased	264,617
Residual authorization	$21,045

The following table summarizes shares repurchased, in thousands:

	Six Months Ended June 30,	
	2015	2014
Shares repurchased	184	166
Total consideration, excluding commissions	$10,987	$9,919

As of June 30, 2015, the Company had purchased an aggregate of 5.8 million shares under the program's outstanding authorizations at an average price per share of $45.40 totaling $264.6 million, excluding commissions.

Dividends

During the six months ended June 30, 2015, the Company declared the following cash dividends, in thousands except per share amounts:

Declaration Date	Record Date	Payment Date	Dividend per Share	Total Dividend Amount
February 19, 2015	March 12, 2015	April 15, 2015	$0.37	$4,580
May 5, 2015	June 3, 2015	July 15, 2015	$0.37	$4,561

During the three months ended June 30, 2015, the dividend of $0.37 per outstanding share of common stock declared on May 5, 2015 was recorded as a reduction to retained earnings. Of the total dividend amount declared in the current quarter, $4.5 million is attributable to shares of common stock outstanding as of the record date and restricted stock units (RSUs) expected to vest in the next twelve months. This amount, along with the portion of dividends declared in prior quarters related to unvested RSUs, is included within dividends payable in the Company's consolidated balance sheet as of June 30, 2015. The remaining balance is attributable to dividends declared on restricted stock units expected to vest subsequent to the next twelve months and is classified as other liabilities in the Company's consolidated balance sheet as of June 30, 2015. Dividends declared on RSUs are forfeitable prior to vesting. All future dividends are subject to declaration by the Company's Board of Directors and may be adjusted due to future business needs or other factors deemed relevant by the Board of Directors.

10. Share-Based Compensation

The table below reflects the Company's share-based compensation expense recognized in the consolidated statements of income, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Instructional costs and services	$199	$60	$427	$308
Marketing and promotional	132	(46)	269	47
Admissions advisory	11	16	18	30
General and administrative	1,815	1,281	3,180	2,373
	2,157	1,311	3,894	2,758

Share-based compensation expense included in operating income				
Tax benefit from share-based compensation expense	809	325	1,452	839
Share-based compensation expense, net of tax	$1,348	$986	$2,442	$1,919

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11. Acquisitions and Other Investments

At June 30, 2015, the Company held a $1.5 million investment in a limited partnership, with a commitment to invest up to an additional $3.5 million through February 2024. During the six months ended June 30, 2015, the Company made investments totaling $57 thousand in the partnership. The partnership invests in innovative companies in the health care field. The Company's investment comprises less than 3.0% of the total partnership interest; accordingly, the Company designated the investment as a cost method investment and classified it within other assets in the consolidated balance sheets as of June 30, 2015 and December 31, 2014.

12. Accumulated Other Comprehensive Loss

The following table summarizes the components of accumulated other comprehensive loss, in thousands:

	Foreign Currency Translation Loss	Unrealized Loss on Marketable Securities	Accumulated Other Comprehensive Loss[1]
Beginning balance, December 31, 2014	$(311)	$(24)	$(335)
Other comprehensive income (loss)	71	(5)	66
Ending balance, June 30, 2015	$(240)	$(29)	$(269)

(1) Accumulated other comprehensive loss is presented net of tax of $14 thousand and $14 thousand as of June 30, 2015 and December 31, 2014, respectively.

There were no reclassifications out of accumulated other comprehensive loss to net income for the three and six months ended June 30, 2015 and 2014.

13. Regulatory Supervision and Oversight

Political and budgetary concerns can significantly affect the Title IV Programs. Congress reauthorizes the Higher Education Act (HEA) and other laws governing Title IV Programs approximately every five to eight years. The last reauthorization of the HEA was completed in August 2008. Additionally, Congress reviews and determines appropriations for Title IV programs on an annual basis through the budget and appropriations processes. As of June 30, 2015, Title IV programs in which the University's learners participate are operative and sufficiently funded.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our historical results of operations and our liquidity and capital resources should be read in conjunction with the consolidated financial statements and related notes that appear elsewhere in this report.

Forward-Looking Statements
Statements contained in this Quarterly Report on Form 10-Q that are not statements of historical fact should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the “Act”). In addition, certain statements in our future filings with the Securities and Exchange Commission (SEC), in press releases, and in oral and written statements made by us that are not statements of historical fact constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to, statements regarding: proposed new programs; regulatory developments; projections, predictions, expectations, estimates or forecasts of our business, financial and operational results and future economic performance; and statements of management’s goals and objectives and other similar expressions concerning matters that are not historical facts. Words such as “may,” “should,” “could,” “would,” “predict,” “potential,” “continue,” “expect,” “a “future,” “intend,” “plan,” “believe,” “estimate,” "confident," and similar expressions, as well as statements in future tense, are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties which may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those suggested by the forward-looking statements include, but are not limited to, those described in “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014, as updated in our subsequent reports filed with the SEC, including any updates or circumstances described in this or other Quarterly Reports on Form 10-Q. The performance of our business and our securities may be adversely affected by these factors and other factors common to businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risks. Therefore, you should consider these risk factors with caution and form your own independent conclusions about the likely effect of these risks on our future performance. Forward-looking statements speak only as of the date on which statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review all the disclosures and risk factors described in this and other documents we file from time to time with the SEC.

Executive Overview
We are an online postsecondary education services company. As of June 30, 2015, our wholly owned subsidiaries included the following:

- Capella University (the University) is a regionally accredited university that offers a variety of undergraduate and graduate degree programs for working adult professionals.
- Resource Development International Limited (RDI) is an independent provider of United Kingdom (UK) university distance learning qualifications that markets, develops and delivers these programs worldwide via its offices and partners across Asia, North America, Africa and Europe.
- Sophia Learning, LLC (Sophia) is an innovative learning platform leveraging technology to support self-paced learning, including credits eligible for transfer to nearly 2,000 college and universities.
- Capella Learning Solutions (CLS) provides online training solutions and services to corporate partners which are delivered through Capella's online learning platform.

We believe we have the right operating strategies in place to continually differentiate ourselves in our markets and drive growth
by supporting learner success, producing affordable degrees, optimizing our comprehensive marketing strategy, serving a

broader set of our learner's professional needs, and establishing new growth platforms. Technology and the talent of our faculty
and employees enable these strategies. We believe these strategies and enablers will allow us to continue to deliver high quality,
affordable education, resulting in continued growth over the long-term. We will continue to invest in these enablers to strengthen the foundation and future of our business.

Key Trends, Developments and Challenges

The following developments and trends present opportunities, challenges and risks toward achieving our goal of providing attractive returns to our shareholders:

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- Innovation. We operate in a very competitive market environment. While we have demonstrated that we can effectively compete and differentiate in our market, we will need to continue to innovate. This includes investing to leverage our competency-based learning infrastructure to develop new academic models such as FlexPath and new business models to drive long-term results. We will need to balance investments that may put pressure on near-term operating income performance with our goal to achieve operating performance improvements and deliver short-and long-term shareholder value.

- Enrollment and persistence. New enrollment and learner persistence improvements are key drivers for total enrollment and revenue growth as well as the Company's profitability. New enrollment, while historically volatile on a quarterly basis, is an early indicator for future growth, and persistence improvement is an indicator for the sustainability of growth. In the second quarter of 2015, new enrollments grew by 2.9 percent compared to 11.1 percent in the same period in 2014. New enrollment is calculated from the last day a new learner can drop a course without financial penalty. Growth characteristics tend to differ by degree program due to different market dynamics. In the second quarter of 2015, overall new enrollment growth was led by our master's and professional doctorate programs. This was offset by year-over-year new enrollment declines in our bachelors programs, which we believe are primarily due to market conditions. New enrollment in our PhD programs also declined as a result of learner success initiatives in addition to market conditions. The primary difference between PhD and professional doctorate programs is the intent and deliverable of the independent research phase. Compared to a PhD, professional doctorate programs can sometimes offer a more affordable and direct path to the educational goals of certain professionals.The combination of new enrollment and persistence improvements continues to be key drivers behind the return to annual total enrollment and revenue growth for the Company. The Company continues its strategic focus on improving early cohort persistence, with 2014 representing the third consecutive year of improvements.

- Doctoral enrollment. During the second quarter of 2015, year-over-year doctoral total enrollment declined by 4.9 percent. It will take time for our doctoral programs to return to total enrollment growth due to a combination of factors, including the extended decision cycles for prospects at the doctoral level and stronger doctoral graduations. We are extending our learner success focus to the comprehensive and dissertation portion of our doctoral programs. Our goal is to address that segment of the learner population that is not making sufficient and timely academic progress in this phase. We expect this initiative to adversely impact our doctoral enrollments, especially in the near-term. To support the return to doctoral growth, we are focusing on redesigning our program offerings, improving affordability, and expanding our doctoral portfolio, including creating new professional doctorate programs.

- Initiatives to improve learner success. As we continue to position Capella to drive sustainable growth, we are focused on improving learner success rates particularly in the first four quarters of enrollment while maintaining a high standard of academic quality and rigor. The first four quarters of enrollment are particularly critical because learners tend to persist at a very high rate after that period. In the second quarter of 2015, we achieved a three percent improvement in early cohort persistence over the prior year. Early cohort persistence measures the four-quarter weighted moving average new cohort persistence rate during learners' first four quarters of enrollment. Going forward, we will increasingly focus on the entire learner lifecycle. Certain initiatives to improve learner success can affect our growth and profitability in the near-term. However, we believe these efforts are in the best interest of our learners and over the long-term will enhance Capella's brand and reputation, which, in turn, positions us for more sustainable long-term growth. Learner success initiatives include the following:

- Investing in our actionable analytics capabilities to further leverage data, refine our models, and accurately predict the likelihood of prospective, new, and current learners persisting to critical thresholds of success;
- Providing timely and clear information to our learners, faculty, advisors and staff to help learners persist and successfully complete their programs;
- Redesigning programs to remove barriers for learner progression and to deliver operational process efficiencies;
-

Piloting, implementing, and optimizing programs such as assessments and orientations to create personalized pathways for different learner groups which focus on transitioning learners into the online environment, creating a supportive community, and providing a proactive support structure;

- Optimizing our marketing approaches to increase emphasis on attracting learners who are more likely to persist in our programs;

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- Promoting affordability and encouraging learners to persist by offering learner success grants to new learners who meet admissions requirements, enroll, apply within certain timeframes, and stay continuously enrolled; and,
- Diversifying outside of Capella University by creating innovative new learning technologies which have potential to increase affordability and better serve the life-long learning needs of working adult professionals and therefore increase learner success.

- Comprehensive marketing strategy. During 2014, we made significant strides in shifting from a demand driven strategy towards a comprehensive marketing strategy which is focused on building relationships with prospective learners early in their decision cycle. This strategy is also designed to attract prospective learners committed to and able to succeed in their academic endeavors. The marketing strategy includes:

- Introducing prospective learners to Capella with a differentiated message in channels such as mass media and strategic relationships with employers and professional organizations,
- Connecting with prospective learners by generating and nurturing inquiries through direct media such as natural search, our website, and display media, and
- Engaging with prospective learners by developing meaningful relationships such as through social media or direct engagement.

Our comprehensive marketing strategy is designed to produce long-term efficiencies and increase our ability to attract high-quality learners on a sustainable basis. We will continue to optimize our strategy and develop our marketing analytics capabilities to continue to deliver long-term sustainable growth. Some of our initiatives may adversely impact our new enrollment, revenues, and operating margins for a period as we pursue improved long-term results. However, our return to annual total enrollment growth gives us confidence that we have the right strategy in place.

- Establishing new growth platforms. We seek to drive long-term growth that is an extension of our core competencies into new and expanded markets. One of our key growth platforms is FlexPath. In 2013, we received approval to offer a new learning model called FlexPath for two programs. In 2014, we received approval for four additional programs as we continued to test and refine the academic model and started our work on developing a sustainable business model for FlexPath. FlexPath is a new learning model that decouples from the credit-hour requirements and allows learners to complete coursework at their own pace and complete activities to demonstrate specific competencies by the end of the learner’s 12-week subscription period. This offering is unique in that Capella University was the first institution with approval from the Higher Learning Commission and the Department of Education to offer and provide Title IV funding for programs at the Bachelor's and graduate level. Only a few other universities received approvals by their accreditor and the Department of Education to offer similar programs. These approvals allow learners enrolled in FlexPath to apply for federal financial aid. We believe this direct assessment model provides an opportunity to expand our served market and drive affordability through lower tuition costs, reduced time to completion, and increased flexibility. We are making steady progress in developing FlexPath, but important work remains. Our goal is to ensure learners have the right experience and that we understand what our learners need to succeed.

In addition to benefiting FlexPath enrollments, our differentiated marketing message related to FlexPath has also accelerated new enrollment growth in certain of our credit-hour based programs. Additionally, although FlexPath is a significant component of our long-term growth strategy, the primary driver for our total enrollment growth remains our credit-hour based programs.

- Redesign of programs and specializations. We continue to evaluate our existing offerings for opportunities to drive affordability and speed to competency, enhance learner success, meet employer needs, maintain programmatic approvals and fulfill evolving regulatory standards. Utilizing our competency based curriculum mapping, we are focused on maximizing efficiencies in our existing programs while delivering even better learning and career outcomes.

- RDI performance. In July 2011, we acquired RDI, which is serving the fast-growing online international higher education market. RDI has a presence in the UK and certain other regions. Although the acquisition has had a positive impact on our revenue growth, RDI has been dilutive to our earnings since the acquisition date and is expected to be dilutive to our earnings throughout the remainder of 2015. If this trend continues and operating

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improvements are not realized, some or all of the goodwill associated with the RDI reporting unit could become impaired in the future. We believe the fair value of the RDI reporting unit remains in excess of the carrying value as of June 30, 2015. Management will assess goodwill for impairment in the fourth quarter of 2015, or earlier 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.

Regulatory Environment

The following summarizes significant regulatory matters applicable to our business. For a more detailed discussion of the regulatory environment and related risks, refer to Part 2, Item 7, Key Trends, Developments and Challenges, and Regulatory Environment in our 2014 Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

- U.S. Legislation and Congressional Activity. In recent years, there has been increased focus by members of the U.S. Congress on the role that proprietary educational institutions play in higher education. Congressional hearings and roundtable discussions have been held, and more are expected to be held in the future, regarding various aspects of the education industry including federal financial aid and military education funding that may result in regulatory changes that affect our business. We have voluntarily provided substantial amounts of information about our business at the request of various Congressional committees and individual members, and we intend to continue being responsive to Congress in this regard.

We cannot predict what legislation, if any, may emanate from Congressional committee hearings or what impact such legislation might have on proprietary institutions and our business in particular. Congressional scrutiny of proprietary institutions increases the likelihood of legislation that will adversely impact our business. In addition, when Congress addresses federal budget deficits, financial aid programs are a potential target for reduction.

If Congress reduced the amount of available Title IV program funding, we would attempt to arrange for alternative sources of financial aid for our students, but private sources would not be able to provide as much funding to our students or on terms comparable to Title IV. In addition, private funding sources could require us to guarantee all or part of this assistance and we might incur other additional costs. For these reasons, private, alternative sources of student financial aid would only partly offset, if at all, the impact on our business of reduced Title IV program funding, and would not be a practical alternative in the case of a significant reduction in Title IV financial aid.

- College Rating System. On December 19, 2014, the U.S. Department of Education released a draft of a College Ratings Framework which was intended to serve as a discussion document on the best way to measure access, affordability and outcomes. These metrics included, but were not limited to: Percentage of students receiving Pell; Expected family contribution; Family Income Quintiles; First-Generation College Status; Average Net Price; Net Price by Quintile; Completion Rates; transfer rates; Labor Market Success, such as Short-term "Substantial Employment" Rates and Long-term Median Earnings; Graduate School Attendance; and Loan Performance Outcomes. The Department requested feedback by February 17, 2015 with the expressed goal of having a rating system in place by the end of 2015. On June 25, 2015, the Department of Education announced that it no longer intends to introduce a college ratings system and instead will create a consumer facing tool for students and families.

- Gainful Employment. The Department of Education published a final rule on October 30, 2014 that went into effect on July 1, 2015. Litigation surrounding this rule has been unsuccessful as the U.S. District Court for the District of Colombia found in favor of the Department of Education on June 23, 2015. The plaintiff announced on July 2, 2015 that it would appeal the District Court decision. The final rule applies to all Gainful Employment (GE) programs, which include non-degree programs at public and private non-profit institutions, and all programs offered by for-profit institutions. The rule establishes a “debt-to-earnings” ratio that GE programs must satisfy to remain eligible for Title IV federal student aid. The final rule also requires institutions to provide certifications regarding a GE program’s satisfaction of programmatic accreditation and state licensure requirements as part of the institutional program participation agreements with the Department of Education. The certification requirements are scheduled to become effective December 31, 2015 in connection with the Department of Education's program participation agreement recertification. We are awaiting the new program participation agreement language and are working with the Department to clarify other issues related to the new certification requirements. Additionally, the final rule includes requirements for the reporting of student and program data by institutions to the Department of Education, and expands the disclosure requirements that have been in effect since July 1, 2011. The rule makes other conforming and technical revisions to the Title IV program participation agreement and related regulations. Refer to the more detailed discussion of recent rulemaking and regulatory activity pertaining to the area of Gainful

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Employment within the Regulatory Environment section of our 2014 Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

- Program Integrity and Improvement. On November 20, 2013, the Department of Education announced another round of negotiated rulemaking to focus on the following issues: cash management of funds provided under the Title IV Federal Student Aid programs, including the use of debit cards and the handling of Title IV credit balances; state authorization for programs offered through distance education or correspondence education; state authorization for foreign locations of institutions located in a State; clock to credit hour conversion; definition of “adverse credit” for borrowers in the Federal Direct PLUS Loan Program; and application of the repeat coursework provisions to graduate and undergraduate programs. Negotiations took place in February, March, and April, 2014. An additional session took place in May, 2014 to examine the remaining issues and take a consensus vote on the entire rule making package. The Committee did not reach consensus at this session, and the development of the draft rule shifted back to the Department of Education.

- Current negotiated rulemaking. On August 8, 2014, the Department of Education published a Notice of Proposed Rulemaking ("NPRM") on the definition of “adverse credit” for borrowers in the Federal Direct PLUS Loan Program. The NPRM reflects agreed upon language established by the negotiated rulemaking committee. The public comment period ended on September 8, 2014, and a final rule was published on October 23, 2014 establishing an effective date of July 1, 2015. No other NPRMs from this round of negotiated rulemaking have been issued. On December 19, 2014 the Department of Education announced its intention to establish a negotiated rulemaking committee to: (1) develop regulations to establish a new Pay as You Earn ("PAYE") repayment plan for those not covered by the existing Pay as You Earn Repayment Plan in the Federal Direct Loan Program; and (2) set forth procedures for Federal Family Education Loan (FFEL) Program loan holders to use in identifying U.S. military servicemembers who may be eligible to receive a lower interest rate on their FFEL Program loans. The committee met in February, March and April of 2015 and reached consensus on all issues. On July 9, 2015, the Department issued an NPRM on the PAYE issue which expands the set of criteria that enables borrowers to qualify for the program. Public comments are due August 10, 2015. No other NPRM's have been issued.

- State Authorization Reciprocity Agreement (SARA). SARA is a nationwide state regulatory initiative intended to make distance education courses more accessible to students across state lines and make it easier for states to regulate and institutions to participate in interstate distance education. On January 27, 2015, Minnesota became the 19th state to join SARA, and on March 6, 2015, Capella University was approved as an institutional participant in SARA.

- Student Loan Cohort Default Rates. To remain eligible to participate in Title IV programs, an educational institution's student loan cohort default rates must remain below certain specified levels. Under current regulations, if an institution's three-year cohort default rate exceeds 30% for three consecutive years or 40% for any given year, it must establish a default prevention task force and develop a default prevention plan with measurable objectives for improving the cohort default rate. Capella University's three-year cohort default rates for the 2011 and 2010 cohorts are 13.0% and 10.9%, respectively. During the first quarter of 2015, the 2012 three-year draft cohort default rates were released by the Department of Education. Capella University's 2012 three-year draft cohort default rate is 9.1%. The 2012 three-year draft rate will be finalized in September 2015. The average cohort default rates for four-year proprietary institutions nationally were 19.1% and 21.8% in fiscal years 2011 and 2010 respectively.

- Higher Learning Commission. The Higher Learning Commission, Capella University’s accrediting body, is developing new standards and an approval process under which it evaluates new competency-based education and direct assessment programs such as FlexPath. This has delayed the approval of new direct assessment programs for Capella and other institutions in the near-term. Accreditors, including the Higher Learning Commission, are developing a robust evaluative framework and high standards, which we believe is foundational to realize the underlying potential of direct assessment programs.

Critical Accounting Policies and Use of Estimates

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014. During the six months ended June 30, 2015, there have been no significant changes to our critical accounting policies.

Results of Operations

Three Months Ended June 30, 2015 Compared to Three Months Ended June 30, 2014

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The following selected financial data table should be referenced in connection with a review of the discussion of our results of operations for the three months ended June 30, 2015:

	Three Months Ended June 30, (Unaudited)		$ Change	% Change	% of Revenue		
$ in thousands	2015	2014	2015 vs. 2014		2015	2014	2015 vs. 2014
Revenues	$108,007	$104,832	$3,175	3.0 %	100.0 %	100.0 %	0.0 %
Costs and expenses:							
Instructional costs and services	47,369	45,530	1,839	4.0	43.9	43.4	0.5
Marketing and promotional	25,798	23,113	2,685	11.6	23.9	22.0	1.9
Admissions advisory	7,353	7,146	207	2.9	6.8	6.8	—
General and administrative	10,372	10,889	(517)	(4.7)	9.6	10.4	(0.8)
Lease amendment charges	—	2,690	(2,690)	(100.0)	—	2.6	(2.6)
Total costs and expenses	90,892	89,368	1,524	1.7	84.2	85.2	(1.0)
Operating income	17,115	15,464	1,651	10.7	15.8	14.8	1.0
Other income (expense), net	54	(171)	225	(131.6)	—	(0.2)	0.2
Income before income taxes	17,169	15,293	1,876	12.3	15.9	14.6	1.3
Income tax expense	6,838	6,249	589	9.4	6.3	6.0	0.3
Effective tax rate	39.8 %	40.9 %					
Net income	$10,331	$9,044	$1,287	14.2 %	9.6 %	8.6 %	1.0 %

Revenues. The increase in revenues compared to the same quarter in the prior year was primarily related to Capella University total enrollment growth of 4.3 percent in 2015, average tuition price increases of 2.5 percent which were implemented in July 2014, and an overall increase in average courses per learner. These increases were partially offset by a larger proportion of undergraduate learners who generate less revenue per learner than our graduate learners, an increase in discounts and grants to support our initiatives to improve learner success, and a decrease in non-Capella University revenues.

Instructional costs and services expenses. Instructional costs and services expenses, and instructional costs and services expenses as a percent of revenue, increased compared to the same quarter in the prior year primarily due to increased staffing levels to support our initiatives to improve learner success and drive total enrollment growth. This overall increase was partially offset by a decrease in bad debt expense, lower non-Capella University expenses, and reduced rent expense due to the lease amendment that occurred in the second quarter of 2014.

Marketing and promotional expenses. Marketing and promotional expenses, and marketing and promotional expenses as a percent of revenue, increased compared to the same quarter of the prior year primarily driven by increased investments in our marketing campaigns and advertising initiatives, as well as additional employee expenses as a result of increased staffing levels.

Admissions advisory expenses. Admissions advisory expenses, and admission advisory expenses as a percent of revenue, remained relatively consistent with the second quarter of 2014.

General and administrative expenses. General and administrative expenses, and general and administrative expenses as a percent of revenue, decreased compared to the same quarter in the prior year primarily due to timing and quarterly spending fluctuations, as well as lower expenses in our non-Capella University subsidiaries.

Lease amendment charges. On April 9, 2014, we accepted notice to activate a lease amendment to our current lease for our premises at 225 South Sixth Street in Minneapolis, Minnesota. During the quarter ended June 30, 2014, we

recorded a one-time charge of $2.6 million in connection with this amendment, and also consolidated other leased office space resulting in an additional charge of $0.1 million.
Other income (expense), net. Other income (expense), net was $0.1 million of income for the three months ended June 30, 2015, and $0.2 million of expense for the three months ended June 30, 2014. Other expense (net) in the prior year quarter primarily consisted of the change in the fair value of the RDI contingent consideration liability, which was paid in 2014 upon the awarding of TDAP. Other income (net) in the current quarter primarily consisted of interest income earned on marketable securities.

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Income tax expense. Income tax expense increased compared to the same quarter in the prior year, while the effective tax rate decreased over the same period. The decrease in the effective tax rate was primarily driven by a decrease in foreign operating losses in the current period. We do not receive a benefit on these losses due to the establishment of a full valuation allowance.

Six Months Ended June 30, 2015 Compared to Six Months Ended June 30, 2014
The following selected financial data table should be referenced in connection with a review of the discussion of our results of operations for the six months ended June 30, 2015:

	Six Months Ended June 30, (Unaudited)		$ Change	% Change	% of Revenue		
$ in thousands	2015	2014	2015 vs. 2014		2015	2014	2015 vs. 2014
Revenues	$217,081	$210,428	$6,653	3.2 %	100.0 %	100.0 %	0.0 %
Costs and expenses:							
Instructional costs and services	94,430	92,830	1,600	1.7	43.5	44.1	(0.6)
Marketing and promotional	53,298	48,874	4,424	9.1	24.6	23.2	1.4
Admissions advisory	14,557	14,073	484	3.4	6.7	6.7	—
General and administrative	20,901	21,354	(453)	(2.1)	9.6	10.1	(0.5)
Lease amendment charges	—	2,690	(2,690)	(100.0)	—	1.3	(1.3)
Total costs and expenses	183,186	179,821	3,365	1.9	84.4	85.5	(1.1)
Operating income	33,895	30,607	3,288	10.7	15.6	14.5	1.1
Other expense, net	(92)	(513)	421	(82.1)	—	(0.2)	0.2
Income before income taxes	33,803	30,094	3,709	12.3	15.6	14.3	1.3
Income tax expense	13,435	12,233	1,202	9.8	6.2	5.8	0.4
Effective tax rate	39.7 %	40.6 %					
Net income	$20,368	$17,861	$2,507	14.0 %	9.4 %	8.5 %	0.9 %

Revenues. The increase in revenues compared to the same period in the prior year was primarily related to Capella University quarterly average total enrollment growth of 4.5 percent in 2015, average tuition price increases of 2.3 percent, which were implemented in July 2014, and an overall increase in average courses per learner. These increases were partially offset by a larger proportion of undergraduate learners who generate less revenue per learner than our graduate learners, an increase in discounts and grants to support our initiatives to improve learner success, and a decrease in non-Capella University revenues.
Instructional costs and services expenses. Instructional costs and services expenses increased compared to the same period in the prior year primarily due to increased staffing levels to support our initiatives to improve learner success and drive total enrollment growth. As a percent of revenue, instructional costs decreased as a result of lower non-Capella University expenses, a decrease in bad debt expense, and reduced rent expense due to the lease amendment that occurred in the prior year.
Marketing and promotional expenses. Marketing and promotional expenses, and marketing and promotional expenses as a percent of revenue, increased compared to the same period of the prior year primarily driven by increased investments in our marketing campaigns and advertising initiatives, as well as additional employee expenses as a result of increased staffing levels.
Admissions advisory expenses. Admissions advisory expenses, and admission advisory expenses as a percent of revenue, remained relatively consistent with the prior year period.

General and administrative expenses. General and administrative expenses, and general and administrative expenses as a percent of revenue, decreased compared to the same period in the prior year primarily due to timing and quarterly spending fluctuations, as well as lower expenses in our non-Capella University subsidiaries.

Lease amendment charges. On April 9, 2014, we accepted notice to activate a lease amendment to our current lease for our premises at 225 South Sixth Street in Minneapolis, Minnesota. During the period ended June 30, 2014, we recorded a one-time charge of $2.6 million in connection with this amendment, and also consolidated other leased office space resulting in an additional charge of $0.1 million.

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Other expense, net. Other expense, net was $0.1 million and $0.5 million for the six months ended June 30, 2015 and June 30, 2014, respectively. The decrease compared to the same quarter in the prior year is primarily attributable to the impact of the change in fair value of the RDI contingent consideration liability in the prior year, which was paid in 2014.

Income tax expense. Income tax expense increased compared to the same period in the prior year, while the effective tax rate decreased over the same period. The decrease in the effective tax rate was primarily driven by a decrease in foreign operating losses in the current period. We do not receive a benefit on these losses due to the establishment of a full valuation allowance.

Liquidity and Capital Resources

Liquidity
We financed our operating activities and capital expenditures during the six months ended June 30, 2015 and 2014 primarily through cash provided by operating activities. Our cash and cash equivalents were $102.7 million and $94.0 million at June 30, 2015 and December 31, 2014, respectively. Our cash and cash equivalents increased primarily due to cash provided by operating activities, which was partially offset by payments for dividends and share repurchases as well as capital expenditures.

On September 30, 2011, we entered into an unsecured revolving credit agreement (the Credit Agreement) with Bank of America, N.A., and certain other lenders. The Credit Agreement provides $100.0 million of borrowing capacity, with an increase option of an additional $50.0 million. The Credit Agreement term ends September 30, 2016. As of June 30, 2015, there were no borrowings under the credit facility and we were in compliance with all debt covenants.

Significant portions of our revenues are derived from Title IV programs. Federal regulations dictate the timing of disbursements under Title IV programs. Learners must apply for new loans and grants each academic year, which begins July 1. Loan funds are provided through the William D. Ford Direct Loan program in multiple disbursements for each academic year. The disbursements are usually received by the beginning of the third week of the term. These factors, together with the timing of when our learners begin their programs, affect our operating cash flow. Based on current market conditions and recent regulatory or legislative actions, we do not anticipate any significant near-term disruptions in the availability of Title IV funding for our learners.

Based on our current level of operations and anticipated growth, we believe our cash provided by operations and other sources of liquidity, including cash, cash equivalents and marketable securities, will provide adequate funds for ongoing operations and planned capital expenditures for the foreseeable future. We can further supplement our liquidity position with the $100.0 million credit facility to fund our operations or to fund strategic investments, if needed.

Operating Activities
Net cash provided by operating activities was $40.9 million and $33.8 million for the six months ended June 30, 2015 and 2014, respectively. The increase was primarily due to the effects of changes in operating assets and liabilities, including an increase in accounts payable and accrued liabilities as a result of the general timing of vendor invoices, as well as an increase in net income. The overall increase was partially offset by decreases in income taxes payable and increases in prepaid expenses and other current assets.

Investing Activities
Net cash used in investing activities is primarily related to the purchase of investments in marketable securities, net of maturities, and investments in property and equipment. Net cash used in investing activities was $14.2 million and $47.0 million for the six months ended June 30, 2015 and 2014, respectively.

Cash used in investing activities for the six months ended June 30, 2015 consisted primarily of investments in property and equipment, as well as purchases of marketable securities, which were offset by maturities of marketable securities. Net purchases and maturities of marketable securities represented cash outflows of $1.8 million and $35.1 million during the six months ended June 30, 2015 and June 30, 2014, respectively.

We believe the credit quality and liquidity of our investment portfolio as of June 30, 2015 is strong. The unrealized gains and losses of the portfolio may remain volatile as changes in the general interest rate environment and supply/demand fluctuations of the securities within our portfolio impact daily market valuations. To mitigate the risk associated with this market volatility, we deploy a relatively conservative investment strategy focused on capital preservation and liquidity. But even with this approach, we may incur investment losses as a result of unusual and unpredictable market developments and we may experience reduced investment earnings if the yields on investments deemed to be low risk remain low or decline further due to unpredictable market developments. In addition, these unusual and unpredictable market developments may also create liquidity challenges for certain of the assets in our investment portfolio.

Capital expenditures were $12.3 million and $10.8 million for the six months ended June 30, 2015 and 2014, respectively, which primarily consisted of investments in foundational infrastructure, the development and refinement of courses, and marketing infrastructure to enhance efficiencies and analytics capabilities.

We lease all of our facilities. We expect to make future payments on existing leases from cash generated from operations.

Financing Activities

Net cash used in financing activities was $18.1 million and $22.5 million for the six months ended June 30, 2015 and 2014, respectively. Cash payments of dividends were $9.1 million and $8.7 million for the six months ended June 30, 2015 and June 30, 2014, respectively. Additionally, in the first six months of 2015, we repurchased $10.5 million of common stock under our share repurchase program compared to $9.9 million in the first six months of 2014. Additionally, as a result of the achievement of TDAP, we made an additional payment of £4.0 million (approximately $6.9 million) to the former shareholders of RDI on May 12, 2014. For the six months ended June 30, 2014, net cash used in financing activities of approximately $6.0 million reflects the initial fair value of the RDI contingent consideration liability recorded at acquisition, while the remaining amount of $0.9 million included within cash flows from operating activities represents the accumulated change in fair value of the RDI contingent consideration liability.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk

The Company has no derivative financial instruments or derivative commodity instruments, and believes the risk related to cash equivalents and marketable securities is limited due to the adherence to its investment policy, which focuses on capital preservation and liquidity. In addition, all investments must have a minimum Standard & Poor’s rating of A minus (or equivalent) by at least one agency at the purchase date. All of the Company's cash equivalents and marketable securities were rated A- or higher as of June 30, 2015 and December 31, 2014, by at least one rating agency. In addition, the Company utilizes money managers who conduct initial and ongoing credit analysis on its investment portfolio to monitor and minimize the potential impact of market risk associated with its cash, cash equivalents and marketable securities. Despite the investment risk mitigation strategies the Company employs, it may incur investment losses as a result of unusual and unpredictable market developments and may experience reduced investment earnings if the yields on investments deemed to be low risk remain low or decline further in this time of economic uncertainty. Unusual and unpredictable market developments may also create liquidity challenges for certain assets in the Company's investment portfolio.

Interest Rate Risk

The Company manages interest rate risk by investing excess funds in cash equivalents and marketable securities bearing a combination of fixed and variable interest rates, which are tied to various market indices. The Company's future investment income may fall short of expectations due to changes in interest rates or it may suffer losses in principal if it is forced to sell securities that have declined in market value due to changes in interest rates. At June 30, 2015, a 10% increase or decrease in interest rates would not have a material impact on the Company's future earnings, fair values, or cash flows.

Foreign Currency Exchange Risk

The Company uses the U.S. dollar as its reporting currency. The functional currencies of its foreign subsidiaries are generally the local currencies. Accordingly, the Company's foreign currency exchange risk is related to the following exposures:

- Adjustments resulting from the translation of assets and liabilities of the foreign subsidiaries into U.S. dollars using exchange rates in effect at the balance sheet dates. These translation adjustments are recorded in accumulated other comprehensive income;
- Earnings volatility translation of income and expense items of the foreign subsidiaries using an average monthly exchange rate for the respective periods; and
- Gains and losses resulting from foreign exchange rate changes related to intercompany receivables and payables that are not of a long-term investment nature and are not denominated in the functional currencies of the respective entities, as well as gains and losses from foreign currency transactions. These items are recorded in other expense, net in the consolidated statements of income.

The Company has not used derivative contracts to hedge foreign currency exchange rate fluctuations.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of its management, including the chief executive officer and the chief financial officer, of the effectiveness of the design and operation of its disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act).

Based upon that evaluation, the chief executive officer and chief financial officer concluded that the Company’s disclosure controls and procedures were effective, as of June 30, 2015, in ensuring that material information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC 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 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.

Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is a party to various lawsuits, claims and other legal proceedings that arise in the ordinary course of business. While the outcomes of these matters are uncertain, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed in the “Risk Factors” section as updated in the Company's Form 10-K for the year ended December 31, 2014.

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

Recent Sales of Unregistered Securities
None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers
During the three months ended June 30, 2015, the Company repurchased $7.1 million of common stock under its share repurchase program.[1] Its remaining authorization for common stock repurchases was $21.0 million at June 30, 2015. The following presents the Company's share repurchases during the quarter ended June 30, 2015:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs
4/1/2015 to 4/30/2015	20,814	$64.63	20,814	$26,782,444
5/1/2015 to 5/31/2015	38,896	52.90	38,896	24,724,867
6/1/2015 to 6/30/2015	66,366	55.45	66,366	21,044,648
Total	126,076	56.18	126,076	21,044,648

(1) The Company announced its current share repurchase program in July 2008. As of June 30, 2015, the Company's Board of Directors has authorized repurchases up to an aggregate amount of $285.7 million in value of common stock under the current program. The Board of Directors authorizes the Company to repurchase outstanding shares of common stock, from time to time, depending on market conditions and other considerations. There is no expiration date on the repurchase authorizations, and repurchases occur at the Company's discretion.

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
(a) Exhibits

Number	Description	Method of Filing
3.1	Amended and Restated Articles of Incorporation.	Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on November 20, 2006.
3.2	Second Amended and Restated By-Laws.	Incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on December 10, 2008.
4.1	Specimen of common stock certificate.	Incorporated by reference to Exhibit 4.1 to Amendment No. 4 to the Company's Registration Statement on Form S-1 filed with the SEC on October 20, 2006.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed electronically.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed electronically.
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.	Filed electronically.
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.	Filed electronically.
EX-101.INS	XBRL Instance Document(1)	Filed electronically.
EX-101.SCH	XBRL Taxonomy Extension Schema Document(1)	Filed electronically.
EX-101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document(1)	Filed electronically.
EX-101.DEF	XBRL Taxonomy Extension Definition Linkbase Document(1)	Filed electronically.
EX-101.LAB	XBRL Taxonomy Extension Label Linkbase Document(1)	Filed electronically.

EX-101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document[1]	Filed electronically.

(1) The XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CAPELLA EDUCATION COMPANY

/s/ J. Kevin Gilligan
July 28, 2015
J. Kevin Gilligan
Chief Executive Officer
(Principal Executive Officer)

/s/ Steven L. Polacek
July 28, 2015
Steven L. Polacek
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)