CAPELLA EDUCATION CO
Form 10-K
February 19, 2015

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

FORM 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year-ended December 31, 2014
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-33140

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

Minnesota	41-1717955
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

Capella Tower 225 South Sixth Street, 9th Floor Minneapolis, Minnesota	55402
(Address of principal executive offices)	(Zip code)

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

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

Common stock, $.01 par value	Nasdaq Global Market
Title of each class	Name of each exchange on which registered

Securities registered pursuant to section 12(g) of the Act:
NONE
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 ¨

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter, was approximately $592.5 million.
The total number of shares of common stock outstanding as of February 13, 2015, was 12,214,705.

DOCUMENTS INCORPORATED BY REFERENCE
Certain portions of the registrant's Definitive Proxy Statement for its 2015 Annual Meeting of Stockholders (which is expected to be filed with the Commission within 120 days after the end of the registrant's 2014 fiscal year) are incorporated by reference into Part III of this Report.

CAPELLA EDUCATION COMPANY
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PART I

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Statements contained in this Annual Report on Form 10-K 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 (the “SEC”), in press releases, and in oral and written statements made by us or with our approval 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; future changes in government policy; projections, predictions, expectations, estimates or forecasts as to our business, financial and operational results and future economic performance; and statements of management’s goals and objectives and other similar expressions concerning matters that are not historical facts. Words such as “may,” “should,” “could,” “would,” “predicts,” “potential,” “continue,” “expects,” “anticipates,” “future,” “intends,” “plans,” “believes,” “estima 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 that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to, those described in “Item 1A—Risk Factors,” below. The performance of our business and our securities may be adversely affected by these factors and by other factors common to other businesses and investments, or to the general economy. Forward-looking statements are qualified by some or all of these risk factors. Therefore, you should consider these risk factors with caution and form your own critical and independent conclusions about the likely effect of these risk factors on our future performance. Such forward-looking statements speak only as of the date on which the statements are made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events or circumstances. Readers should carefully review the disclosures and the risk factors described in this and other documents we file from time to time with the SEC, including our reports on Forms 10-Q and 8-K to be filed in fiscal 2015.

Item 1. Business

Overview

Capella Education Company (the Company) is an online postsecondary education services company. Our wholly owned subsidiaries include the following:

- Capella University (the University) offers a variety of doctoral, master’s and bachelor’s programs in the following markets: public service leadership, nursing and health sciences, behavioral health and human services, business management and information technology, and education. We focus on master's and doctoral degrees, with 71% of our learners enrolled in a master’s or doctoral degree program. Our academic offerings are based on a fully embedded competency-based curricula and infrastructure that are delivered in an online format that is convenient and flexible. We design our offerings to help working adult learners develop specific competencies they can employ in their workplace. We actively support and engage with our learners throughout their programs to enhance their prospects for successful program completion. We believe the relevance and convenience of our programs provide a quality educational experience for our learners. At December 31, 2014, we offered over 1,740 online courses and 43 academic programs with 145 specializations to over 36,000 learners.
- Resource Development International (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. RDI’s online distance learning offerings span from degree-entry programs to doctoral level programs and are offered in a variety of disciplines, including business, management, psychology, law, and computing. RDI enhances the Company’s market leadership through access to the fast-growing international higher education market, with a presence in the UK and certain other countries.
- Sophia Learning, LLC (Sophia) is a social teaching and learning platform that integrates education with technology. In 2012, Sophia launched the Pathways for College Credit program, which offers convenient online learning covering general education requirements for a fraction of the cost of a faculty-led college course.
- Capella Learning Solutions (CLS) is a subsidiary created in 2013 that provides online training solutions and services to corporate partners which are delivered through Capella's online learning platform.

Our History

We were founded in 1991 as a Minnesota corporation. In 1993, we established our wholly owned university subsidiary, then named The Graduate School of America, to offer doctoral and master’s degrees through distance learning programs in management, education, human services and interdisciplinary studies. In 1995, we launched our online format for delivery of our doctoral and master’s degree programs over the Internet. Through our early entry into online education, we gained extensive experience in the delivery of effective online programs. In 1997, our university subsidiary received accreditation from the North Central Association of Colleges and Schools (later renamed The Higher Learning Commission of the North Central Association of Colleges and Schools). In 1998, we expanded our original portfolio of academic programs by introducing doctoral and master’s degrees in psychology and a master of business administration degree. In 1999, to expand the reach of our brand in anticipation of moving into the bachelor’s degree market, we changed our name to Capella Education Company and the name of our university to Capella University. In 2000, we introduced our bachelor’s degree completion program in information technology, which provided instruction for the last two years of a four-year bachelor’s degree. In 2004, we expanded our addressable market through the introduction of our four-year bachelor’s degree programs in business and information technology. In November 2006, we completed an initial public offering of our common stock and in May 2007, we completed a follow-on offering of our common stock.

Over the past several years, we introduced numerous new programs and specializations across all of our markets, including the launch of doctoral, master’s and bachelor’s level programs within our public service leadership market. In 2010, we formed a joint venture with Sophia, an online social teaching and learning platform, in which we were the majority owner. On April 16, 2012, we acquired the remaining interest in Sophia which is now a wholly owned subsidiary as of that date. In 2011, we acquired RDI, an independent provider of distance learning. Additionally, the Company introduced CLS - providing online training solutions and services to corporate partners - in 2013. Also in 2013 - with approval from our regional accreditor - the Company began offering its BS in Business and MBA programs under the FlexPath model, a new direct assessment degree delivery program. Additionally, in 2014, the Department of Education approved the Company's term-based and non-term based FlexPath offerings for eligibility to receive federal financial aid under Title IV programs. In January 2015, Capella University launched a new School of Nursing and Health Sciences, further demonstrating the Company's commitment to providing competency-based advanced education in nursing and health care.

Industry

The U.S. market for postsecondary education is large and highly fragmented. According to the National Center for Education Statistics (NCES) Projections of Education Statistics to 2012, released in February 2014, the total number of postsecondary learners enrolled as of the fall of 2011 was 21.0 million and is expected to increase to 23.9 million by 2022. We believe the forecasted growth in postsecondary enrollment is a result of a number of factors including the significant and measurable personal income premium that is attributable to postsecondary education, and an increase in demand by employers for professional and skilled workers.

According to the U.S. Census Bureau’s 2009-2013 American Community Survey five-year estimates, 63.2% of adults (persons 25 years of age or older) do not possess a postsecondary degree. Of the 21.0 million postsecondary learners enrolled as of the fall of 2011, the NCES estimated that 8.3 million were adults, representing approximately 40% of total enrollment. We expect adults will continue to represent a large segment of the postsecondary education market as they seek additional education to secure better jobs, or to remain competitive or advance in their current careers.

During 2014, Eduventures, Inc., an education consulting and research firm, published a report projecting continued, although slowed, growth in online degrees through 2017, with growth beginning to accelerate again in 2018.

Competition

The postsecondary education market is highly fragmented and competitive, with no private or public institution holding a significant market share. We compete primarily with public and private degree-granting regionally accredited colleges and universities. Our competitors include both traditional and for-profit colleges and universities offering online programs, such as American Public University, Ashford University, Colorado Technical University, Grand Canyon University, Kaplan University, Liberty University, Southern New Hampshire University, Strayer University, University of Phoenix, Walden University, and Western Governors University. Traditional colleges and universities increasingly offer a variety of distance education alternatives to professional adults. Competition from traditional colleges and universities is expected to increase as they expand their online offerings.

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

- Relevant, high-quality and accredited program offerings;
- Reputation of the college or university and marketability of the degree;
- Flexible, convenient, and dependable access to programs and courses;
- Regulatory approvals;
- Qualified and experienced faculty;
- Level of learner support;
- Affordability of the program;
- Availability of Title IV funds;
- Marketing and selling effectiveness; and
- The time necessary to earn a degree.

Our Competitive Strengths

We believe we have the following competitive strengths:

Commitment to Academic Quality. We are committed to providing our learners with a rewarding and challenging academic experience. Our commitment to academic quality is a tenet of our culture, and we believe that quality is an important consideration to those learners who choose Capella University. Having originated as an institution exclusively focused on graduate degree education, we have historically promoted an educational experience based on high academic standards. We continue to apply this approach as we have expanded our graduate and undergraduate programs. Today, we believe that our commitment to academic quality is reflected in our curricula, faculty, learner support services and academic oversight processes. The impact of this commitment is evidenced by the satisfaction of our learners both during their educational experience and their career success following graduation. Data released by the Department of Education in connection with gainful employment regulations and independent national surveys indicate higher income levels and high learner satisfaction of Capella graduates compared to other proprietary education providers.

Deep Competency-based Learning Infrastructure. Capella's academic programs have been distinctively designed for online delivery. For the past 10 years, we have wholly integrated and continually invested in a competency-based learning approach throughout our university. As a result, we are able to map academic and professional standards to all of our degree programs and more fully support students as they progress through their program. Competency-based learning is comprised of three main elements:

- Professionally-aligned curriculum designed around measurable skills, knowledge, and abilities needed to be successful in a career;
- Faculty scholar and practitioners who are experienced leaders in their field and have a deep understanding of foundational theory and needs of the profession;
- Real-world assignments that measure the mastery of competency.

Every assignment associated with Capella's courses is meaningful and purposeful because all are aligned with academic and professional standards. Learning activities are designed to give learners the relevant information they need and to develop the capabilities they can use immediately in their career.

Our competency-based curriculum design offers flexibility while promoting a high level of interaction with other learners and faculty members. Underpinning the curriculum design is a comprehensive infrastructure that enables extensive predictive and actionable analytics capabilities which we leverage to develop and implement learner success and process improvements and to develop new academic learning models. This includes our FlexPath program which offers the potential to significantly reduce the cost of a degree, accelerate the time required for degree completion, and better align learning to the needs of employers and society. Traditionally, degree programs are constructed around credit hours that measure the time required to complete specific courses. Under the FlexPath model, degree programs are constructed around the direct assessment of demonstrated competencies and the application of learning.

Extensive Learner Support Services. We are committed to providing high quality, responsive and convenient learner support services to our learners. Our support services include: academic services, such as advising, writing, tutoring and research services; administrative services, such as online class registration and transcript requests; library services; financial aid counseling; and career counseling services. Increasingly, we are leveraging analytics to create processes to proactively reach out to learners and to create a personalized experience for our learners. The results have been very encouraging and are reflected in our early cohort persistence improvements and continued high learner satisfaction.

Focus on Innovation. The education market is undergoing significant changes to address national challenges including the affordability of higher education and meeting the skill requirements of employers. Our focus on regulatory compliance, Capella's reputation as a quality institution, deep systems and analytical infrastructure and a culture to help our learners succeed has uniquely positioned Capella for innovation. The introduction of the FlexPath program and our return to total enrollment growth demonstrate this ability. Our goal is to continue to invest in developing new academic and business models and processes to drive excellence in executing our strategies to drive long-term sustainable growth, and meet today's educational challenges.

Our Operating Strategy

Our faculty and staff are focused on helping our learners succeed. To that end, we are pursuing the following operating strategies:

- Focusing on learner success, including improving retention rates while maintaining high standards of academic quality and rigor,
- Maintaining our ability to offer affordable degrees, where learners receive a high return on their investment,
- Expanding and optimizing our relationship-based marketing efforts and increasingly personalizing the prospective learner experience,
- Further strengthening and expanding our product offering and the alignment of our offering with employer needs, and

- Driving consumer adoption of new growth platforms such as FlexPath.

We are focused on the following operational priorities to deliver these strategies:

Competency-Based Curriculum. We continue to refine and implement best practices for teaching and learning models and focus on learner success by improving completion rates. Our goal is to further strengthen our position as a recognized leader in high quality, online learning.

We are committed to delivering a superior academic, professionally aligned, real-world education to our learners. Capella University's competency-based curriculum is designed for busy, experienced professionals who want to gain the relevant competencies to help advance their career. We seek to develop a deep understanding of the professions we serve and the competencies required of skilled professionals in these fields. This commitment guides the development of our competency based curricula, the recruitment of our faculty and staff, and the design of our support services. We continue to advance tools that provide learners, faculty, and staff with timely information and actionable interventions to improve learning outcomes. We use the results of internal assessments to develop an understanding of the specific needs and readiness of each individual learner at the start of a program. Through the use of competency-based curricula and transparent measurement of course and program outcomes, we seek to provide our learners with the most direct path to the skills and knowledge learners need to be successful in their careers, including a portfolio of professional competencies, and support for career advancement as well as the degree itself.

Learner Success. Capella serves a unique learner. Our learners tend to be professionals with an average age of 39 and pursuing a graduate degree to fulfill a strong desire to be at the forefront of their profession. Our programs surround these learners with a supportive, flexible, and engaging environment to help them achieve academic success. This includes a comprehensive focus on improving early cohort persistence, personalizing the on-boarding experience for new learners, simplifying learners' administrative interactions with Capella, and continuing to improve the quality and frequency of interaction between our learners and our faculty.

We look for opportunities to improve our learners' educational experience and increase the likelihood of learners successfully completing degree programs. We also seek to facilitate an even closer relationship between our faculty and learners to further drive learner success. We believe our superior online experience, and competency-based curriculum focused on providing immediate and applicable value, the most direct path to goal achievement, and professional credibility are core to our differentiation strategy and will continue to enhance learner satisfaction, leading to higher levels of engagement, persistence, brand advocacy and referrals. Additionally, we are building a long-term roadmap in order to maintain our ability to offer affordable degrees that lead to a compelling return on the learner's investment and will ensure the Capella University brand remains competitively positioned.

Relationship-Based Marketing. We continue to focus on building the Capella brand and establishing our strong differentiation as a high quality and professionally aligned online university. We continue to expand on this differentiation through a variety of initiatives, including creating brand recognition, optimizing marketing efforts, interacting with prospective learners earlier in the decision process, the use of analytics, and expanding strategic employer relationships. We will continue to leverage our data rich environment and analytical capabilities to drive greater marketing efficiencies, higher quality inquiries and improved conversion rates from prospective new learners. Our marketing strategy is designed to attain greater strategic control over our new enrollment growth and strengthen engagement with our learners and alumni.

Innovation and Diversification. We also seek to drive growth through a multifaceted strategy of enhancing existing program offerings and developing new and innovative programs and specializations. Our market and product teams focus on certain vertical markets as we strive to enhance our existing program offerings by continuously improving course design and technology, and obtaining specialized accreditation and additional state approval of programs leading to professional licensure and select endorsements. Within our current target markets, we seek to expand our program and specialization offerings, while also targeting additional professions. We challenge ourselves to innovate and explore opportunities that leverage our existing Capella University competency-based infrastructure, analytics, expertise, brand reputation, and educational capabilities to increase affordability, speed to competency, flexibility, and alignment with employer needs, leading to stronger demand potential and long-term growth opportunities. Through our focus on innovation we have developed new technologies, new learning and business models, and are entering new markets, which are essential ingredients for long-term growth. In 2013, Capella University offered its first courses in its Bachelor of Science (BS) and Masters programs under the FlexPath model, a new direct assessment degree delivery program. Traditionally, degree programs are constructed around credit hours that measure the time required to complete specific courses. Under the FlexPath model, degree programs are constructed around the direct assessment of demonstrated competencies and the application of learning.

Capella University

Capella University is accredited by the the Higher Learning Commission. The Higher Learning Commission is one of six regional accrediting agencies recognized by the Secretary of the Department of Education as a reliable indicator of educational quality. Accreditation by a recognized accrediting agency is required for an institution to become and remain eligible to participate in Title IV programs.

Our Approach to Academic Quality

We believe the following critical elements promote a high level of academic quality at Capella University:

- Curricula. We design the curricula for our programs around professional competencies desired for high performance in each field and at the appropriate degree level. The particular competencies are identified and validated through a variety of external sources and reviews. There are specific expected learning outcomes for each program and course-level competencies that align to those outcomes. We assess the learner's achievement of the expected learning outcomes and course competencies during his or her period of enrollment.

- Faculty. We select our faculty based on their academic credentials as well as their teaching and practitioner experience. Our faculty members tend to be practitioners as well as scholars, bringing relevant, practical experience from their professional careers into the courseroom. As of December 31, 2014, approximately 86% of our faculty members have a doctoral degree. We invest in the professional development of our faculty members through required training in online teaching techniques as well as events and discussions designed to foster sharing of best practices and a commitment to academic quality. We also communicate clear expectations regarding the quality of faculty and learner interactions, and monitor achievement of those expectations.

- Online course design. We employ a comprehensive design framework to ensure that our online courses offer consistent learning experiences, high quality interactions, and the tools required for assessing learning outcomes. We regularly assess data related to course outcomes as well as learner assessments to identify opportunities for course enhancements and upgrades.

- Learner support. We establish teams comprised of both academic and administrative personnel in areas including advising, academic support, financial aid counseling and administration, library and career counseling services to serve as important points of contact to learners throughout the duration of their studies. Most of our support services are accessible online, allowing users to access these services at a time and in a manner that is convenient to them. We believe that a strong and reliable support network is as important to maintaining learner motivation and commitment as the knowledge and engagement of our faculty. In FlexPath, a similar average number of learners are served in each course, but the faculty focus is on assessing competency demonstrations and providing rich formative feedback through the assessment process.

In addition to these traditional components of academic quality, our teaching approach and the online format of our programs offer several features that enrich the learning experience for our primarily professional adult learners:

Low learner to faculty ratio. Our credit-bearing courses average about 17 learners, providing each learner the opportunity to interact directly with our faculty and to receive individualized feedback and attention. By ensuring each learner is encouraged to actively participate, the instructor is better enabled to evaluate the learner's understanding of course material, which we believe strengthens the academic quality of our programs.

Diverse learner population. Our online format allows us to focus on adult learners as well as to attract a diverse population of learners with a variety of professional backgrounds and life experiences.

Practitioner-oriented course experience. Our courses are designed to encourage learners to incorporate workplace issues or projects into their studies. This approach provides relevant context to many of the academic theories covered by our curricula, and allows learners to immediately apply value to their current career or profession.

Time efficiency. While many campus-based learners are required to spend time commuting, parking, or otherwise navigating a large campus, our online learning format enables our learners to focus their time on course assignments and discussions. In addition, we design our programs and courses to achieve the most efficient time to completion. Our FlexPath option further optimizes the potential for efficiency with its self-paced design and elimination of pre-determined learning activities. This allows learners to prepare, submit and complete their assessments when they are ready, rather than on the course’s schedule. The FlexPath approach enables learners to quicken or slow their pace as they see fit.

Residential colloquia experience. Our residential colloquia, required for doctoral and certain master’s learners pursuing professional licensure, provides the opportunity to engage in face-to-face interaction with other learners and faculty. This creates a rich learning experience with relevant content to help prepare our learners for particular stages of their academic program. In addition, we offer residential colloquia to our psychology and counseling learners as a key component of their required learning experience.

Curricula

Our program offerings cover five markets: public service leadership, nursing and health sciences behavioral health and human services, business, management and technology, and education. At December 31, 2014, we offered 43 academic programs with 145 specializations within these markets:

Public Service Leadership

Doctor of Philosophy in Human Services	Master of Science in Human Services
Multidisciplinary Human Services	Multidisciplinary Human Services
Nonprofit Management and Leadership	Social and Community Services
Social and Community Services	Master of Nonprofit Management and Leadership (MNML)
Doctor of Philosophy in Public Safety	Master of Science in Public Safety
Emergency Management	Criminal Justice
Criminal Justice	Emergency Management

Nursing and Health Sciences

Doctor of Public Administration (DPA)	Master of Science in Nursing
General Public Administration	General Nursing
Doctor of Health Administration (DHA)	Nurse Educator
General Health Administration	RN-to-MSN Nurse Educator
Health Care Leadership	RN-to-MSN General Nursing
Health Policy and Advocacy	RN-to-MSN Nursing Informatics
Doctor of Public Health (DrPH)	RN-to-MSN Nursing Leadership and Administration
Epidemiology	Nursing Informatics
Health Advocacy and Leadership	Nursing Leadership and Administration
Doctor of Nursing Practice (DNP)	Diabetes Nursing
Master of Public Administration (MPA)	RN to MSN Diabetes Nursing
General Public Administration	Master of Public Health (MPH)
Master of Health Administration (MHA)	General Public Health
General Health Administration	Health Management and Policy
Health Care Operations	Social and Behavioral Sciences
Health Care Leadership	Doctor of Philosophy in Human Services
Health Care Informatics	Health Care Administration
Master of Science in Human Services	Doctor of Philosophy in Nursing Education
Gerontology	

Social and Behavioral Sciences

Doctor of Philosophy in Counselor Education and Supervision	Master of Science in Marriage and Family Counseling/Therapy
General Counselor Education and Supervision	General Marriage and Family Counseling/Therapy
Doctor of Philosophy in Advanced Studies in Human Behavior	Master of Science in Mental Health Counseling
General Advanced Studies in Human Behavior	General Mental Health Counseling
Doctor of Psychology (PsyD)	Master of Science in Psychology
Clinical Psychology	Applied Behavior Analysis
Doctor of Philosophy in Psychology	Child and Adolescent Development
General Psychology	Clinical Psychology
Addiction Psychology	Counseling Psychology
Industrial/Organizational Psychology	General Psychology (FlexPath option available)
Educational Psychology	Sport Psychology

Doctor of Psychology in School Psychology
Doctor of Social Work
- General Social Work

Master of Science in Addiction Counseling
- General Addiction Counseling

Master of Science in School Counseling
- General School Counseling

- Educational Psychology
- Evaluation, Research, and Measurement
- School Psychology
- Industrial/Organizational Psychology (FlexPath option available)
- Leadership Coaching Psychology

Master of Science in Studies in Human Behavior
- General Studies in Human Behavior

Business and Technology

Doctor of Business Administration
- Business Intelligence
- Global Operations and Supply Chain Management
- Strategy and Innovation
- Finance
- Marketing
- Accounting
- Human Resource Management
- Information Technology Management
- Leadership
- Project Management

Doctor of Philosophy in Business Management
- Accounting
- General Business Management
- Finance
- Human Resource Management
- Information Technology Management
- Leadership
- Marketing
- Project Management
- Management Education
- Strategy and Innovation

Master of Science in Information Assurance and Security
- Specialization in Digital Forensics
- Specialization in Network Defense

Master of Business Administration
- Accounting
- Finance
- Business Intelligence (FlexPath option available)
- Entrepreneurship (FlexPath option available)
- General Business Administration (FlexPath option available)
- Global Operations and Supply Chain Management
- Human Resource Management (FlexPath option available)
- Information Technology Management
- Project Management (FlexPath option available)
- Marketing
- Health Care Management (FlexPath option available)

Master of Science in Information Systems and Technology Mgmt.
- General Information Systems and Technology Management (FlexPath option available)
- Project Management

Master of Science in Human Resources Management
- General Human Resource Management

Master of Science in Leadership
- General Leadership

Doctor of Philosophy in Information Technology
- General Information Technology
- Information Assurance and Security
- Information Technology Education
- Project Management

Undergraduate Studies

Bachelor of Science in Business
- Accounting
- Business Administration (FlexPath option available)
- Finance
- Human Resource Management (FlexPath option available)
- Management and Leadership (FlexPath option available)
- Marketing
- Project Management (FlexPath option available)
- Health Care Management (FlexPath option available)

Bachelor of Science in Information Technology

Bachelor of Science in Psychology
- General Psychology (FlexPath option available)

Bachelor of Science in Nursing (BSN)
- RN-to-BSN Completion

Bachelor of Science in Public Safety
- Criminal Justice
- Emergency Management
- Homeland Security

General Information Technology (FlexPath option available)
Information Assurance and Security
Project Management
Health Information Technology

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Education

Doctor of Education (EdD)
- Education Leadership and Management
- Reading and Literacy
- Curriculum and Instruction
- Adult Education

Education Specialist (EdS)
- Curriculum and Instruction
- Leadership in Educational Administration

Master of Science in Higher Education
- Adult Education
- Integrative Studies
- Higher Education Leadership and Administration

Master of Science in Education
- Curriculum and Instruction
- Early Childhood Education
- English Language Learning and Teaching
- K-12 Studies in Education
- Leadership in Educational Administration
- Reading and Literacy
- Special Education Teaching
- Instructional Design for Online Learning
- Training and Performance Improvement

Doctor of Philosophy in Education (PhD)
- Curriculum and Instruction
- Instructional Design for Online Learning
- K-12 Studies in Education
- Leadership in Educational Administration
- Special Education Leadership
- Leadership for Higher Education
- Postsecondary and Adult Education
- Professional Studies in Education
- Training and Performance Improvement

Our credit hour courses are offered on a quarterly academic schedule, which generally coincides with calendar quarters. We offer new learners in most programs the flexibility to begin the first course in their program of study at the beginning of any month. These learners then enroll in subsequent courses on a regular quarterly course schedule. Depending on the program, learners generally enroll in one to two courses per quarter. Each course has a designated start date, and the majority of our courses last for ten weeks.

To meet traditional University course requirements, learners typically need to access the online courseroom multiple times each week. However, the courses are developed to be taken asynchronously, so learners can attend each course as it fits their weekly schedule. Learners are required to respond to questions posed by the instructor, as well as comments made by other learners. This provides for an interactive experience in which each learner is both encouraged and required to be actively engaged. Faculty is also required to have substantive engagement in each course each week. Additional learning experiences may include team projects and/or research papers. Our online format provides a digital record of learner interactions for the course instructor to assess learners' levels of engagement and demonstration of required competencies. The course design also includes assessment of learning outcomes.

The primary exception to our online format is for doctoral learners and for certain master's degree candidates pursuing professional licenses. These learners participate in periodic residential colloquia, year-in-residencies, supervised practica and internships as a complement to their courses. Colloquia typically lasts from three to 42 days and is required, on average, once per year for learners in applicable programs. The supervised practica and internships vary in length based on the program in which the learner is enrolled.

We also offer certificate programs, which consist of a series of courses focused on a particular area of study, for learners who seek to enhance their skills and knowledge. Online certificate courses can be taken to prepare for a graduate degree program or on a stand-alone basis. The duration of our certificate programs ranges from two quarters to approximately two years.

In 2013, Capella University introduced FlexPath, a new direct assessment degree delivery program. Under the FlexPath model, degree programs are constructed around the direct assessment of demonstrated competencies and the application of learning. FlexPath is a self-paced style of program without the conditions of pre-set deadlines where learners can move quickly through more familiar areas of study and more slowly through areas they are less familiar with as they grasp new concepts and skills. The Department of Education has approved the Company's term based and non-term based FlexPath offerings for eligibility to receive federal financial aid under Title IV programs.

Faculty & Other Employees
We seek to hire faculty who have teaching and/or practitioner experience in their particular discipline and who possess significant and appropriate academic credentials. As of December 31, 2014, approximately 86% of our faculty members have a doctoral degree. We provide significant training to new faculty members, including an online development program focused on the Capella way of effective online teaching, our educational philosophy, teaching expectations and our online platform, prior to offering a teaching assignment. In addition, we provide professional development and training for all faculty members on an ongoing basis. To evaluate the performance of our faculty members, we regularly monitor courseroom activity and assess both learner satisfaction with the courseroom experience and learner performance against course outcomes.

Our faculty consists of full-time academic administrators, faculty chairs, core faculty and part-time faculty. Our full-time academic administrators' primary responsibilities are to monitor the quality and relevance of our curricula, to recruit and manage teaching faculty and to ensure we maintain standards of accreditation. Our faculty chairs supervise the faculty in their respective specializations. Our core faculty and part-time faculty teach courses, serve on curriculum or other relevant committees, work on curriculum development in their areas of expertise, and serve as comprehensive exam and dissertation mentors to our doctoral learners.

We also employ non-faculty staff in university services, academic advising and academic support, enrollment services, university administration, financial aid, information technology, human resources, finance and other administrative functions. As of December 31, 2014, we employed 2,944 faculty and non-faculty staff. None of our employees is a party to any collective bargaining or similar agreement with us.

Learner Support Services
The learner support services we provide to all learners include:

Academic services. We provide learners with a variety of services designed to support their academic success. These services include new learner orientation, technical support, academic advising, research services (particularly for doctoral degree candidates), writing services and online tutoring. Additionally, interactive, self-paced modules supporting academic and personal success skills are available for learners through our online portal. We also provide appropriate educational accommodations to learners with documented disabilities through our disability support services team. Besides traditional academic advising, our advising model has been transformed to provide additional focus on coaching new learners during the first year of their academic experience. The advising process is supported by the use of tools that are informed by predictive analytics that identify at risk behaviors and the learners' mastery of competencies. Advisors and faculty collaborate proactively to intervene and help learners stay on track and be successful.

Administrative services. We provide learners with the ability to access a variety of administrative services both telephonically and via the Internet. For example, learners can register for classes, apply for financial aid, pay their tuition and access their billing statements and transcripts online. In addition, our financial aid counselors provide personalized online and telephonic support to our learners including counseling regarding financing their education. We believe this online accessibility provides the convenience and self-service capabilities that our learners value.

Capella University Library services. We provide learners with online access to the Capella University Library. Learners have 24-hour access to library databases, instructional guides, and tutorials, as well as email, chat, phone, and fax access to all librarians and other staff during certain time periods. Access to resources is primarily provided through Summon, a web discovery tool that indexes Capella Library's database content and 360 Link, an index of all of the Library's journals and e-books by title. The Library provides online access to a comprehensive collection of scholarly and professional resources and print materials through the InterLibrary Loan (ILL) service. Learners may request books, book chapters, articles, and other resources held by other universities nationwide using our InterLibrary

Loan (ILL) service. Articles and book chapters are sent via email at no charge and books are sent via FedEx with a return postage mailer. The ILL service is provided through Capella Library's partnership with MLibrary at the University of Michigan, InfoNOW at the University of Minnesota, and through direct purchase partners.

The digital collections of the Capella Library include databases, full text journals, electronic books, full text dissertations, and millions of company records. Capella University Library provides links to local academic and public libraries, health libraries, and federal depositories. A few of the services provided by the Capella University Library includes online tutorials, webinars, and Library Research Guides. Librarians and reference technicians offer assistance on research assignments, teach effective search strategies to enhance research skills, and provide dissertation literature review consultations. Specific librarian liaisons in the library attend each graduate colloquia where they are available for one on one consultations and also provide drop-in library orientation information sessions.

Career center services. Our staff offers career counseling, job search advising, and career management support to all Capella learners and alumni. Our career counselors interact with learners and alumni via email, telephone, and online seminars to assist with career-related activities such as resume development, curriculum vitae and cover letter development; interview preparation; effective job search strategies; and career advancement efforts. The Career Center's online iGuide resources help learners gather occupational information and trends, access job postings, and view sample job search documents. Our counselors also assist with prospective learners' selection of the Capella University program and specialization that best suits their professional aspirations.

Admissions

Capella University's admission process is designed to offer access to prospective learners who seek the benefits of a postsecondary education while providing feedback to prospects regarding their ability to successfully complete their chosen program. Prior to the first course in their program of study, learners are generally required to complete an orientation to online education and a skills assessment, the results of which enable us to develop an understanding of the specific needs and readiness of each individual learner. Learners must successfully complete the first course in their program of study to continue their education.

Learners enrolling in our bachelor's programs must have a high school diploma or a GED and demonstrate competence in writing and logical reasoning during the first course of their program of study. Additionally, applicants to our undergraduate programs who do not have transferable credits from an accredited higher education institution are required to pass assessments in writing and reading prior to acceptance into the program. Learners enrolling in our graduate programs must have the requisite academic degree from an accredited institution and a specified minimum grade point average. In addition to our standard admission requirements, we require applicants to some of our programs to provide additional application material and information, and/or interview with, and be approved by faculty.

Marketing

We engage in a range of relationship-based marketing activities to build the Capella brand, differentiate us from other educational providers, increase awareness and consideration with prospective learners, generate inquiries for enrollment, remind and motivate current learners to re-register each quarter, and stimulate referrals from current learners and graduates. These marketing activities include Internet, television, print, radio, email, social media and direct mail advertising campaigns. Other marketing activities include supportive outreach to current learners, participation in seminars and trade shows, and development of key marketing relationships with corporate, healthcare, armed forces, government, and educational organizations. Online advertising (display, social, mobile, search and through aggregators) currently generates our largest volume of inquiries from prospective learners.

Enrollment

As of the last day of classes in the quarter ended December 31, 2014, our enrollment was 36,309 learners. Of the learners who responded to our demographic survey, approximately 75% were female and approximately 54% were people of color. Our learner population is geographically distributed primarily throughout the United States. Our end of period enrollments as of December 31, 2014 increased 2.5% percent compared to December 31, 2013, making 2014 our first year of total enrollment growth since 2010. Total enrollment growth was driven primarily by favorable levels of new enrollment growth and persistence improvements.

The following summarizes our learners as of the last day of the quarter ended December 31, 2014:

	Total Enrollment	
	Number of Learners	Percent of Total

Doctoral	10,100	27.8	%
Master’s	15,700	43.2	%
Bachelor’s	9,500	26.2	%
Other	1,009	2.8	%
Total	36,309	100.0	%

Tuition and Fees

Our tuition rates vary by type and length of program and by degree level, such as doctoral, master's or bachelor's. For all learners in our credit hour master's and bachelor's programs, tuition is charged on a per course basis. Prices per course for credit hour programs ranged from approximately $1,400 to $2,600 for the 2014-2015 academic year (the academic year that began in July 2014) and from $1,200 to $2,500 for the 2013-2014 academic year (the academic year that began in July 2013). The price of the course varies based upon the number of credit hours, the degree level of the program, and the discipline. For FlexPath learners, tuition is priced at a fixed amount per quarter. Tuition for learners seeking a bachelor's degree through FlexPath is priced at a quarterly amount of $2,000, and tuition for learners enrolled in master's level programs through FlexPath is priced at $2,200 per quarter.

The majority of doctoral programs are priced at a fixed quarterly amount ranging from approximately $4,300 to $4,700 per learner for the 2014-2015 academic year and from $4,300 to $4,700 per learner for the 2013-2014 academic year, regardless of the number of courses in which the learner was registered. For select doctoral programs, tuition is charged on a per course basis. Prices per course ranged from $2,600 to $4,400 for the 2014-2015 academic year and from $1,900 to $4,300 for the 2013-2014 academic year.

"Other" in the enrollment table above refers primarily to certificate-seeking learners. Certificate programs generally consist of four courses, and the price of a course depends on the number of credit hours and the discipline. Prices per course in certificate programs generally ranged from approximately $1,500 to $2,600 for the 2014-2015 academic year and from $1,500 to $2,500 for the 2013-2014 academic year.

Tuition increases are specific to the program specialization and depend on market conditions, program differentiation or changes in operating costs that have an impact on price adjustments of individual programs or specializations. Capella University implemented a weighted average tuition increase of 2.6% for the 2014-2015 academic year. The University's website, www.capella.edu, provides additional details regarding tuition costs and credits required by individual degree. These program costs will vary by learner based upon the program and specialization selected, the number of courses taken per quarter and the number of transfer credits earned at other institutions.

We offer scholarships and tuition discounts, under a variety of different programs, to members of the armed forces and in connection with our various corporate, healthcare, federal and educational marketing relationships, for example:

- U.S. armed forces relationships and discount program available to all members of the U.S. armed forces, including active duty members, veterans, National Guard members, reservists, civilian employees of the Department of Defense and immediate family members of active duty personnel.
- Corporate, healthcare and federal relationships with more than 500 large and mid-size organizations.
- Educational relationships that encourage graduates of nearly 300 community colleges to enroll in our undergraduate programs, and faculty and administrators to enroll in our graduate programs.

As of December 31, 2014, approximately 24% of our learners received a discount in connection with these programs.

Throughout the past several years, we expanded and refined our offering of learner success scholarships under a variety of different programs, to promote affordability and encourage learners to remain enrolled. Learners must meet admission requirements, and enroll and apply within certain timeframes to receive the scholarships, which are generally awarded over a period of four to eight consecutive quarters. As of December 31, 2014, approximately 14% of our learners received a Capella awarded scholarship.

Technology

Capella University provides learners and faculty members a secure, web-based technology environment through which they can learn about our offerings, access courses and support resources, utilize self-service tools, and engage in a private social network for academic collaboration and professional growth. This environment supports our structured, credit bearing programs as well as our FlexPath direct assessment offerings. The University captures and stores comprehensive data across the lifecycle of our learners and embraces analytics to create differentiation and value.

Online courseroom. The University is a leader in competency-based learning and provides the instructional content of each course, along with tools to facilitate course discussions, assessments, grading and submission of assignments, through our online courseroom environment. We operate the Blackboard Learn System as our online courseroom platform. Through this platform, Capella supports more than 1,740 online courses each quarter.

Learner portal. Our iGuide platform acts as a virtual campus to our learners, providing them with a variety of support resources and networking tools to connect with fellow learners and faculty. Learners also use iGuide to access their online courseroom, community discussions, e-books, the library, financial aid, and self-service tools. iGuide is delivered on Liferay Portal, a Java-based Web portal and content management system platform.

Learner and faculty support. We utilize an Oracle/PeopleSoft Enterprise Resource Planning (ERP) platform to provide support services to our learners and faculty, including learner participation monitoring, course registration, transcript requests and financial aid applications. In addition, we offer our learners and faculty members online access to library resources, including comprehensive databases of articles, journals, and books across academic disciplines.

Internal administration. We use Oracle’s PeopleSoft ERP to perform internal administrative and operational functions. Our learner information system manages learner academic data and accounts receivable information, and our document management system stores and sorts learner applications, academic records and marketing data. We also employ PeopleSoft’s Customer Relationship Management (CRM) software to organize and process prospective learner information.

Service-oriented architecture. Data from each of Capella’s primary technology platforms – the Blackboard Learn System, the Liferay Portal, and the PeopleSoft Enterprise Resource Planning system – is shared through a custom-built service oriented architecture. Capella uses this architecture to build integrated, personalized learning and service applications for learners and faculty, which are then accessed through our portal and the Blackboard Learn System.

Infrastructure. Our servers and storage infrastructure are co-located in a third-party primary hosting facility and at a separate third-party backup data center. We perform redundant backup of software and data. We currently use a combination of Unix and Windows-based software on Cisco, HP, and Oracle/Sun hardware.

Enterprise Data Warehouse (EDW) and analytics. Capella’s EDW is our comprehensive repository of data throughout the learner lifecycle. We have built the EDW in a phased approach and continue to expand the EDW to include additional depth of academic data (learning data and engagement data) – including learner and faculty activity in our courseroom, learner demonstration of learning outcomes, accreditation alignments of academic content, and other data. Data from the EDW is made available to stakeholders through a powerful set of reporting and data analytics tools based on Microsoft and SAS software.

Information security. Capella has an information security program that includes leadership, tools, processes, and training. To protect our information assets, Capella’s information security practices are designed to reduce information security and IT risks, respond to incidents, establish appropriate standards and controls, and establish, implement, and maintain information security policies and procedures. These practices include an education and training program on information security and privacy matters for employees and external stakeholders.

Mobile. Capella provides a suite of applications to support faculty and learners who use mobile devices to engage with the University. Mobile platforms Capella supports include iPhone, iPad, Android, and mobile-optimized web sites. Capella’s mobile solutions focus on enabling student productivity, with features including courseroom interactions, degree planning tools, alerts and notifications, self-service capabilities, e-books, and academic and professional networking.

Visitor Center. The Visitor Center provides a fully responsive, engaging and exploration-friendly experience in which potential learners can acquaint themselves with our value proposition and key offerings. The site also provides prospective learners with a personalized path to get the right information at the right time in their decision making cycle and enables them to ascertain their readiness to enroll in one of our programs.

Intellectual Property

Intellectual property is important to our business. We rely on a combination of copyrights, trademarks, service marks, trade secrets, agreements with third parties, and confidentiality agreements and practices to protect our proprietary rights. In many instances, our course content is produced for us by faculty and other content experts under work for hire agreements pursuant to which we own the course content in return for a fixed development fee. In certain limited cases, we license course content from a third party on a royalty fee basis.

We own many registered and unregistered trademarks for use in our business. We have trademark or service mark registrations and pending applications in the U.S. and select foreign jurisdictions, including “CAPELLA,” “CAPELLA EDUCATION

COMPANY,” “CAPELLA UNIVERSITY,” "SOPHIA," and certain distinctive logos, along with various other trademarks and service marks related to our specific offerings. We also own domain name rights to “www.capellaeducationcompany.com,” “www.capellaeducation.com,” “www.capella.edu,” “www.capellauniversity.edu,” "www.capellaresults.com,"www.rdi.co.uk," and "www.sophia.org," as well as other words and phrases important to our business.

Available Information

Our corporate Internet address is www.capellaeducation.com. 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 pursuant to Section 13(a) of 15(d) of the Exchange Act, soon after they are electronically filed with the SEC. In addition, our earnings conference calls and presentations to the financial community are web cast live via our website. In addition to visiting our website, you may read and copy public reports we file with the SEC at the SEC’s Public Reference Room at 100 F. Street NE, Washington DC 20549, or at www.sec.gov. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Information contained on our website is expressly not incorporated by reference into this Form 10-K.

REGULATORY ENVIRONMENT

Learners attending Capella University finance their education through a combination of individual resources, corporate reimbursement programs and federal financial aid programs. Capella University participates in the federal student financial aid programs authorized under Title IV. For the year-ended December 31, 2014, approximately 77% of our revenues (calculated on a cash basis) were derived from Title IV programs. In connection with a learner's receipt of federal financial aid, we are subject to extensive regulation by the Department of Education, state education agencies and our accrediting agency, The Higher Learning Commission of the North Central Association of Colleges and Schools. In particular, the Title IV programs, and the regulations issued thereunder by the Department of Education, subject us to significant regulatory scrutiny in the form of numerous standards that we must satisfy to participate in the federal student financial aid programs. To participate in Title IV programs, a school must be:

- authorized to offer its programs of instruction by the applicable state education agencies in the states in which it is physically located (in our case, Minnesota), and where its activities require an approval to operate;
- accredited by an accrediting agency recognized by the Secretary of the Department of Education; and
- certified as an eligible institution by the Department of Education.

Our business activities are planned and implemented to achieve compliance with the rules and regulations of the state, regional and federal agencies that regulate our activities. We have established regulatory compliance and management systems and processes under the oversight of our Chief Financial Officer and our General Counsel that are designed to meet the requirements of this regulatory environment.

Accreditation

Capella University has been institutionally accredited since 1997 by The Higher Learning Commission of the North Central Association of Colleges and Schools, a regional accrediting agency recognized by the Secretary of the Department of Education. In January 2015, Capella University's accreditation with the Higher Learning Commission was reaffirmed. The re-affirmation enables Capella University to continue to participate in Title IV programs. The next reaffirmation of accreditation will take place in 2022-2023. Accreditation is a non-governmental system for recognizing educational institutions and their programs for learner performance, governance, integrity, educational quality, faculty, physical resources, administrative capability and resources, and financial stability. In the United States, this recognition comes primarily through private voluntary associations that accredit institutions and programs of higher education. To be recognized by the Secretary of the Department of Education, accrediting agencies must adopt specific standards for their review of educational institutions. These associations, or accrediting agencies, establish criteria for accreditation, conduct peer-review evaluations of institutions and professional programs for accreditation and publicly designate those institutions that meet their criteria. Accredited schools are subject to periodic review by accrediting agencies to determine whether such schools maintain the performance, integrity and quality required for accreditation.

The Higher Learning Commission is the same accrediting agency that accredits such universities as Northwestern University, the University of Chicago, the University of Minnesota and other degree-granting public and private colleges and universities in its region (namely, the States of Arizona, Arkansas, Colorado, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, New Mexico, North Dakota, Ohio, Oklahoma, South Dakota, West Virginia, Wisconsin, and Wyoming).

Accreditation by The Higher Learning Commission is important to us. Colleges and universities depend, in part, on accreditation in evaluating transfers of credit and applications to graduate schools. Employers rely on the accredited status of institutions when evaluating a candidate's credentials, and corporate and government sponsors under tuition reimbursement programs look to accreditation for assurance that an institution maintains quality educational standards. Moreover, institutional accreditation by an accrediting agency recognized by the Secretary of the Department of Education is necessary for eligibility to participate in Title IV programs.

State Regulatory Accountability

We are registered with the Minnesota Office of Higher Education, the regulatory agency governing the State of Minnesota, where Capella University is located. We are required by the Higher Education Act to maintain registration with the Minnesota Office of Higher Education to participate in Title IV programs.

The increasing popularity and use of the Internet and other online services for the delivery of education has led and may lead to the adoption of new laws and regulatory practices and new interpretations of existing laws and regulations in the United States or foreign countries. These new laws, regulations and interpretations may relate to issues such as the requirement that online education institutions be licensed to operate in one or more jurisdictions where they have no physical location or other presence. For instance, in some states, we are required to seek licensure or authorization because our recruiters meet with prospective learners in the state. In other cases, the state higher educational agency has required licensure or authorization because we enroll learners who reside in the state. New laws, regulations or interpretations related to doing business over the Internet could increase our cost of doing business and affect our ability to recruit learners in particular states, which could, in turn, negatively affect enrollments and revenues and have a material adverse effect on our business.

In addition to Minnesota, Capella University is licensed or authorized to operate or certified to offer degree programs in the following states: Alabama, Arizona, Arkansas, Florida, Georgia, Iowa, Kansas, Kentucky, Louisiana, Maryland, Nevada, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Washington, West Virginia, Wisconsin, and Wyoming. We are formally licensed or authorized to operate in these states because we have determined that our activities in each state constitute a presence that requires licensure or authorization by these states' higher educational agencies. In some cases, the licensure or authorization is only for specific programs or specific activities. Because we enroll learners from each of the 50 states, as well as the District of Columbia, and because we may undertake activities in other states that constitute a presence or otherwise subject us to the jurisdiction of the respective state educational agency, we may, from time to time, need to seek licensure or authorization to operate in additional states. Additionally, state regulations in states in which we are not licensed may limit certain of our activities, such as residencies and internships in programs requiring those experiences.

State Professional Licensure

Many states have specific requirements that an individual must satisfy in order to be licensed as a professional in a specified field. Learners often seek to obtain professional licensure in their chosen fields following graduation. Their success in obtaining licensure typically depends on several factors, including the individual merits of the graduate, as well as the following, among other factors:

- whether the institution and the program were approved by the state in which the graduate seeks licensure, or by a professional association;
- whether the program from which the learner graduated meets all state requirements for professional licensure; and
- whether the institution and/or the specific program is accredited.

Due to varying requirements for professional licensure in each state, Capella University’s catalog and web site inform learners of the risks associated with obtaining professional licensure and more specifically states that (1) Capella University makes no representation or guarantees that completion of any educational program ensures that the learner will be able to obtain individual professional licensure or certification, and (2) learners are solely responsible for determining and complying with state, local, or professional licensure and certification requirements.

When we learn that a state has refused to grant licensure to one of our graduates, we take one or more of the following actions. In certain instances, where we believe the state’s refusal to license one of our graduates may be incorrect, we assist graduates by providing clarifying information to the state. If we know that a state will not license one of our graduates because a Capella University program is not accredited by a specific third party or it does not meet other licensing requirements, we use our best efforts to convey that information to prospective learners before they enroll in such program. In instances where states inform us that they will impose restrictions on residencies and internships, we notify existing learners and use our best efforts to communicate the information to prospective learners. In all cases, we semi-annually remind our learners by email that they need to communicate directly with the state in which they intend to seek licensure to fully understand the licensing requirements of that state.

Nature of Federal, State and Private Financial Support for Postsecondary Education

The federal government provides a substantial part of its support for postsecondary education through Title IV programs in the form of grants and loans to learners who can use those funds at any institution that has been certified as eligible by the Department of Education. Aid under Title IV is awarded based on the school’s determined cost of attendance and the student's expected family contribution, as determined by the Free Application for Federal Student Aid (FAFSA). All recipients of Title IV funds must maintain satisfactory academic progress and must also progress in a timely manner toward completion of their program of study. In addition, we must ensure that Title IV funds are properly accounted for and disbursed in the correct amounts and in a timely manner to eligible learners.

Capella University learners receive loans and grants to fund their education primarily under the Federal Direct Loan Program (FDLP) and the Federal Pell Grant (Pell) Title IV programs. In 2014, approximately 77% of our revenues (calculated on a cash basis) were derived from tuition financed under Title IV federal financial aid.

•FDLP. Under the FDLP, the Department of Education, rather than a private lender, makes loans to learners. In 2014, approximately 74% of our revenues (calculated on a cash basis) were derived from the FDLP. Effective July 1, 2010, with the discontinuation of the Federal Family Education Loan Program (FFELP), the vast majority of our learners rely on FDLP loans to fund their programs.

•Pell Grants. Under the Pell program, the Department of Education awards grants to bachelor's learners who demonstrate financial need. In 2014, approximately 3% of our revenues (calculated on a cash basis) were derived from the Pell program.

Certain learners are eligible to receive funds from educational assistance programs administered by the U.S. Department of Veterans Affairs through the Minnesota Department of Veterans Affairs. Some Capella University learners finance all or a portion of their own education or receive full or partial tuition reimbursement from their employers. Finally, eligible learners can also access private loans through a number of different lenders for funding at current market interest rates. For the year-ended December 31, 2014, less than one percent of our learners utilized private loans, and less than one percent of our revenue was derived from private loans.

Regulation of Federal Student Financial Aid Programs

To be eligible to participate in Title IV programs, an institution must comply with specific standards and procedures set forth in the Higher Education Act and the regulations issued thereunder by the Department of Education. An institution must, among other things, be licensed or authorized to offer its educational programs by the state within which it is physically located (in our case, Minnesota), and where its activities require an approval to operate, and maintain institutional accreditation by a recognized accrediting agency. Capella University is fully certified through June 30, 2020 to participate in the Title IV programs.

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

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

Congressional Action. Congress reauthorizes the Higher Education Act approximately every five to eight years. Congress most recently reauthorized the Higher Education Act in 2008. The reauthorized Higher Education Act continued all of the Title IV programs in which we participate, but made numerous revisions to the requirements governing the Title IV programs, including provisions relating to the relationships between institutions and lenders that make student loans, student loan default rates, and the formula for revenue that institutions are permitted to derive from the Title IV programs. In addition, further rulemaking by the Department of Education may impose additional requirements on institutions that participate in Title IV programs. Committee leadership of both the U.S. House of Representatives and Senate began reauthorization hearings in the latter half of 2013. Existing programs and participation requirements are subject to change in this process. Additionally, funding for the student financial assistance programs may be impacted during appropriations and budget actions.

Administrative Capability. Department of Education regulations specify extensive criteria by which an institution must establish that it has the requisite "administrative capability" to participate in Title IV programs. Failure to satisfy any of the standards may lead the Department of Education to find the institution ineligible to participate in Title IV programs or to place the institution on provisional certification as a condition of its participation. To meet the administrative capability standards, an institution must, among other things:

- Comply with all applicable Title IV program regulations;
- Have capable and sufficient personnel to administer the federal student financial aid programs;
- Have acceptable methods of defining and measuring the satisfactory academic progress of its learners;
- Not have cohort default debt rates above specified levels;
- Have various procedures in place for safeguarding federal funds;

- Not be, and not have any principal or affiliate who is, debarred or suspended from federal contracting or engaging in activity that is cause for debarment or suspension;
- Provide financial aid counseling to its learners;
- Refer to the Department of Education's Office of Inspector General any credible information indicating that any applicant, learner, employee, or agent of the institution, has been engaged in any fraud or other illegal conduct involving Title IV programs;
- Submit in a timely manner all reports and financial statements required by the regulations; and
- Not otherwise appear to lack administrative capability.

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

- Require the repayment of Title IV funds;
- Transfer the institution from the U.S. Department of Education's advance system of receiving Title IV program funds to its reimbursement system, under which a school must disburse its own funds to learners and document the learners' eligibility for Title IV program funds before receiving such funds from the U.S. Department of Education;
- Place the institution on provisional certification status; or
- Commence a proceeding to impose a fine or to limit, suspend or terminate the participation of the institution in Title IV programs.

If we are found not to have satisfied the Department of Education's "administrative capability" requirements, we could lose, or be limited in our access to, Title IV program funding.

Financial Responsibility. The Higher Education Act and Department of Education regulations establish extensive standards of financial responsibility that institutions such as Capella University must satisfy to participate in Title IV programs. These standards generally require that an institution provide the resources necessary to comply with Title IV program requirements and meet all of its financial obligations, including required refunds and any repayments to the Department of Education for liabilities incurred in programs administered by the Department of Education.

The Department of Education evaluates institutions on an annual basis for compliance with specified financial responsibility standards utilizing a complex formula that uses line items from the institution's audited financial statements. The standards focus on three financial ratios: (1) equity ratio (which measures the institution's capital resources, financial viability and ability to borrow); (2) primary reserve ratio (which measures the institution's ability to support current operations from expendable resources); and (3) net income ratio (which measures the institution's ability to operate at a profit or within its means). An institution's financial ratios must yield a composite score of at least 1.5 for the institution to be deemed financially responsible without the need for further federal oversight. We have applied the financial responsibility standards to our Capella University audited financial statements as of and for the years ended December 31, 2013 and 2012, and calculated a composite score of 3.0 for both years, which is the maximum score attainable. We therefore believe that we meet the Department of Education's financial responsibility standards. We will finalize our composite score as of and for the year-ended December 31, 2014 in early 2015, and expect to meet the composite score requirements. If the Department of Education were to determine that we did not meet the financial responsibility standards due to a failure to meet the composite score or other factors, we could establish financial responsibility on an alternative basis by, among other things:

- posting a letter of credit in an amount equal to at least 50% of the total Title IV program funds received by the institution during the institution's most recently completed fiscal year;
- posting a letter of credit in an amount equal to at least 10% of such prior year's Title IV program funds received by us, accepting provisional certification, complying with additional Department of Education monitoring requirements and agreeing to receive Title IV program funds under an arrangement other than the Department of Education's standard advance funding arrangement; or
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complying with additional Department of Education monitoring requirements and agreeing to receive Title IV program funds under an arrangement other than the Department of Education's standard advance funding arrangement such as the "reimbursement" system of payment or cash monitoring.

Failure to meet the Department of Education’s “financial responsibility” requirements, either because we do not meet the Department of Education’s minimum composite score to establish financial responsibility or are unable to establish financial responsibility on an alternative basis, would cause us to lose access to Title IV program funding.

Title IV Return of Funds. Under the Department of Education’s return of funds regulations, an institution must first determine the amount of Title IV program funds that a learner “earned.” If the learner withdraws during the first 60% of any period of enrollment or payment period, the amount of Title IV program funds that the learner earned is equal to a pro rata portion of the funds for which the learner would otherwise be eligible. If the learner withdraws after the 60% threshold, then the learner has earned 100% of the Title IV program funds. The institution must return to the appropriate Title IV programs, in a specified order, the lesser of (i) the unearned Title IV program funds and (ii) the institutional charges incurred by the learner for the period multiplied by the percentage of unearned Title IV program funds. An institution must return the funds no later than 45 days after the date of the institution’s determination that a learner withdrew. If such payments are not made timely, an institution may be subject to adverse action, including being required to submit a letter of credit equal to 25% of the refunds the institution should have made in its most recently completed year. Under Department of Education regulations, late returns of Title IV program funds for 5% or more of learners sampled in the institution’s annual compliance audit constitutes material non-compliance. Regulations require that a company's return of Title IV funds error rate be under 5% for two consecutive annual Title IV compliance audits.

The “90/10 Rule.” A requirement of the Higher Education Act commonly referred to as the “90/10 Rule,” applies only to “proprietary institutions of higher education,” which includes Capella University. Under the 2008 reauthorization of the Higher Education Act, effective upon the date of the law’s enactment, an institution is subject to loss of eligibility to participate in the Title IV programs if, on a cash accounting basis, it derives more than 90% of its fiscal year revenue, for two consecutive fiscal years, from Title IV program funds. An institution whose rate exceeds 90% for any single fiscal year will be placed on provisional certification for at least two fiscal years and may be subject to other conditions specified by the Secretary of Education. For the year-ended December 31, 2014, we derived approximately 77% of our revenues (calculated on a cash basis) from Title IV program funds.

Student Loan Defaults. Under the Higher Education Act, an educational institution may lose its eligibility to participate in some or all of the Title IV programs if defaults on the repayment of federally guaranteed student loans by its learners exceed certain levels. For each federal fiscal year, a rate of student defaults (known as a “cohort default rate”) is calculated for each institution with 30 or more borrowers entering repayment in a given federal fiscal year by determining the rate at which borrowers who become subject to their repayment obligation in that federal fiscal year default by the end of the second federal fiscal year. For such institutions, the Department of Education calculates a single cohort default rate for each federal fiscal year that includes in the cohort all current or former student borrowers at the institution who entered repayment on any FFELP Stafford loans or FDLP loans during that year.

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, an educational institution will lose its eligibility to participate in Title IV programs if its three-year measuring period student loan cohort default rate equals or exceeds 30% for three consecutive cohort years, or 40% for any given year. Capella University's three-year cohort default rates for the 2011, 2010, and 2009 cohorts are 13.0%, 10.9%, and 9.7% respectively. The increase is primarily due to the overall economic environment, and a slight increase in the percentage of Capella University learners enrolled in a bachelor's program, who generally have a higher default rate compared to graduate learners. The average cohort default rates for proprietary institutions nationally were 19.1% and 21.8% in fiscal years 2011 and 2010 respectively.

The cohort default rate requirements were modified by the Higher Education Opportunity Act enacted in August 2008 to increase by one year the measuring period for each cohort. Starting in September 2012, the Department of Education published the official three-year cohort default rates in addition to the two-year rates, beginning with the 2009 cohort, and two-year cohort default rates were no longer calculated following the release of the 2011 two-year rates.

Incentive Compensation Rules. As a part of an institution's program participation agreement with the Department of Education and in accordance with the Higher Education Act, the institution may not provide any commission, bonus or other incentive payment to any person or entity engaged in any learner recruitment, admissions or financial aid awarding activity based directly or indirectly on success in securing enrollments or financial aid. Failure to comply with the incentive compensation rules could result in loss of eligibility to participate in federal student financial aid programs or financial penalties.

Gainful Employment. The Department of Education published a Notice of Proposed Rulemaking on March 25, 2014. The proposed 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 proposed rule was similar to the draft language last discussed at the third negotiated rulemaking committee session in December 2013. The draft rule established two “accountability metrics” that GE programs must satisfy in order to remain eligible for Title IV federal student aid, specifically debt to earnings (DTE) ratios and programmatic cohort default rate (pCDR) thresholds. Unlike the accountability metrics in the Department of Education’s previous GE rule, the accountability metrics under the Department of Education's draft proposal operate independently from one another. Consequently, in order for a GE program to maintain its Title IV eligibility under the proposed rule, it must satisfy both the DTE and pCDR requirements. The proposed rule also required institutions to provide certifications and disclosures regarding a GE program’s satisfaction of programmatic accreditation and state licensure requirements. Additionally, the proposed 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 further made other conforming and technical revisions to the Title IV program participation agreement and related regulations. The rule closed for public comment on May 25, 2014, and the Department of Education issued a Final Rule on October 31, 2014.

The most significant change reflected by the Final Rule is the application of a single “accountability metric,” rather than two metrics as in the earlier proposed rule. The Final Rule abandons the previously proposed Programmatic Cohort Default Rate (“pCDR”) metric for purposes of a GE program’s Title IV student aid eligibility, instead adding the pCDR to the multitude of required GE program disclosures, and instead will assess continued eligibility of GE programs solely by their performance against the following Debt-to-Earnings (“DTE”) measures:

Pass: Programs whose graduates have annual loan payments less than 8% of total earnings, OR less than 20% of discretionary earnings.

“Zone”: Programs that do not pass and whose graduates have annual loan payments between 8% and 12% of total earnings, OR between 20% and 30% of discretionary earnings.

Fail: Programs whose graduates have annual loan payments greater than 12% of total earnings AND greater than 30% of discretionary earnings.

Ineligible: Programs that fail in 2 out of any 3 consecutive years OR have a combination of zone and failing DTE rates for four consecutive years for which DTE rates are calculated.

Earnings are calculated by the Department using Social Security Administration data. Earnings information is then aggregated and made available to institutions. The Department has stated that they will receive SSA earnings data in early 2016 and will release to institutions by mid-2016. Without access to this data institutions cannot predict the impact to individual programs.

If a program fails or is in the zone for draft DTE rates during the transition period, the Department will calculate transitional draft DTE rates using the median loan debt of the students who completed the program during the most recently completed award year (2014-2015) and the earnings used to calculate the draft DTE rates. The final DTE rate for purposes of any sanctions will be the lower of the draft or transitional DTE rate. The transition period is 5 years for programs with durations of 1 year or less, 6 years for programs between 1 and 2 years in length, and 7 years for programs of more than 2 years.

If a GE program could become ineligible in the subsequent award year based on its DTE metrics, the institution is required to inform students and prospective students that the program could lose Title IV eligibility. The warning must state that the program has not passed standards established by the Department, based on amounts students borrow for enrollment in the program and their reported earnings. The warning must also inform students that if the program does not pass the standards in the future, students who are then enrolled may not be able to use federal student grants or loans to pay for the program. The Final Rule also requires institutions to provide certifications regarding a GE program's satisfaction of programmatic accreditation and state licensure requirements. The final rule expands the currently required disclosures for GE programs. Beginning January 1, 2017, institutions will be required to provide these disclosures for each GE program through an updated template provided by the Department. The Final Rule becomes effective July 1, 2015.

The continuing eligibility of our educational programs for Title IV funding could be at risk due to factors beyond our control, such as changes in the actual or deemed income level of our graduates, changes in student borrowing levels, increases in interest rates, changes in the federal poverty income level relevant for calculating discretionary income, changes in the percentage of our former students who are current in repayment of their student loans, and other factors.

Compliance Reviews. We are subject to announced and unannounced compliance reviews and audits by various external agencies, including the Department of Education, its Office of Inspector General (OIG), state licensing agencies, the Department of Veterans Affairs and accrediting agencies. As part of the Department of Education's ongoing monitoring of institutions' administration of Title IV programs, The Higher Education Act and Department of Education regulations also require institutions to annually submit a compliance audit conducted by an independent certified public accountant in accordance with Government Auditing Standards and applicable audit standards of the Department of Education. In addition, to enable the Secretary of Education to make a determination of financial responsibility, institutions must annually submit audited financial statements prepared in accordance with Department of Education regulations.

The OIG is responsible for, among other things, promoting the effectiveness and integrity of the Department of Education's programs and operations. With respect to educational institutions that participate in Title IV funding programs, the OIG conducts its work primarily through compliance audits and investigations. An OIG compliance audit typically focuses on whether an institution administers federal funds in accordance with applicable rules and regulations, whereas an investigation typically indicates a concern regarding potential fraud or abuse involving federal funds. We perform periodic reviews of our compliance with the various applicable regulatory requirements. We have not been notified by any of the various regulatory agencies of any significant noncompliance matters that would adversely impact our ability to participate in Title IV programs.

Potential Effect of Regulatory Violations. If Capella University fails to comply with the regulatory standards governing Title IV programs, the Department of Education could impose one or more sanctions, including transferring Capella University to the reimbursement or cash monitoring system of payment, seeking to require repayment of certain Title IV program funds, requiring Capella University to post a letter of credit in favor of the Department of Education as a condition for continued Title IV certification, taking emergency action against Capella University, referring the matter for criminal prosecution or initiating proceedings to impose a fine or to limit, condition, suspend or terminate the participation of Capella University in Title IV programs.

Capella University also may be subject, from time to time, to complaints and lawsuits relating to regulatory compliance brought not only by our regulatory agencies, but also by other government agencies and third parties, such as present or former learners or employees and other members of the public.

Restrictions on Adding Educational Programs. State requirements and accrediting agency standards may, in certain instances, limit our ability to establish additional programs. Many states require approval before institutions can add new programs under specified conditions. The Higher Learning Commission, the Minnesota Office of Higher Education, and other state educational regulatory agencies that license or authorize us and our programs, require institutions to notify them in advance of implementing new programs, and upon notification may undertake a review of the institution's licensure, authorization or accreditation.

Generally, if an institution eligible to participate in Title IV programs adds an educational program after it has been designated as an eligible institution, the institution must apply to the Department of Education to have the additional program designated as eligible. However, a degree-granting institution is not obligated to obtain the Department of Education's approval of additional programs that lead to an associate, bachelor's, professional or graduate degree at the same degree level(s) previously approved by the Department of Education. Similarly, an institution is not required to obtain advance approval for new programs that both prepare learners for gainful employment in the same or related recognized occupation as an educational program that has previously been designated as an eligible program at that institution and meet certain minimum-length requirements. However, the Department of Education, as a condition of certification to participate in Title IV programs, can require prior approval of such programs or otherwise restrict the number of programs an institution may add. In the event that an institution that is required to obtain the Department of Education's express approval for the addition of a new program fails to do so, and erroneously determines that the new educational program is eligible for Title IV program funds, the institution may be liable for repayment of Title IV program funds received by the institution or learners in connection with that program. In connection with Department of Education rulemaking in 2010, certain modifications to Department of Education rules relating to the addition of new programs took effect on July 1, 2011. Specifically, in addition to state approvals, Department of Education approval may be required for certain new program offerings. These rules, as a part of the gainful employment package, were vacated by the U.S. District Court for the District of Columbia on June 30, 2012.

Eligibility and Certification Procedures. Each institution must apply to the Department of Education for continued certification to participate in Title IV programs at least every six years, or when it undergoes a change of control, and an institution may come under the Department of Education's review when it expands its activities in certain ways, such as opening an additional location or, in certain cases, when it modifies academic credentials that it offers. Capella University is fully certified through June 30, 2020 to participate in the Title IV programs. Our recertification process is described more fully in the section "Regulatory Environment–Regulation of Federal Student Financial Aid Programs."

School Acquisitions. When a company, partnership or any other entity or individual acquires a school that is eligible to participate in Title IV programs, that school undergoes a change of ownership resulting in a change of control as defined by the Department of Education. Upon such a change of control, a school's eligibility to participate in Title IV programs is generally suspended until it has applied for recertification by the Department of Education as an eligible school under its new ownership, which requires that the school also re-establish its state authorization and accreditation. The Department of Education may temporarily and provisionally certify an institution seeking approval of a change of ownership under certain circumstances while the Department of Education reviews the institution's application. The time required for the Department of Education to act on such an application may vary substantially. The Department of Education's recertification of an institution following a change of control will be on a provisional basis.

Change in Ownership Resulting in a Change of Control. In addition to school acquisitions, other types of transactions can also cause a change of control. The Department of Education, most state education agencies and our accrediting agency all have standards pertaining to the change of control of schools, but these standards are not uniform. Department of Education regulations describe some transactions that constitute a change of control, including the transfer of a controlling interest in the voting stock of an institution or the institution's parent corporation. With respect to a publicly traded corporation, Department of Education regulations provide that a change of control occurs in one of two ways: (i) if there is an event that would obligate the corporation to file a Current Report on Form 8-K with the SEC disclosing a change of control or (ii) if the corporation has a shareholder that owns at least 25% of the total outstanding voting stock of the corporation and is the largest shareholder of the corporation, and that shareholder ceases to own at least 25% of such stock or ceases to be the largest shareholder. These standards are subject to interpretation by the Department of Education. A significant purchase or disposition of our voting stock could be determined by the Department of Education to be a change of control under this standard. Many states include the sale of a controlling interest of common stock in the definition of a change of control requiring approval. A change of control under the definition of one of these agencies would require us to seek approval of the change in ownership and control to maintain our accreditation, state authorization or licensure. The requirements to obtain such approval from the states and our accrediting commission vary widely. In some cases, approval of the change of ownership and control cannot be obtained until after the transaction has occurred.

When a change of ownership resulting in a change of control occurs at a for-profit institution, the Department of Education applies a different set of financial tests to determine the financial responsibility of the institution in conjunction with its review and approval of the change of ownership. The institution is required to submit a same-day audited balance sheet reflecting the financial condition of the institution immediately following the change in ownership. The institution's same-day balance sheet must demonstrate an acid test ratio of at least 1:1, which is calculated by adding cash and cash equivalents to current accounts receivable and dividing the sum by total current liabilities (and excluding all unsecured or uncollateralized related party receivables). In addition, the same-day balance sheet must demonstrate positive tangible net worth. If the institution does not satisfy these requirements, the Department of Education may condition its approval of the change of ownership on the institution's agreeing to letters of credit, provisional certification, and/or additional monitoring requirements, as described in the above section on "Financial Responsibility."

A change of control also could occur as a result of future transactions in which Capella Education Company or Capella University is involved. Some corporate reorganizations and some changes in the board of directors are examples of such transactions. Moreover, the potential adverse effects of a change of control could influence future decisions by us and our shareholders regarding the sale, purchase, transfer, issuance or redemption of our stock. In addition, the adverse regulatory effect of a change of control also could discourage bids for shares of our common stock and could have an adverse effect on the market price of our common stock.

Item 1A. Risk Factors

Risks Related to the Extensive Regulation of Our Business

If we fail to comply with the extensive regulatory requirements for our business, we could face significant restrictions on our operations and monetary penalties, including loss of access to federal loans and grants for our learners on which we are substantially dependent.

As a provider of higher education, we are subject to extensive U.S. regulation on both the federal and state levels. In particular, the Higher Education Act, as amended and reauthorized from time to time, and related regulations impose significant regulatory scrutiny on Capella University, and all other higher education institutions that participate in the various federal student financial aid programs under Title IV of the Higher Education Act (Title IV programs). The Higher Education Act, as reauthorized, mandates specific regulatory responsibilities for each of the following components of the higher education regulatory triad: (1) the federal government through the U.S. Department of Education; (2) independent accrediting agencies recognized by the Department of Education; and (3) state higher education regulatory bodies.

In 2014, Capella University derived approximately 77% of its revenues (calculated on a cash basis) from Title IV programs, administered by the U.S. Department of Education. A significant percentage of our learners rely on the availability of Title IV program funds to cover their cost of attendance at Capella University and related educational expenses.

The applicable regulatory requirements cover virtually all phases of our operations, including educational program offerings, facilities, instructional and administrative staff, administrative procedures, marketing and recruiting, financial operations, processing refund payments to the U.S. Department of Education for withdrawn learners, commencement of new educational programs, and changes in our corporate structure and ownership.

The regulations, standards and policies of the various regulatory agencies frequently change and are subject to interpretative uncertainty, particularly where they are crafted for traditional schools rather than our on-line academic delivery model. Changes in, or new interpretations of, applicable laws, regulations, or standards could have a material adverse effect on our accreditation, authorization to operate in various states, permissible activities, receipt of funds under Title IV programs, or costs of doing business. We cannot predict how all of the requirements applied by these agencies will be interpreted or whether we will be able to comply with these requirements in the future.

If we are found to be in noncompliance with any applicable regulations, standards or policies, any one of the relevant regulatory agencies may be able to do one or more of the following:

- Impose monetary fines or penalties;
- Limit or terminate our operations or ability to grant degrees and diplomas;
- Restrict or revoke our accreditation, licensure or other approvals to operate;
- Limit, suspend or terminate our eligibility to participate in Title IV programs or state financial aid programs;
- Require repayment of funds received under Title IV programs or state financial aid programs;
- Require us to post a letter of credit with the U.S. Department of Education;
- Subject us to heightened cash monitoring by the U.S. Department of Education;
- Transfer us from the U.S. Department of Education's advanced system of receiving Title IV program funds to its reimbursement system, under which a school must disburse its own funds to learners and document the learners' eligibility for Title IV program funds before receiving such funds from the U.S. Department of Education;
- Subject us to other civil or criminal penalties; and/or
- Subject us to other forms of censure.

In addition, in some circumstances of noncompliance or alleged noncompliance, we may be subject to lawsuits including qui tam lawsuits under the Federal False Claims Act or various, similar, state false claim statutes. In these actions, private plaintiffs seek to enforce remedies under the Federal False Claims Act on behalf of the federal government and, if successful, are entitled to recover their costs and to receive a portion of any amounts recovered by the federal government in the lawsuit. These lawsuits can be prosecuted by a private plaintiff in respect of some action taken by us, even if the Department of Education does not agree with plaintiff's theory of liability. We could incur significant legal expenses defending ourselves against any such claims, and an adverse resolution of any future lawsuits could have an effect on our operating results and growth prospects.

Any of the penalties, injunctions, restrictions or other forms of censure listed above could have a material adverse effect on our business, financial condition, results of operations and cash flows. If we lose our Title IV eligibility, we would experience a dramatic and adverse decline in revenue and we would be unable to continue our business as it currently is conducted.

Rulemaking by the U.S. Department of Education could materially and adversely affect our business.
The U.S. Department of Education has additionally promulgated or engaged in rulemaking on substantive matters in the past three years that impact our business, including the following:

Effective during 2014:

- Final gainful employment regulations were published by the Department of Education with the final rule issued on October 31, 2014. These regulations go into effect on July 1, 2015.

- A negotiated rulemaking committee was convened by the Department of Education in February 2014 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.

- 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. A final rule was published on October 23, 2014 and will become effective on July 1, 2015. No other NPRMs from this round of negotiated rulemaking have been issued.

Effective during 2013:

- A negotiated rulemaking committee was convened by the Department of Education in September 2013 on the topic of gainful employment. No new rules that could have a substantial impact on our business were promulgated by the U.S. Department of Education in 2013.

Effective during 2012:

- Regulations requiring certain disclosures to students related to gainful employment.

These regulations have increased our operating costs and in some cases required us to change the manner in which we operate our business. New or amended regulations in the future could further negatively impact our business.

Failure to comply with U.S. Department of Education rules regarding incentive compensation could result in monetary penalties and sanctions.
A school participating in Title IV programs may not pay any commission, bonus or other incentive payments to any person involved in student recruitment or admissions or awarding of Title IV program funds, if such payments are based in any part, directly or indirectly, on success in enrolling students or obtaining student financial aid. Failure to comply could result in monetary penalties and/or sanctions imposed by the Department of Education, which could result in lower enrollments, revenue, and net operating income. The law and regulations governing this requirement do not establish clear criteria for compliance in all circumstances. Department of Education rulemaking in 2011 eliminated the twelve safe harbors and, in lieu of the safe harbors, some of the relevant concepts relating to the incentive compensation limitations are defined. These changes increase the uncertainty about what constitutes incentive compensation and which employees are covered by the regulation. This makes the development of effective and compliant performance metrics more difficult to establish.

If Capella University does not maintain its registration in Minnesota, it may not operate or participate in Title IV programs or operate in a number of other states.

A school that grants degrees, diplomas or certificates must be authorized by the relevant education agency of the state in which it is located. Capella University is deemed to be located in the State of Minnesota and is registered with the Minnesota Office of Higher Education. Minnesota registration is also required for our learners to be eligible to receive funding under Title IV programs. Such registration may be lost or withdrawn if Capella University fails to submit renewal applications and other required submissions to the state in a timely manner, or if Capella University fails to comply with material requirements under Minnesota statutes and rules for continued registration. Loss of state registration of Capella University from the Minnesota Office of Higher Education would terminate our ability to provide educational services as well as our eligibility to participate in Title IV programs. Capella must also remain in good standing with the Minnesota Office of Higher Education to obtain and maintain authorization or licensure to operate in states outside of Minnesota. Should our registration with the Minnesota Office of Higher Education be terminated, our ability to operate in other states would also cease, and it would have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our failure to comply with state authorization requirements or other regulations of various states could result in actions that would have a material adverse effect on our enrollments, revenues and results of operations.
We must be authorized to operate or otherwise certified to enroll students by the appropriate postsecondary regulatory authority in each state where we conduct activities that require authorization, or be exempt from such regulatory authorization, usually based on recognized accreditation. As of December 31, 2014, in addition to Minnesota, Capella University is licensed or authorized to operate or certified to offer degree programs in the following states: Alabama, Arizona, Arkansas, Florida, Georgia, Iowa, Kansas, Kentucky, Louisiana, Maryland, Nevada, North Carolina, Ohio, Pennsylvania, South Carolina, Tennessee, Washington, West Virginia, Wisconsin, and Wyoming. We are formally licensed or authorized to operate in these states because we have determined that our activities in each state constitute a presence that requires licensure or authorization by these states' higher educational agencies. In some cases, the licensure or authorization is only for specific programs or specific activities. Because we enroll learners from each of the 50 states, as well as the District of Columbia, and because we may undertake activities in other states that constitute a presence or otherwise subject us to the jurisdiction of the respective state educational agency, we may, from time to time, need to seek licensure or authorization to operate in additional states. Additionally, state regulations in states in which we are not licensed may limit certain of our activities, such as residencies and internships in programs requiring those experiences. If we lose any of our approvals or experience a delay in obtaining or cannot obtain these approvals or evidence such approvals are not necessary, we may be unable to enroll learners in impacted states, and our business could be materially and adversely impacted.

We are in a time period where many states are reevaluating and revising their authorization regulations, especially as applied to distance education. This increased review and scrutiny has increased uncertainty regarding our regulatory status and ability to offer programs in certain states. If these pressures and uncertainty continue in the future, it could have a material impact on our enrollments, revenue, results of operations and cash flow. If we fail to comply with state licensing or authorization requirements, we may be subject to the loss of state licensure or authorization. Loss of authorization in one or more states could increase the likelihood of additional scrutiny and potential loss of operating and/or degree granting authority in other states in which we operate, which would further impact our business.

We are subject to extensive regulations by the states in which we are authorized or licensed to operate. State laws typically establish standards for instruction, qualifications of faculty, administrative procedures, marketing, recruiting, financial operations and other operational matters. State laws and regulations may limit our ability to offer educational programs and to award degrees. Some states may also prescribe financial regulations that are different from those of the Department of Education. We are required to post surety bonds in several states. If we fail to comply with state licensing requirements, we may lose our state licensure or authorizations. Failure to comply with the requirements of the Minnesota Office of Higher Education could result in Capella University losing its registration with the Minnesota Office of Higher Education, its eligibility to participate in Title IV programs, or its ability to offer certain programs, any of which would have a material impact on our operations.

Attorneys General in several states have become more active in enforcing consumer protection laws, especially related to recruiting practices and the financing of education at proprietary educational institutions. In addition, several Attorneys General have recently partnered with the Federal Consumer Financial Protection Bureau to review industry practices. If our past or current business practices at Capella University are found to violate applicable consumer protection laws, we could be subject to monetary fines or penalties and possible limitations on the manner in which we conduct our business, which could materially and adversely affect our business, financial condition, results of operations and cash flows. To the extent that more states commence such investigations or multiple states act in a concerted manner, the cost of responding to these inquiries and investigations could increase significantly and the potential impact on our business would be substantially greater.

The inability of our graduates to obtain licensure or other specialized outcomes in their chosen professional fields of study could reduce our enrollments and revenues, and potentially lead to litigation that could be costly to us.
Certain of our graduates seek professional licensure or other specialized outcomes in their chosen fields following graduation. Their success in obtaining these outcomes depends on several factors, including the individual merits of the learner, but also

may depend on whether the institution and the program were approved by the state or by a professional association, whether the program from which the learner graduated meets all state requirements and whether the institution is accredited. Certain states have refused to license or certify learners from particular Capella University programs due to the fact that the program did not meet one or more of the state's specific licensure requirements or were not approved by the state for purposes of professional licensure. In addition, professional associations may refuse to certify specialized outcomes for our learners for similar reasons. We have had to respond to claims brought against us by former learners as a result of such refusals. For instance, certain states have denied our graduates professional licensure because the Capella University program from which they graduated did not have a sufficient number of residency hours, did not include a state-approved clinical program, did not satisfy state coursework requirements, or was not accredited by a specific third party (such as the American Psychological Association). The state requirements for licensure are subject to change, as are the professional certification standards, and we may not immediately become aware of changes that may impact our learners in certain instances. In the event that one or more states refuses to recognize our learners for professional licensure, and/or professional associations refuse to certify specialized outcomes for our learners, based on factors relating to our institution or programs, the potential growth of our programs would be negatively impacted, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. In addition, we could be exposed to litigation that would force us to incur legal and other expenses that could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Failure to comply with new U.S. Department of Education rules regarding Gainful Employment could result in significant adverse consequences, including ineligibility for our learners to participate in Title IV programs.
Under the Higher Education Act, as reauthorized, proprietary schools are generally eligible to participate in Title IV programs only in respect of educational programs that lead to "gainful employment in a recognized occupation."

In connection with this requirement, proprietary postsecondary institutions are required to disclose to prospective students each eligible program's recognized occupations, cost, completion rate, job placement rate, and median loan debt of program completers. These reporting requirements increase our costs of operations and could adversely impact student enrollment, persistence and retention if our reported program information compares unfavorably with other reporting educational institutions.

On October 31, 2014, the U.S. Department of Education issued a Final Rule specifically on the topic of gainful employment. The Final Rule applies to all Gainful Employment programs, which include all programs offered by for-profit institutions. Under the Final Rule, the continued eligibility of Gainful Employment programs to participate in Title IV programs will be based on the programs' performance against the following Debt-to-Earnings (DTE) measures:

- Pass: Programs whose graduates have annual loan payments less than 8% of total earnings, OR less than 20% of discretionary earnings.

- "Zone": Programs that do not pass and whose graduates have annual loan payments between 8% and 12% of total earnings, OR between 20% and 30% of discretionary earnings.

- Fail: Programs whose graduates have annual loan payments greater than 12% of total earnings AND greater than 30% of discretionary earnings.

- Ineligible: Programs that fail in 2 out of any 3 consecutive years OR have a combination of zone and failing DTE rates for four consecutive years for which DTE rates are calculated.

Earnings are calculated by the Department using Social Security Administration (SSA) data. Earnings information is then aggregated and made available to institutions. The Department has stated that they will receive SSA earnings data in early 2016 and will release to institutions by mid-2016. Without access to this data institutions cannot predict the impact to individual programs.

If a program fails or is in the zone for draft DTE rates during the transition period, the Department will calculate transitional draft DTE rates using the median loan debt of the students who completed the program during the most recently completed award year (2014-2015) and the earnings used to calculate the draft DTE rates. The final DTE rate for purposes of any sanctions will be the lower of the draft or transitional DTE rate. The transition period is five years for programs with durations of one year or less, six years for programs between one and two years in length, and seven years for programs of more than two years.

If a GE program could become ineligible in the subsequent award year based on its DTE metrics, the institution is required to inform students and prospective students that the program could lose Title IV eligibility. The warning must state that the program has not passed standards established by the Department, based on amounts students borrow for enrollment in the program and their reported earnings. The warning must also inform students that if the program does not pass the standards in the future, students who are then enrolled may not be able to use federal student grants or loans to pay for the program. The Final Rule also requires institutions to provide certifications regarding a GE program's satisfaction of programmatic accreditation and state licensure requirements, effective as of December 31, 2015 as part of the program participation agreement with the Department of Education. The final rule also expands the currently required disclosures for GE programs. Beginning January 1, 2017, institutions will be required to provide these disclosures for each GE program through an updated template provided by the Department. The Final Rule becomes effective July 1, 2015.

Under the final gainful employment regulations, the continuing eligibility of our educational programs for Title IV program funding is at risk due to factors beyond our control, such as changes in the actual or deemed income level of our graduates, changes in student borrowing levels, increases in interest rates, changes in the federal poverty income level relevant for calculating discretionary income, changes in the percentage of our former students who are current in repayment of their student loans, and other factors. In addition, the programmatic accreditation and licensure certification requirements are ambiguous and create uncertainty as to whether we will be able to certify certain of our programs. These factors related to the final gainful employment regulations could reduce our ability to confidently offer or continue certain types of programs for which there is market demand, and therefore would impact our ability to maintain or grow our business.

Action by the U.S. Congress to revise the laws governing the federal student financial aid programs or reduce funding for those programs, including changes applicable only to proprietary educational institutions, could reduce our learner population and increase our costs of operation.
The U.S. Congress must periodically reauthorize the Higher Education Act and annually determine the funding level for each Title IV program. The Higher Education Act was last reauthorized in 2008 by the Higher Education Opportunity Act. Changes to the Higher Education Act, including changes in eligibility and funding for Title IV programs, are likely to occur in subsequent reauthorizations, but we cannot predict the scope or substance of any such changes.

In recent years, there has been increased focus by Congress on the role that proprietary educational institutions play in higher education. We cannot predict what legislation, if any, may emanate from Congressional committee hearings or what impact any such legislation might have on the proprietary education sector and our business in particular.

Any action by Congress that significantly reduces Title IV program funding through across-the-board funding reductions, or otherwise, or materially impacts the eligibility of our institutions or students to participate in Title IV programs would have a material adverse effect on our enrollment, financial condition, results of operations and cash flows. Congressional action could also require us to modify our practices, for instance by reducing our marketing expenses or otherwise modifying our marketing practices, in ways that increase our administrative costs and reduce our enrollment and operating income.

We would lose our eligibility to participate in federal student financial aid programs if the percentage of our revenues derived from those programs is too high, in which event we could not conduct our business in its present form.
A requirement of the Higher Education Act, as reauthorized by the Higher Education Opportunity Act, commonly referred to as the “90/10 Rule”, applies only to proprietary institutions of higher education, which includes Capella University. Under this rule, a proprietary institution will be ineligible to participate in Title IV programs if for any two consecutive fiscal years it derives more than 90% of its cash basis revenue, as defined in the rule, from Title IV programs. An institution that derives more than 90% of its revenue from Title IV programs for any single fiscal year will be automatically placed on provisional certification for two fiscal years and will be subject to possible additional

sanctions determined to be appropriate under the circumstances by the U.S. Department of Education in the exercise of its broad discretion. While the Department of Education has broad discretion to impose additional sanctions on such an institution, there is only limited precedent available to predict what those sanctions might be, particularly in the current regulatory environment. The Department of Education could specify any additional conditions as a part of the provisional certification and the institution's continued participation in Title IV programs. These conditions may include, among other things, restrictions on the total amount of Title IV program funds that may be distributed to learners attending the institution; restrictions on programmatic and geographic expansion; requirements to obtain and post letters of credit; additional reporting requirements to include additional interim financial reporting; or any other conditions imposed by the Department of Education. Should an institution be subject to a provisional certification at the time that its current program participation agreement expired, the effect on recertification of the institution or continued eligibility in Title IV programs pending recertification is uncertain. An institution that derives more than 90% of its revenue from Title IV programs for two consecutive fiscal years will be ineligible to participate in Title IV programs for at least two fiscal years.

Capella University is required to calculate this percentage at the end of each fiscal year; as of December 31, 2014, our percentage was approximately 77%. If an institution is determined to be ineligible to participate in Title IV programs due to the 90/10 Rule, any disbursements of Title IV program funds while ineligible must be repaid to the Department of Education.

The 90/10 Rule percentage for Capella University could increase in the future depending on the degree to which our various initiatives are effective, the impact of future changes in our enrollment mix, and regulatory and other factors outside our control, including any reduction in government tuition assistance for military personnel, including veterans, or changes in the treatment of such funding for purposes of the 90/10 Rule calculation. Currently, tuition assistance for military personnel, including veterans, is not treated as Title IV revenue under the 90/10 Rule and, therefore, based on the prescribed order of application per the regulations, a majority of such funding is included in the “10%” portion of the rule calculation. A reduction in the availability of this type of funding, or a change (through either legislation or executive order) that requires that it be treated in the same manner as Title IV funding under the 90/10 Rule, would increase our 90/10 Rule percentage.

Any necessary further efforts to reduce the 90/10 Rule percentage for Capella University, especially if the percentage exceeds 90% for a fiscal year, may involve taking measures which reduce our revenue, increase our operating expenses, or both, in each case perhaps significantly. If the 90/10 Rule is not changed to provide relief for institutions like Capella University, we may be required to make structural changes to our business in order to remain in compliance. These changes may materially alter the manner in which we conduct our business and materially and adversely impact our business, financial condition, results of operations and cash flows.

An increase in our student loan default rates could result in the loss of eligibility to participate in Title IV programs, which would materially and adversely affect our business.
To remain eligible to participate in Title IV programs, educational institutions must maintain student loan cohort default rates below specified levels. The U.S. Department of Education reviews an educational institution’s cohort default rate annually as a measure of administrative capability. Each cohort is the group of students who first enter into student loan repayment during a federal fiscal year (ending September 30). For each federal fiscal year, the cohort default rate is calculated for each institution with 30 or more borrowers entering repayment in a given federal fiscal year by determining the rate at which borrowers who become subject to their repayment obligation in that federal fiscal year default by the end of the second federal fiscal year. The cohort default rates are published by the Department of Education approximately 12 months after the end of the measuring period. Thus, in September 2014, the Department of Education published the three-year cohort default rates for the 2011 cohort, which measured the percentage of students who first entered into repayment during the year-ended September 30, 2011 and defaulted prior to September 30, 2013. If an institution’s three-year cohort default rate exceeds 30% for three consecutive years or 40% for any given year, it will be ineligible to participate in Title IV programs and, as a result, its students would not be eligible for federal student financial aid.

If the Department of Education suspends or terminates our certification, we would lose eligibility to participate in Title IV programs.
Capella University is fully certified through June 30, 2020 to participate in the Title IV programs. The Department of Education may also review our continued certification to participate in Title IV programs in the event we expand our activities in certain ways, such as opening an additional location or, in certain cases, if we modify the academic credentials that we offer. The Department of Education could limit, suspend or terminate our participation in Title IV programs for violations of the Higher Education Act or Title IV regulations. Title IV eligibility is critical to the continued operation of our business. If Capella University becomes ineligible to participate in Title IV federal student financial aid programs, we could not conduct our business as it is currently conducted, and it would have a material adverse effect on our business, financial condition, results of operations and cash flows.

If any regulatory audit, investigation or other proceeding finds us not in compliance with the numerous laws and regulations applicable to the postsecondary education industry, we may not be able to successfully challenge such finding and our business could suffer.

Due to the highly regulated nature of the postsecondary education industry, we are subject to audits, compliance reviews, inquiries, complaints, investigations, claims of non-compliance and lawsuits by federal and state governmental agencies, regulatory agencies, accrediting agencies, present and former students and employees, shareholders and other third parties, any of whom may allege violations of any of the regulatory requirements applicable to us. If the results of any such claims or actions are unfavorable to us, we may be required to pay monetary fines or penalties, be required to repay funds received under Title IV programs or state financial aid programs, have restrictions placed on or terminate our schools' or programs' eligibility to participate in Title IV programs or state financial aid programs, have limitations placed on or terminate our schools' operations or ability to grant degrees and certificates, have our schools' accreditations restricted or revoked, or be subject to civil or criminal penalties. Any one of these sanctions could materially adversely affect our business, financial condition, results of operations and cash flows and result in the imposition of significant restrictions on us and our ability to operate.

If we fail to maintain our institutional accreditation or if our institutional accrediting body loses recognition by the U.S. Department of Education, we could lose our ability to participate in Title IV programs and lose our authorization to operate in a number of states.
Capella University is accredited by the Higher Learning Commission. The Higher Learning Commission is one of six regional accrediting agencies recognized by the Secretary of the Department of Education as a reliable indicator of educational quality. Accreditation by a recognized accrediting agency is required for an institution to become and remain eligible to participate in Title IV programs.

In January 2015, Capella University’s accreditation with the Higher Learning Commission was reaffirmed. The re-affirmation enables Capella University to continue to participate in Title IV programs. The next reaffirmation of accreditation will take place in 2022-2023.

To remain accredited, we must continuously meet HLC’s Criteria for Accreditation and Core Components relating to, among other things, performance, governance, institutional integrity, educational quality, faculty, administrative capability, resources and financial stability. Failure to meet any of these criteria or core components could result in the loss of accreditation at the discretion of The Higher Learning Commission.

If the U.S. Department of Education ceased to recognize The Higher Learning Commission for any reason, Capella University would not be eligible to participate in Title IV programs beginning 18 months after the date such recognition ceased unless The Higher Learning Commission was again recognized or our institution was accredited by another accrediting body recognized by the U.S. Department of Education. The Higher Learning Commission’s next scheduled review by the Department of Education’s National Advisory Committee on Institutional Quality & Integrity is Spring 2015.

A failure to demonstrate “financial responsibility” may result in the loss of eligibility by Capella University to participate in Title IV programs or require the posting of a letter of credit to maintain eligibility to participate in Title IV programs.
To participate in Title IV programs, an eligible institution must satisfy specific measures of financial responsibility prescribed by the Department of Education, or post a letter of credit in favor of the Department of Education and possibly accept other conditions on its participation in Title IV programs. The Department of Education may also apply such measures of financial responsibility to the operating company and ownership entities of an eligible institution and, if such measures are not satisfied by the operating company or ownership entities, require the institution to post a letter of credit in favor of the Department of Education and possibly accept other conditions on its participation in Title IV programs. Any obligation to post a significant letter of credit could increase our costs of regulatory compliance. If Capella University is unable to secure a letter of credit, it would lose its eligibility to participate in Title IV programs. In addition to the obligation to post a letter of credit, an institution that is determined by the Department of Education not to be financially responsible can be transferred from the “advance” system of payment of Title IV funds to cash monitoring status or to the “reimbursement” system of payment. Limitations on, or termination of, Capella University’s participation in Title IV programs as a result of its failure to demonstrate financial responsibility would limit Capella University’s learners’ access to Title IV program funds, which could significantly reduce our enrollments and revenues and materially and adversely affect our business, financial condition, results of operations and cash flows.

A failure to demonstrate “administrative capability” may result in the loss of Capella University's eligibility to participate in Title IV programs.

Department of Education regulations specify extensive criteria an institution must satisfy to establish that it has the requisite “administrative capability” to participate in Title IV programs. If an institution fails to satisfy any of these criteria or comply with any other Department of Education regulations, the Department of Education may:

- Require the repayment of Title IV funds;
- Transfer the institution from the “advance” system of payment of Title IV funds to cash monitoring status or to the “reimbursement” system of payment;
- Place the institution on provisional certification status; or
- Commence a proceeding to impose a fine or to limit, suspend or terminate the participation of the institution in Title IV programs.

If we are found not to have satisfied the Department of Education's "administrative capability" requirements we could be limited in our access to, or lose, Title IV program funding, which would significantly reduce our enrollment and revenues and materially and adversely affect our business, financial condition, results of operations and cash flows.

Risks Related to Our Business

If we are not able to continuously innovate our academic offerings and our business model, including to address increased competition with competency-based learning models, we will not be able to keep pace and effectively compete in the highly competitive proprietary higher education market.
Our success is built in part on our ability to innovate and adapt to quickly changing market dynamics. The pace of innovation in higher education continues to accelerate, especially with the more widespread adoption of competency-based learning models. The number of competency-based learning models, including direct assessment programs approved by the U.S. Department of Education to offer Title IV financial aid, is expected to increase in the upcoming years. As more competitors are approved to participate in such programs, competition in the market will continue to intensify. We need to continue to innovate ahead of market requirements and competitive models or our offerings may become less successful which could materially and adversely affect our business, prospects, financial condition, results of operations and cash flows.

Changes we are making to our business to enhance our ability to improve learner success may adversely affect our growth rate, profitability, financial condition, results of operations and cash flows.
In order to improve the learner experience, attract learners who are more likely to persist in our programs, and improve the persistence of new and current learners, we continue to implement a number of important changes and initiatives to transition our business to more effectively support our students and improve their educational outcomes. Certain of these enhancements may adversely impact the number of learners who enroll in our programs. Other initiatives may impact enrollments as we proactively work with learners who are not making sufficient and timely academic progress. In addition, we are investing significant resources in these learner success initiatives, which will have an impact on our business, financial condition, results of operations and cash flows, particularly in the near term.

We may experience reduced revenues and operating margins if the number of our learners enrolled in doctoral programs continues to decrease, or if our learner success initiatives are not successful.
The doctoral enrollment trends for Capella University continue to be negative. We are proactively seeking to attract doctoral enrollment through enhanced marketing, affordability and product offerings. We are also extending our learner success focus to the comprehensive and dissertation portion of the doctoral program.

Our learner success efforts include the continued optimization of the doctoral experience, including engaging learners earlier in preparation for the comprehensive and dissertation phase, leveraging analytics to personalize mentor support and effectiveness, and increasing visibility to milestone completion for learners. These changes will continue to impact total enrollment as we proactively address learners who are not making sufficient and timely academic progress in the comprehensive and dissertation phase. The nature of these interactions often results in learner success but in some cases the learners still do not obtain their intended outcome. Proactive, increased interactions with individual learners and other significant investments in doctoral initiatives will have an impact on our business, financial condition, results of operations and cash flows, particularly in the near term.

Our financial performance depends in part on our ability to keep pace with current market needs, build our brand and maintain affordability.
The updates and expansions of our existing programs and the development of new programs and specializations may not be accepted by existing or prospective learners or the employers of our graduates. If we cannot respond to changes in market requirements, our business may be adversely affected. We have shifted to a brand-driven marketing strategy in order to decrease our reliance on aggregators and improve the quality of the learners enrolling at Capella University. This shift has significantly lowered our inquiry volume, and if we are unable to maintain improvements in

our conversion rates and retain enrolled learners, our business, financial condition, results of operations and cash flows would be adversely impacted.

In addition, there is increasing focus and pressure on higher education providers to improve affordability. If we are unable to keep pace with market and external expectations regarding affordability, our business, financial condition, results of operations and cash flows could be adversely impacted.

Efforts to diversify our business outside of the traditional areas served by Capella University may adversely impact our financial performance.

As we seek opportunities to expand our business and serve markets beyond those traditionally served by Capella University, including employer-based solutions, we will encounter strategic and operational challenges different than those within our core business. Additionally, investing in diversification and innovation may require significant resources and negatively impact our operating income and cash flows. If we are unable to successfully capitalize on these opportunities, our business, financial condition, results of operations and cash flows would be adversely impacted.

Certain of our programs have specialized accreditations and/or state approvals; our business may be adversely impacted if we are unable to obtain such accreditations or approvals in the future, or if such accreditations or approvals impose requirements that impact other aspects of our business.
Certain of our programs, especially at the master's and doctorate level, have specialized accreditations or program approvals which are desirable to our learners and may be important to learners obtaining licensure or certification in their chosen field of study. In addition, certain of our education-related programs are approved by the Minnesota Board of Teaching or other state higher educational oversight authorities. If we are unable to obtain or renew such accreditations or approvals in the future, our programs will be less attractive to prospective learners and our current learners in such programs will be negatively impacted. In addition, these specialized accrediting bodies or state agencies may impose requirements which adversely impact our business, such as limiting or closing enrollments to certain programs, imposing specific faculty to learner ratios or dictating the way in which we name and market related programs. These situations could adversely affect our business, financial condition, results of operations and cash flows.

Our financial performance depends on our ability to continue to develop awareness among, and attract and retain, high quality learners.
Building awareness of Capella University and the programs we offer among working adult professionals, Capella's primary target market, is critical to our ability to attract prospective learners. If we are unable to successfully market and advertise our educational programs, Capella University's ability to attract and enroll prospective learners in such programs could be adversely affected, and consequently, our ability to increase revenue or maintain profitability could be impaired. It is also critical to our success that we convert these prospective learners to enrolled learners in a cost-effective manner and that these enrolled learners remain active in our programs. Some of the factors that could prevent us from successfully enrolling and retaining learners in our programs include:

- The emergence of more successful competitors;
- Factors related to our marketing, including the costs of Internet advertising and broad-based branding campaigns;
- Performance problems with our online systems;
- Failure to maintain accreditation;
- Learner dissatisfaction with our services and programs, including with our customer service and responsiveness;
- Adverse publicity regarding us, our competitors, or online or for-profit education in general;
- Price reductions by competitors that we are unwilling or unable to match;
- A decline in the acceptance of online education or our degree offerings by learners or current and prospective employers;
- Increased regulation of online education, including in states in which we do not have a physical presence;
- A decrease in the perceived or actual economic benefits that learners derive from our programs;
- Litigation or regulatory investigations that may damage our reputation;
- Difficulties in executing on our strategy as a preferred provider to employers for the vertical markets we serve; and
- Building and leveraging our presence in social media and mobile-device services.

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

We face intense and increasing competition in the postsecondary education market, especially in the online education market, which could decrease our market share, increase our cost of attracting learners and put downward pressure on our tuition rates.

Postsecondary education, especially in the online market, is highly competitive and becoming increasingly so as the industry is undergoing profound changes at an unprecedented rate. We compete with traditional public and private two-year and four-year colleges and other proprietary schools, as well as corporate universities and software companies providing online education and training software. In addition, we face competition from various emerging nontraditional, credit-bearing and noncredit-bearing education programs, provided by both proprietary and not-for-profit providers. Each of these competitors may offer programs similar to ours at lower tuition levels as a result of government subsidies, government and foundation grants, tax-deductible contributions and other financial sources not available to for-profit institutions. An increasing number of traditional colleges and community colleges are offering distance learning and other online education programs, including programs that are geared towards the needs of working learners. This trend has been accelerated by private companies that provide and/or manage online learning platforms for traditional colleges and community colleges. As the proportion of traditional colleges providing alternative learning modalities increases, we will face increasing competition for students from traditional colleges, including colleges with well-established reputations for excellence. As the online and distance learning segment of the postsecondary education market matures, we believe that the intensity of the competition we face will continue to increase.

This intense competition could make it more challenging for us to enroll students who are likely to succeed in our educational programs, which could adversely affect our enrollment levels and put downward pressure on our tuition rates, either of which could materially and adversely affect our business, financial condition, results of operations and cash flows.

The external demands for increased affordability will continue to impact our business. For example, as the market continues to mature, certain of our competitors have begun to reduce tuition rates or offer significant discounts in the form of grants or scholarships. Capella University, like other universities particularly in the proprietary sector, has increased our use of grants to improve learner persistence and as incentive to increase demand. Continuation of this trend will further decrease the amount of tuition we receive from learners unless we can increase persistence and/or increase our spending to pursue new market opportunities. In addition, certain of our competitors have increased their focus on markets and learners that we have historically served, and these actions could increase costs and decrease our enrollments and revenue. As Capella University seeks to strengthen its employer alignment, we face increased competition in maintaining and developing new marketing relationships with corporations and other employers, particularly as employers become more selective as to which online universities they will encourage their current employees to attend and from which online universities they will hire prospective employees. These competitive factors could adversely affect our enrollments, revenue, business, financial condition, results of operations and cash flows.

If we fail to maintain adequate systems and processes to detect and prevent fraudulent activity in learner enrollment and financial aid, our business could be adversely impacted.
As we continue to grow, we are susceptible to an increased risk of fraudulent activity by outside parties with respect to learner enrollment and student financial aid programs. While we believe past incidents of fraudulent activity have been relatively isolated, we cannot be certain that our systems and processes will always be adequate in the face of increasingly sophisticated and ever-changing fraud schemes. The potential for outside parties to perpetrate fraud in connection with the award and disbursement of Title IV program funds, including as a result of identity theft, may be heightened due to our nature as an online education provider. We must maintain systems and processes to identify and prevent fraudulent applications for enrollment and financial aid. Efforts we take to identify and prevent fraudulent applications may also impose additional processes on potential legitimate learners which could adversely affect our enrollments, revenue, business, financial condition, results of operations and cash flows.

The Department of Education requires institutions that participate in Title IV programs to refer to the Office of the Inspector General of the Department of Education any credible information indicating that any applicant, employee, third-party servicer, or agent of the institution that acts in a capacity that involves administration of the Title IV programs has been engaged in any fraud or other illegal conduct involving Title IV programs. If the systems and processes that we have established to detect and prevent fraud are inadequate, the Department of Education may find that we do not satisfy its "administrative capability" requirements. This could limit our access to, or cause us to lose, Title IV program funding, which would adversely affect our enrollment, revenues, results of operations and cash flows. In addition, our ability to participate in Title IV programs is conditioned on our maintaining accreditation by an accrediting agency that is recognized by the Secretary of Education. Any significant failure to adequately detect fraudulent activity related to learner enrollment and financial aid could cause us to fail to meet our accrediting agencies' standards. Furthermore, under the Higher Education Act, accrediting agencies that evaluate institutions that offer distance learning programs, as we do, must require such institutions to have processes through which the institution establishes that a learner who registers for a distance education program is the same learner who participates in and receives credit for the program. Failure to meet our accrediting agencies' standards could result in the loss of accreditation at the discretion of our accrediting agencies, which could result in a loss of our eligibility to participate in Title IV programs and would adversely affect our business, financial condition, results of operations and cash flows.

We rely on third party vendors, and the outsourcing increases our operational and compliance risk.
We rely on third party vendors to provide services to us and our learners. While we monitor and assess the service of these vendors, it is possible their service and response levels may be less than ours, and that they may not have adequate business continuity planning. In addition, using third party vendors increases compliance risk, if they do not adequately protect learners' sensitive data or personally identifiable information, or if they do not comply with applicable federal or state regulations applicable to our business. In the event of any of those or related actions or omissions by third party vendors, our business, financial condition, results of operations and cash flows could be adversely impacted.

System disruptions and vulnerability from security risks to our online computer networks could impact our business and financial performance and damage the reputation of Capella University, limiting our ability to attract and retain learners.
The performance and reliability of our technology infrastructure is critical to our reputation and ability to attract and retain learners. Any system error or failure, or a sudden and significant increase in bandwidth usage, could result in the unavailability of our course room platform, damaging our business and financial performance and the reputation of Capella University. Our technology infrastructure could be vulnerable to interruption or malfunction due to events beyond our control, including natural disasters, terrorist activities and telecommunications failures. Our core computer network infrastructure is concentrated in a single geographic area. If we experience a catastrophic failure or unavailability for any reason of both our principal data center and backup data center, we may need to replicate the function of these data centers elsewhere, which may require expensive and time-consuming equipping and restoring activities. The disruption from such an event could significantly impact our operations and have a material adverse effect on our reputation, business, financial condition, results of operations and cash flows.

We may experience interruptions or failures in our computer systems as a result of ongoing maintenance of and enhancements to our enterprise resource planning system, course room platform, and/or server system. Any interruption to our technology infrastructure could have a material adverse effect on our ability to attract and retain learners and could require us to incur additional expenses to correct or mitigate the interruption.

Our computer networks may also be vulnerable to cyber attacks such as unauthorized access, computer hackers, computer viruses, malware and other security problems and system disruptions. We engage with multiple information security assessment providers on a periodic basis to review, assess and remediate our information security program. We utilize this information to audit ourselves to ensure that we are continually monitoring the security of our technology infrastructure, but it may still be vulnerable to threats. Circumvention of information security measures could lead to misappropriation of personally identifiable or proprietary information or cause interruptions or malfunctions in operations. As a result, we may be required to expend significant resources to protect against the threat of these security breaches, respond to loss or exposure of data or to alleviate problems caused by these breaches, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

The personal information that we collect may be vulnerable to breach, theft or loss that could adversely affect our reputation and operations.
Possession and use of personal information in our operations subjects us to risks and costs that could harm our business. Capella University collects, uses and retains large amounts of personal information regarding our learners and their families, including social security numbers, tax return information, personal and family financial data and credit card numbers. We also collect and maintain personal information of our employees in the ordinary course of our business. Some of this personal information is held and managed by certain of our vendors. Although we use security and business controls to limit access and use of personal information, circumvention of these controls could occur, and could result in a breach of learner or employee privacy. In addition, errors in the storage, use or transmission of personal information could result in a breach of learner or employee privacy.

Possession and use of personal information in our operations also subjects us to legislative and regulatory burdens that could require notification of data breaches and restrict our use of personal information. We cannot guarantee that a breach, loss or theft of personal information will not occur. A breach, theft or loss of personal information regarding our learners and their families or our employees that is held by us or our vendors could have a material adverse effect on our reputation and results of operations and result in liability under state and federal privacy statutes and legal actions by state attorneys, general and private litigants, and any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We may experience increased costs, reduced margins and an increase in bad debt expense if the proportion of our learners who are enrolled in our bachelor's degree programs continues to increase.
Our bachelor's degree programs are currently growing at a faster rate than our doctoral or master's degree programs. This bachelor's degree growth has caused the proportion of our learners enrolled in bachelor's degree programs to increase, while the proportion enrolled in our doctoral programs has decreased. This mix shift may continue in the future, and we may experience certain negative consequences, such as decreased revenue per learner, higher cost per new enrollment, lower retention rates and/or higher learner services costs, higher default rates, an increase in our learner loan cohort default rate, an increase in bad debt expense, an increase in the percentage of our revenue derived from Title IV funding under the 90/10 Rules, more limited ability to implement tuition price increases and other effects that may adversely affect our operating results.

We rely on exclusive proprietary rights and intellectual property that may not be adequately protected under current laws, and we encounter disputes from time to time relating to our use of intellectual property of third parties.
Our success depends in part on our ability to protect our proprietary rights. We rely on a combination of copyrights, trademarks, service marks, trade secrets, confidentiality agreements and practices, and other agreements to protect our proprietary rights. We rely on service mark and trademark protection in the United States and select foreign jurisdictions to protect our rights to the marks “CAPELLA,” “CAPELLA EDUCATION COMPANY,” and “CAPELLA UNIVERSITY,” as well as distinctive logos and other marks associated with our services. We rely on agreements under which we obtain rights to use course content developed by faculty members and other third-party content experts. We cannot guarantee that these measures will be adequate, that we have secured, or will be able to secure, appropriate protections for all of our proprietary rights in the United States or select foreign jurisdictions, or that third parties will not infringe upon or violate our proprietary rights. Despite our efforts to protect these rights, unauthorized third parties may attempt to duplicate or copy the proprietary aspects of our curricula, online resource material and other content. Our management's attention may be diverted by these attempts and we may need to use funds in litigation to protect our proprietary rights against any infringement or violation, which could have a material adverse affect on our business, financial condition, results of operation and cash flows.

We may encounter disputes from time to time over rights and obligations concerning intellectual property, and we may not prevail in these disputes. Third parties have in the past and may again in the future raise claims against us alleging an infringement or violation of the intellectual property of that third party. Some third party intellectual property rights may be extremely broad, and it may not be possible for us to conduct our operations in such a way as to avoid those intellectual property rights. Any such intellectual property claim could subject us to costly litigation and impose a significant strain on our financial resources and management personnel regardless of whether such claim has merit. Our general liability and cyber liability insurance may not cover potential claims of this type adequately or at all, and we may be required to alter the content of our classes or pay monetary damages or license fees to third parties, which could have a material adverse affect on our business, financial condition, results of operations and cash flows.

Our learner population and revenues could decrease if the government tuition assistance offered to U.S. Armed Forces personnel is reduced or eliminated, if the tuition discounts which we offer to U.S. Armed Forces personnel are reduced or eliminated, or if our informal arrangements with any military bases deteriorate.
Active duty members of the U.S. Armed Forces are eligible to receive tuition assistance from the government, which they may use to pursue postsecondary degrees. We offer tuition discounts generally ranging from 10% to 15% to all members of the U.S. Armed Forces and immediate family members of active duty U.S. Armed Forces personnel. As of December 31, 2014, learners receiving a military discount comprised approximately 11% of total enrollment. We also have non-exclusive agreements with various educational institutions of the U.S. Armed Forces pursuant to which we have agreed to accept credits toward a Capella University degree from certain military educational programs.

These agreements generally may be terminated by either party upon 30 to 45 days notice. Additionally, we have informal arrangements with several military bases pursuant to which the bases make information about Capella University available to interested service members. Each of these informal arrangements is not binding on either party and either party could end the arrangement at any time. If our informal arrangement with any military base deteriorates or ends, our efforts to recruit learners from that base will be impaired. In the event that governmental tuition assistance programs to active duty members of the U.S. Armed Forces are reduced or eliminated, if our tuition discount program which we offer U.S. Armed Forces personnel and their immediate family members is reduced or eliminated, or if our informal arrangements with any military base deteriorates, this could materially and adversely affect our revenues, results of operations and cash flows.

If we fail to offer products aligned with employer expectations or do not maintain existing, and develop additional, relationships with employers, our future growth may be impaired.

Our success depends in part on our ability to offer products aligned with learners' professional goals and employer expectations. If our products are not aligned with these external needs, then our offerings will be less successful and this would materially and adversely affect our business, prospects, financial condition, results of operations and cash flows.

In addition, we currently have relationships with large employers to provide their employees with the opportunity to obtain degrees through us while continuing their employment. These relationships are an important part of our strategy as they provide us with a steady source of potential working adult learners for particular programs and also serve to increase our reputation among high-profile employers. If we are unable to develop new relationships, or if our existing relationships deteriorate or end, our efforts to seek these sources of potential working adult learners will be impaired, and this could materially and adversely affect our business, prospects, financial condition, results of operations and cash flows.

Our activities outside the U.S. subjects us to risks inherent in international operations.
As part of our growth strategy, we have acquired a proprietary educational institution in the UK, and we may actively pursue additional acquisitions outside the U.S. To the extent that we make such acquisitions, we will face risks that are inherent in international operations, including:

- Complexity of operations across borders;
- Compliance with foreign legal and regulatory environments;
- Currency exchange rate fluctuations;
- Monetary policy risks, such as inflation, hyperinflation and deflation;
- Price controls or restrictions on exchange of foreign currencies;
- Potential political and economic instability in the countries in which we operate, including potential student uprisings;
- Expropriation of assets by local governments;
- Multiple and possibly overlapping and conflicting tax laws;
- Compliance with anti-corruption laws and regulations such as the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act of 2010;
- Potential unionization of employees under local labor laws and local labor laws that make it more expensive and complex to negotiate with, retain or terminate employees;
- Greater difficulty in utilizing and enforcing our intellectual property and contract rights;
- Failure to understand the local culture and market;
- Limitations on the repatriation of funds; and
- Increased acts of terrorism and war, epidemics and natural disasters in new geographic regions.

Our credit agreement limits our ability to take various actions.
In certain circumstances, our credit agreement limits our ability to take various actions, including paying dividends, repurchasing shares, offering loans to learners, and acquiring and disposing of assets or businesses. Accordingly, we may be restricted from taking actions that management believes would be desirable and in the best interests of us and our shareholders. Our credit agreement also requires us to satisfy specified financial and non-financial covenants, including covenants relating to regulatory compliance. A breach of any covenants contained in our credit agreement would result in an event of default under the agreement and allow the lenders to pursue various remedies, including accelerating the repayment of any indebtedness outstanding under the agreement, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our corporate headquarters occupies approximately 371,000 square feet in Minneapolis, Minnesota, under a lease that expires in October 2018. Options exist under that lease to allow us to occupy up to 85,000 additional square feet over the next three years. Renewal terms under this lease allow for us to extend the current lease for up to two additional five-year terms. We believe our existing facilities are adequate for current requirements and that additional space can be obtained on commercially reasonable terms to meet future requirements, if any.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

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

Market Information

Our common stock trades on the Nasdaq Global Market under the symbol "CPLA." The following table sets forth, for the periods indicated, the high and low sales price of the Company's common stock as reported on the Nasdaq Global Market.

	High	Low
2014		
First Quarter (January 1, 2014 – March 31, 2014)	$72.08	$59.70
Second Quarter (April 1, 2014 – June 30, 2014)	$64.09	$53.82
Third Quarter (July 1, 2014 – September 30, 2014)	$68.22	$54.70
Fourth Quarter (October 1, 2014 – December 31, 2014)	$76.96	$59.91
2013		
First Quarter (January 1, 2013 – March 31, 2013)	$33.01	$27.28
Second Quarter (April 1, 2013 – June 30, 2013)	$46.03	$28.60
Third Quarter (July 1, 2013 – September 30, 2013)	$57.50	$42.02
Fourth Quarter (October 1, 2013 – December 31, 2013)	$67.86	$52.61

Holders

As of February 12, 2015, there were approximately 28 holders of record of our common stock, which includes nominees or broker dealers holding stock on behalf of beneficial owners.

Dividends

On December 10, 2014, the Board of Directors declared a dividend of $0.37 per share of common stock to shareholders of record as of December 24, 2014 to be paid on January 15, 2015. There is no guarantee that dividends will be declared in the future, and payment of dividends will be at the discretion of the Board of Directors and will be dependent on projections of future earnings, cash flow, financial requirements of the Company and other factors as the Board of Directors deems relevant.

Securities Authorized for Issuance under Equity Compensation Plans

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

Performance Graph

The following graph compares the cumulative total return of our common stock, an industry peer group index, and the Nasdaq Composite Index from December 31, 2009 through December 31, 2014. We believe our industry peer group represents the majority of the market value of publicly traded companies whose primary business is postsecondary education.

The returns set forth on the following graph are based on historical results and are not intended to suggest future performance. The performance graph assumes $100 investment on December 31, 2009 in either our common stock, the companies in our industry peer group, or the Nasdaq Composite Index. Data for the Nasdaq Composite and our peer groups assume reinvestment of dividends.

The Peer Group included in the performance graph above consists of American Public Education, Inc. (APEI), Apollo Group, Inc. (APOL), Bridgepoint Education, Inc. (BPI), DeVry Education Group, Inc. (DV), Grand Canyon Education, Inc. (LOPE), and Strayer Education, Inc. (STRA).

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

Recent Sales of Unregistered Securities
None.

Use of Proceeds
Not applicable.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers
During the three months ended December 31, 2014, the Company used $3.0 million to repurchase 45 thousand shares of common stock under its repurchase program.[1] Its remaining authorization for common stock repurchases was $32.0 million at December 31, 2014. The following presents the Company's share repurchases during the quarter ended December 31, 2014:

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
10/1/2014 to 10/31/2014	21,192	$ 63.05	21,192	$ 33,719,817
11/1/2014 to 11/30/2014	11,992	69.39	11,992	32,887,691
12/1/2014 to 12/31/2014	11,986	$ 71.44	11,986	$ 32,031,423
Total	45,170	66.96	45,170	32,031,423

(1) The Company announced its current share repurchase program in July 2008. As of December 31, 2014, 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 6. Selected Financial Data

The following tables set forth our selected consolidated financial and operating data as of the dates and for the periods indicated. You should read this data together with “Item 7 - Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes, included elsewhere in this Annual Report on Form 10-K. The selected consolidated statements of income data for each of the years in the three-year period ended December 31, 2014, and the selected consolidated balance sheet data as of December 31, 2014 and 2013, have been derived from our audited consolidated financial statements, which are included elsewhere in this Annual Report on Form 10-K. The selected consolidated statements of income data for the years ended December 31, 2011 and 2010, and selected consolidated balance sheet data as of December 31, 2012, 2011 and 2010, have been derived from our audited consolidated financial statements not included in this Annual Report on Form 10-K. Historical results are not necessarily indicative of the results of operations to be expected for future periods.

	Year-Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands, except per share amounts)				
Statements of Income:					
Revenues	$421,967	$415,623	$421,890	$430,043	$426,123
Operating income	$64,095	$59,877	$59,383	$80,102	$95,001
Net income attributable to Capella Education Company	$37,943	$35,203	$36,477	$52,115	$61,270
Diluted net income attributable to Capella Education Company per common share	$3.03	$2.80	$2.76	$3.40	$3.64
Weighted average number of common shares outstanding, diluted	12,535	12,566	13,220	15,314	16,848

	Year-Ended December 31,				
	2014	2013	2012	2011	2010
Other Data:	(in thousands, except per share amounts and enrollments)				
Depreciation and amortization [(a)]	$23,798	$25,877	$29,255	$24,165	$18,512
Net cash provided by operating activities	$65,188	$69,349	$64,828	$80,304	$88,407
Capital expenditures	$20,584	$18,728	$23,278	$29,587	$25,481
EBITDA [(b)]	$87,893	$85,754	$88,824	$104,839	$113,604
Free cash flow [(c)]	$44,604	$50,621	$41,550	$50,717	$62,926
Dividends declared per common share	$1.42	$0.35	$—	$—	$—
Total enrollment [(d)]	36,309	35,432	36,329	37,704	39,477

	As of December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and current portion of marketable securities	$123,622	$142,439	$115,499	$127,044	$193,234
Working capital [(e)]	$106,049	$116,567	$104,163	$112,749	$176,858
Total assets	$254,357	$250,249	$212,888	$235,473	$262,558
Long term liabilities	$12,032	$12,045	$18,945	$23,215	$12,159
Shareholders’ equity	$195,034	$182,019	$152,102	$162,599	$208,586

(a) Depreciation and amortization is calculated using the straight-line method over the estimated useful lives of the assets. Amortization includes amounts related to purchased software, capitalized website development costs, internally developed software, and acquired intangible assets.

(b) EBITDA consists of net income attributable to Capella Education Company minus other income (expense), net plus income tax expense and plus depreciation and amortization. Other income (expense), net consists primarily of interest expense for the amortization of debt issuance costs, commitment fees charged on the unused portion of the credit facility, and the change in the fair value of the RDI contingent consideration liability, net of interest income earned on marketable securities. We use EBITDA as a measure of operating performance. However, EBITDA is not a recognized measurement under U.S. generally accepted accounting principles (GAAP) and when analyzing our operating performance, investors should use EBITDA in addition to, and not as an alternative for, net income as determined in accordance with GAAP. Because not all companies use identical calculations, our presentation of EBITDA may not be comparable to similarly titled measures of other companies. Furthermore, EBITDA is not intended to be a measure of free cash flow, as it does not consider certain cash requirements such as tax payments.

We believe EBITDA is useful to investors in evaluating our operating performance and liquidity because it is widely used to measure a company’s operating performance without regard to items such as depreciation and amortization. Depreciation and amortization can vary depending upon accounting methods and the book value of assets. We believe EBITDA presents a meaningful measure of corporate performance exclusive of our capital structure and the method by which assets were acquired.

Our management uses EBITDA:

- as a measurement of operating performance, because it assists us in comparing our performance on a consistent basis, as it removes depreciation, amortization, interest and taxes; and
- in presentations to the members of our board of directors to enable our board to have the same measurement basis of operating performance as is used by management to compare our current operating results with corresponding prior periods and with the results of other companies in our industry.

The following table provides a reconciliation of net income to EBITDA:

	Year-Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Net income attributable to Capella Education Company	$37,943	$35,203	$36,477	$52,115	$61,270
Other (income) expense, net	725	179	45	(1,811)	(2,038)
Income tax expense	25,427	24,495	23,047	30,370	35,860
Depreciation and amortization	23,798	25,877	29,255	24,165	18,512
EBITDA	$87,893	$85,754	$88,824	$104,839	$113,604

(c) Free cash flow is derived by deducting capital expenditures from cash flow from operating activities as presented in the statement of cash flows under GAAP. We use free cash flow as one measure to monitor and evaluate performance. However, free cash flow is not a recognized measurement under GAAP, and when analyzing our cash generating ability, investors should use free cash flow in addition to, and not as an alternative for, cash flow from operating activities as determined in accordance with GAAP. Because not all companies use identical calculations, our presentation of free cash flow may not be comparable to similarly titled measures of other companies.

We believe free cash flow is a meaningful measure to investors because it permits investors to view our performance using the same tools that management uses to assess our cash generating capabilities. We believe this measure is also useful to investors because it is an indication of cash flow that may be available to fund further investments in future growth initiatives.

Management uses free cash flow:

- as an indicator of the Company's cash generating capabilities after considering investments in capital assets which are necessary to maintain and enhance existing operations. Cash flow from operating activities adds back non-cash depreciation expense to earnings and thereby does not reflect a charge for necessary capital expenditures; and
- in presentations to the members of our board of directors to enable our board to have the same measurement basis of cash generating capabilities as is used by management to compare our current cash generating capabilities with corresponding prior periods and with the results of other companies in our industry.

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The following table provides a reconciliation of cash flow from operating activities to free cash flow:

	Year-Ended December 31,				
	2014	2013	2012	2011	2010
	(in thousands)				
Net cash provided by operating activities	$65,188	$69,349	$64,828	$80,304	$88,407
Capital expenditures	(20,584)	(18,728)	(23,278)	(29,587)	(25,481)
Free cash flow	$44,604	$50,621	$41,550	$50,717	$62,926

(d) Total enrollment reflects the total number of learners registered in a course as of the last day of classes for such periods.

(e) Working capital is calculated by subtracting total current liabilities from total current assets.

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

You should read the following discussion together with the consolidated financial statements and the related notes included elsewhere in this report.

Overview

Executive Overview

We are an online postsecondary education services company. As of December 31, 2014, our wholly owned subsidiaries included the following:

- Capella University (the University) is a regionally accredited university offering a variety of undergraduate and graduate degree programs primarily for working adults.
- Resource Development International Limited (RDI) is an independent provider of United Kingdom (UK) university distance learning qualifications and markets, develops and delivers these programs worldwide via its offices and partners across Asia, North America, Africa and Europe.
- Sophia Learning, LLC (Sophia) is a social teaching and learning platform that integrates education with technology.
- Capella Learning Solutions (CLS) is a subsidiary created in 2013 that 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 through innovation in our academic and business model and to drive growth by supporting learner success, producing affordable degrees, refining 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:

- Innovation. We operate in a very competitive market environment. While we demonstrated in 2014 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 persistence improvements are key drivers for total enrollment and revenue growth as well as the Company’s profitability. New enrollment is an early indicator for future growth and persistence improvement is an indicator for the sustainability of growth. In 2014, new enrollments grew by 8.7 percent on an annual basis compared to 2.2 percent in 2013. New enrollment is calculated from the last day a

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new learner can drop a course without financial penalty. Growth characteristics tend to differ by degree program due to different market dynamics. In 2014, new enrollment growth was led by our master's programs while our doctoral programs lagged due to longer decision cycles and other factors. During 2014, we reached a significant milestone by returning to total enrollment growth of 2.5 percent compared to 2013 after experiencing total enrollment declines since fiscal year 2011. The combination of new enrollment and persistence improvements were key drivers behind the return to annual total enrollment and revenue growth for the Company in 2014. In 2014, the Company continued its strategic focus on improving early cohort persistence, achieving the third consecutive year of improvements.

- Doctoral enrollment. During 2014, year-over-year Doctoral total enrollment declined by 5.6 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 in 2013 and 2014. We are extending our learner success focus to the comprehensive and dissertation portion of our Doctoral programs. Our goal is to address the learner population that is not making sufficient and timely academic progress in this phase and expect this initiative to 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 professional doctorate portfolio.

- 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 since learners tend to persist at a very high rate after that time period. In 2014 we achieved a four percent improvement over the prior year in early cohort persistence. 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;
- 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 that 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. In 2014, we largely completed our shift 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 of time 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. 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 throughout each quarter and complete activities to demonstrate specific competencies by the end of the quarter. 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 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. Therefore, 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. In our continued efforts to drive affordability, speed to competency, and learner success, we are focused on maximizing efficiencies in our existing programs while delivering the same learning outcomes. Our curriculum is based on competency mappings, which we are able to leverage as we redesign existing offerings. We believe these types of redesigns have the potential to increase persistence rates, learner success, and affordability.

- Current market and regulatory environment. The environment remains very competitive. We believe our initiatives to improve learner success and innovation in our academic and business model will position us to continue to be a leader in the online postsecondary education market. Additionally, we are working to even more closely align with employers. Developments in the federal regulatory environment impact us as well, including the enacting of gainful employment rules and the reauthorization of the Higher Education Act of 1965, as amended, and the current Department of Education rulemaking processes. Many states have also become more active in regulating online education, especially regarding approval to operate requirements, and enforcement of consumer protection laws by state attorneys general, with a focus on proprietary institutions. While we have a strong track record of regulatory compliance, such actions, even if not directed at Capella University, may result in unforeseen consequences and may make our operating environment more challenging.

- Lease amendment. On April 3, 2014, we accepted notice to activate an amendment to our current lease for our premises at 225 South Sixth Street in Minneapolis, MN. Pursuant to the amendment, in June 2014, we returned

54,940 square feet of our previously leased space of 426,165 square feet. Employees located in this area were relocated to other areas within our remaining space. We recorded a charge of approximately $2.6 million during the year-ended December 31, 2014 in connection with this amendment, which is included within the lease amendment charge line item of the consolidated statements of income.

We also consolidated other leased office space resulting in an additional charge of $0.1 million during the year- ended December 31, 2014. This amount is included within the lease amendment charge line item of the consolidated statements of income.

Regulatory Environment

- 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 combined with federal budget deficits increases the likelihood of legislation that will adversely impact our business. As Congress further addresses these 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. The Framework is intended to serve as a discussion document on the best way to measure access, affordability and outcomes. These metrics include, but are 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 has requested public feedback by February 17, 2015.

- Gainful Employment. The Department of Education published a Notice of Proposed Rulemaking on March 25, 2014. The proposed 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 proposed rule was similar to the draft language last discussed at the third negotiated rulemaking committee session in December 2013. Refer to a more detailed discussion of recent rulemaking and regulatory activity pertaining to the area of Gainful Employment within the Regulatory Environment section of the document.

- Current negotiated rulemaking. 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 February 19-21, March 26-28, and April 23-25, 2014. An additional session took place May 19-20, 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.

On August 8, 2014, the Department of Education published a 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.

- Program Participation Agreement. The Department of Education approved Capella University's Program Participation Agreement (PPA) in August 2014. Capella University is fully certified by the Department of Education to participate in Title IV programs through June 30, 2020.

- Minnesota Office of Higher Education student debt information request. The Minnesota Office of Higher Education (MOHE) is developing state level metrics related to average student loan debt. The data request was sent to all schools located within the state. The final report will be published by institution and sector (public 2-year, public 4-year, private not-for-profit, and private for-profit) covering average educational loan debt (excluding PLUS loans) of degree recipients by award level for 2011-2012. The student loan debt is debt from all sources (federal, state, institution, private) known to the institution. We are working with MOHE on this request. The date for the report to be published has not been determined.

- 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, it must establish a default prevention task force and develop a default prevention plan with measurable objectives for improving the cohort default rate.

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, an educational institution will lose its eligibility to participate in Title IV programs if its three-year measuring period student loan cohort default rate equals or exceeds 30% for three consecutive cohort years, or 40% for any given year. Capella University's three-year cohort default rates for the 2011, 2010, and 2009 cohorts are 13.0%, 10.9%, and 9.7% respectively. The increase is primarily due to the overall economic environment, and a slight increase in the percentage of Capella University learners enrolled in a bachelor's program, who generally have a higher default rate compared to graduate learners. The average cohort default rates for four-year proprietary institutions nationally were 19.1%% and 21.8% in fiscal years 2011 and 2010 respectively.

The cohort default rate requirements were modified by the Higher Education Opportunity Act enacted in August 2008 to increase by one year the measuring period for each cohort. Starting in September 2012, the Department of Education published the official three-year cohort default rates in addition to the two-year rates, beginning with the 2009 cohort, and two-year cohort default rates were no longer calculated following the release of the 2011 two-year rates.

Overview of Revenues and Expenses

Revenues. Revenues consist principally of tuition. During each of 2014, 2013, and 2012 tuition represented approximately 98.6%, 98.1%, and 99.1% of our revenues, respectively. Factors affecting our revenues include: (i) the number of enrollments; (ii) the number of courses per learner; (iii) our degree and program mix; (iv) the number of programs and specializations we offer; (v) annual tuition adjustments; (vi) the number of colloquia events and learners at each event; and (vii) the amount of scholarships, tuition discounts, and learner success grants offered to learners.

Enrollments for a particular time period are defined as the number of learners registered in a course on the last day of classes within that period. We offer monthly start options for newly enrolled learners. Learners who start their program in the second or third month of a quarter transition to a quarterly schedule beginning in their second quarter. Enrollments are a function of the number of continuing learners at the beginning of each period and new enrollments during the period, which are offset by graduations, withdrawals and inactive learners during the period. Inactive learners for a particular period include learners who are not registered in a class and, therefore, are not generating revenues for that period, but who have not withdrawn from Capella University. We believe that our enrollments are influenced by the attractiveness of our program offerings and learning experience, the effectiveness of our marketing and recruiting efforts, the quality of our faculty, the number of programs and specializations we offer, the availability of federal and other funding, the length of our educational programs, the seasonality of our enrollments, general economic conditions, and the regulatory environment.

The following is a summary of our Capella University learners as of the last day of classes for the years ended December 31, 2014, 2013, and 2012:

	Year-Ended December 31,		
	2014	2013	2012
Doctoral	10,100	10,700	11,023
Master’s	15,700	14,931	15,596
Bachelor’s	9,500	8,828	8,800
Other	1,009	973	910
Total	36,309	35,432	36,329

Tuition and fees. Our Capella University tuition rates vary by type and length of program and by degree level, such as doctoral, master’s or bachelor’s. For all learners in our credit hour master’s and bachelor’s programs, tuition is charged on a per course basis. Prices per course for credit hour programs ranged from approximately $1,400 to $2,600 for the 2014-2015 academic year (beginning in July 2014) and from $1,200 to $2,500 for the 2013-2014 academic year (beginning in July 2013). The price of the course varies based upon the number of credit hours, the degree level of the program and the discipline. For FlexPath learners, tuition is priced at a fixed amount per quarter. Tuition for learners seeking a bachelor's degree through FlexPath is priced at a quarterly amount of $2,000, and tuition for learners enrolled in master's level programs through FlexPath is priced at $2,200 per quarter.

The majority of doctoral programs are priced at a fixed quarterly amount ranging from approximately $4,300 to $4,700 per learner for the 2014-2015 academic year and from $4,300 to $4,700 per learner for the 2013-2014 academic year, regardless of the number of courses in which the learner was registered. For select doctoral programs, tuition is charged on a per course basis. Prices per course ranged from $2,600 to $4,400 for the 2014-2015 academic year and from $1,900 to $4,300 for the 2013-2014 academic year.

“Other” in the enrollment table above refers primarily to certificate-seeking learners. Certificate programs generally consist of four courses, and the price of a course depends on the number of credit hours and the discipline. Prices per course in certificate programs generally ranged from approximately $1,500 to $2,600 for the 2014-2015 academic year and from $1,500 to $2,500 for the 2013-2014 academic year.

Tuition increases have not historically been, and may not be in the future, consistent across our programs and specializations due to market conditions, program differentiation or changes in operating costs that have an impact on price adjustments of individual programs or specializations. Capella University implemented a weighted average tuition increase of 2.6% for the 2014-2015 academic year.

Refer to the University’s website, www.capella.edu, for tuition costs and credits required by individual degree. These program costs will vary by learner based upon the program and specialization selected, the number of courses taken per quarter and the number of transfer credits earned at other institutions. Reductions in tuition charges from our standard rates primarily include discounts associated with military and various corporate, healthcare, federal and educational marketing relationships, along with institutional scholarships, and learner success grants. Learner success grants are generally awarded over four to eight quarters.

A large portion of our learners rely on funds received under various government-sponsored student financial aid programs - predominantly Title IV programs - to pay a substantial portion of their tuition and other education-related expenses. During the years ended December 31, 2014, 2013, and 2012, approximately 77%, 78%, and 79%, respectively, of our revenues (calculated on a cash basis) were attributable to funds derived from Title IV programs. In addition to Title IV funding, our learners receive financial aid from other governmental sources, tuition reimbursement from their employers or the Department of Defense or finance their education with their own funds or through private financing institutions.

Operating costs and expenses. The following details a description of the costs included in our operating expense categories, including (i) instructional costs and services expenses, (ii) marketing and promotional expenses, (iii) admissions advisory expenses, and (iv) general and administrative expenses.

- Instructional costs and services. Instructional costs and services expenses primarily consist of compensation and costs related to the delivery and administration of our educational programs and includes costs related to faculty, learner support services, financial aid, the development of courses and programs and other related costs, and bad debt expense. Also included are expenses related to an allocation of facility, depreciation and amortization, and information technology costs that are attributable to providing educational services to our learners.

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- Marketing and promotional. Marketing and promotional expenses primarily consist of costs related to marketing activities to build Capella's brand, increase awareness and consideration by prospective learners, and generate inquiries for enrollment. These marketing activities include costs for advertising, participation in seminars and trade shows, compensation for marketing personnel and development of key marketing relationships with corporate, healthcare, armed forces, government and educational organizations. Marketing and promotional expenses also include an allocation of facility, depreciation and amortization, and information technology costs that are attributable to marketing and promotional efforts. Our marketing and promotional expenses are generally affected by the cost of advertising media, the efficiency of our marketing efforts, salaries and benefits for our sales personnel, brand spending, and the number of advertising initiatives for new and existing academic programs.

- Admissions advisory. Admissions advisory expenses primarily consist of costs related to compensation for admissions personnel (for example, enrollment services and registrar's office) as well as other costs directly related to the admissions advisory function. Admissions advisory expenses also include an allocation of facility, depreciation and amortization, and information technology costs that are attributable to admissions advisory efforts.

- General and administrative. General and administrative expenses primarily consist of costs related to corporate costs, legal and professional fees and other related costs such as salaries and benefits of employees engaged in corporate management, new business development, finance, compliance and other corporate functions. General and administrative expenses also include an allocation of facility, depreciation and amortization, and information technology costs attributable to such functions.

Other income (expense), net. Other income (expense), net consists primarily of interest income earned on cash, cash equivalents and marketable securities and interest expense for the amortization of debt issuance costs, commitment fees charged on the unused portion of the credit facility, and the change in the fair value of the RDI contingent consideration liability.

Net loss attributable to noncontrolling interest. Net loss attributable to noncontrolling interest consists of Sophia’s noncontrolling owner’s portion of Sophia’s losses, prior to acquiring the remaining noncontrolling interest in 2012.

Critical Accounting Policies and Use of Estimates

The discussion of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (GAAP). In connection with the preparation of our financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates and assumptions on historical experience and on various other assumptions that we believe are reasonable under the circumstances. On an ongoing basis, we evaluate our estimates and assumptions, including those related to revenue recognition, allowance for doubtful accounts, contingencies, share-based compensation expense, other than temporary impairments, goodwill and intangible assets, and income taxes. The results of our analysis form the basis for making assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions, and the impact of such differences may be material to our consolidated financial statements.

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

Revenue recognition. Tuition revenue represented approximately 98.6%, 98.1%, and 99.1% of our revenues recognized for each of the years ended December 31, 2014, 2013, and 2012, respectively. Traditional course tuition revenue is deferred and recognized as revenue ratably over the period of instruction, which is generally from one and a half to three months. If a learner withdraws or drops a course, we follow the University refund policy, which generally is: 100 percent refund through five days, 75 percent refund from six to twelve days, and zero percent refund for the remainder of the period. The refund policy varies slightly for learners within certain states due to state rules or regulations. We do not recognize revenue for learners who enroll but never engage in the courseroom. Refunds are recorded as a reduction of revenue in the period that the learner withdraws from a course. When we are required to return Title IV funds to the Department of Education, the learner is not released from his or her payment obligation to the University.

Colloquia tuition revenue is recognized over the length of each colloquium, which ranges from three to 42 days. Deferred revenue in any period represents the excess of tuition and fees received as compared to tuition and fees recognized as revenue in the consolidated statements of income and is reflected as a current liability on our consolidated balance sheets.

We also enter into arrangements to provide program development and management consulting services to other third parties to establish or expand their training and educational programs. These arrangements often include the delivery of multiple products and services, primarily including hosting the training, providing maintenance and support, and other professional services. For arrangements that involve multiple elements, we recognize revenue for delivered elements when they have stand-alone value to the customer, they have been accepted by the customer, and for which there are only customary refund or return rights. Arrangement consideration is allocated to the deliverables based on the relative selling price of each element. The selling price used for each deliverable is based on vendor-specific objective evidence (VSOE) of fair value if available, third-party evidence (TPE) of fair value if VSOE is not available, or estimated selling price if neither VSOE nor TPE is available. Estimated selling price is determined in a manner consistent with that used to establish the price to sell the deliverable on a standalone basis. Revenue is recognized for each element in a manner consistent with the nature of the product or service delivered.

Allowance for doubtful accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability, failure or refusal of our learners to make required payments. We determine the allowance for doubtful accounts amount based on an analysis of our accounts receivable portfolio and historical write-off experience, and current economic conditions, recoveries and trends.

In establishing our credit practices, we seek to strike an appropriate balance between prudent learner credit policies and learner retention. Accordingly, we periodically review and alter learner credit policies to achieve that objective by restricting or expanding the availability of credit we extend. Changes to credit practices may impact enrollments, revenues, accounts receivables, our allowance for doubtful accounts and bad debt expense. If changes in credit practices result in higher receivable balances, if the financial condition of our learners deteriorates resulting in an impairment of their ability to pay, or if we underestimate the allowances required, additions to our allowance for doubtful accounts may be necessary, which will result in increased instructional costs and services expenses in the period such determination is made.

During the years ended December 31, 2014, 2013, and 2012, we recognized bad debt expense of $14.8 million, $15.1 million, and $17.3 million, respectively. As of December 31, 2014 and 2013, the allowance for doubtful accounts was $6.6 million and $7.1 million, respectively, which represented 26.8% and 29.5% of gross accounts receivable as of the respective dates. A one percent change in our allowance for doubtful accounts as a percentage of gross accounts receivable as of December 31, 2014 would have resulted in a change in pre-tax income of $0.2 million.

We have not made any material changes in the accounting methodology we use to estimate our allowance for doubtful accounts during the past three fiscal years; however, we routinely evaluate our estimation methodology for adequacy and modify it as necessary. In doing so, we believe our allowance for doubtful accounts reflects the amount of receivables that will become uncollectible by considering our most recent collections experience, changes in trends and other relevant factors.

Contingencies. We accrue for costs associated with contingencies including, but not limited to, regulatory compliance and legal matters when such costs are probable and reasonably estimable. Liabilities established to provide for contingencies are adjusted as further information develops, circumstances change, or contingencies are resolved. We base these accruals on management’s estimate of such costs, which may vary from the ultimate cost and expenses associated with any such contingency.

Share-based compensation. Our outstanding share-based payment awards consist of market stock units (MSUs), stock options, and restricted stock units (RSUs). We measure and recognize compensation expense for share-based payment awards made to employees and directors based on estimated fair values of the share award on the date of grant.

The fair value of our MSUs are estimated as of the date of grant using a Monte Carlo simulation. The Monte Carlo simulation is based on the expected 90 calendar day average market price of our common stock prior to the vesting date and the expected number of MSUs that will convert into common shares. In determining share-based compensation for MSUs, the Monte Carlo simulation approach is applied in a risk-neutral framework with inputs including volatility, the risk-free interest rate, and expected dividends.When estimating the grant date fair value of the MSUs, the daily closing prices of our stock are forecast over the 90 calendar days ending on the last day of the service period, using a Monte Carlo simulation. Numerous iterations of the Monte Carlo simulation are performed, based on the framework described above, to develop a distribution of future stock price paths. The estimated fair value of an MSU equals the average of the discounted present values from each of the simulation paths produced by the Monte Carlo simulation. We recognize share-based compensation expense for MSU awards using the straight-line method, over the period that the awards are expected to vest. Compensation cost related to an award with a market condition will be recognized regardless of whether the market condition is satisfied, provided that the requisite service has been provided.

The fair value of our service-based stock options is estimated as of the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Year-Ended December 31,		
	2014	2013	2012
Weighted-average exercise price (1)	$64.82	$32.26	$40.48
Expected life (in years) (2)	4.53	4.47	4.39
Expected volatility (3)	41.76 %	46.38 %	48.83 %
Risk-free interest rate (4)	1.37 %	0.74 %	0.73 %
Dividend yield (5)	2.16 %	— %	— %
Weighted-average fair value of options granted	$19.52	$12.46	$16.23

(1) The weighted-average exercise price is equal to the Company's weighted-average stock price as of the grant date during each of the respective years.
(2) The expected life of our options granted during the years ended December 31, 2014, 2013, and 2012 is based upon our historical stock option exercise, forfeiture, and expiration activity.
(3) The expected volatility assumption for the years ended December 31, 2014, 2013, and 2012 is based upon the Company's historical stock price for a period commensurate with the expected life of the options.
(4) The risk-free interest rate assumption is based upon the U.S. Treasury zero coupon yield curve on the grant date for a maturity similar to the expected life of the options.
(5) The dividend yield assumption is based on our history and expectation of regular dividend payments. We initiated a quarterly cash dividend in the fourth quarter of 2013. Prior to this time, we have not historically paid dividends.

In determining share-based compensation expense, significant management judgment and assumptions are required concerning such factors as expected term, expected volatility and forfeitures. In our opinion, the assumptions that have the most significant effect on the fair value of our service-based stock options and, therefore, share-based compensation expense, are the expected life and expected volatility.

The following table illustrates how changes to the Black-Scholes option pricing model assumptions would affect the weighted-average fair values as of the grant date for grants made during fiscal year 2014:

	Expected Volatility		
Expected Life (Years)	36.8%	41.8%	46.8%
4.0	$16.45	$18.68	$20.87
4.5	$17.18	$19.52	$21.77
5.0	$17.83	$20.24	$22.58

As share-based compensation expense is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Therefore, changes in the forfeiture assumptions do not impact the total amount of expense ultimately recognized over the requisite service period. Rather, different forfeiture assumptions only impact the timing of expense recognition over the requisite service period.

Goodwill and Intangible Assets. Goodwill represents the excess of the purchase price of an acquired business over the fair value assigned to the underlying assets acquired and liabilities assumed. At the time of an acquisition, we allocate the goodwill and related acquired assets and liabilities to its reporting unit. Management identifies its reporting units by assessing whether the components of its operating segment constitutes businesses for which discrete financial information is available and management regularly reviews the operating results of those components. We assess goodwill annually for impairment on the first day of 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.

Before employing detailed quantitative impairment testing methodologies, we first evaluate the likelihood of impairment by considering qualitative factors relevant to the reporting unit, such as macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, and any other factors that have a significant bearing on fair value. Based on this analysis, if we determine that it is more likely than not that goodwill is impaired, we apply detailed quantitative testing methodologies. Our detailed quantitative testing methodologies include assessing goodwill for impairment at the reporting unit level by applying a two-step test. In the first step, we compare the fair value of the reporting unit to the carrying value of its net assets. If the fair value of the reporting unit exceeds the carrying value of the net assets of the reporting unit, goodwill is not impaired and no further testing is required. However, if the carrying value of the net assets of the reporting unit exceeds the fair value of the reporting unit, we perform a second step to determine the implied fair value of the goodwill and compare it to the carrying value of the goodwill. An impairment loss is recognized to the extent the implied fair value of the goodwill is less than the carrying amount of the goodwill.

We completed our fiscal year 2014 goodwill impairment test for the RDI reporting unit using the first day of the fourth quarter as the assessment date, and did not identify any impairment charges for the year-ended December 31, 2014 as the estimated fair value of the reporting unit exceeded the carrying value in the step one impairment test. We performed step one of the quantitative goodwill impairment test using a combination of an income-based approach and a market-based approach to determine fair value.

The income approach consisted of a discounted cash flow model that included probability weighted projections of future cash flows for the RDI reporting unit under various scenarios, calculating a terminal value, and discounting such cash flows by a risk-adjusted rate of return. The determination of fair value of the RDI reporting unit primarily consists of using unobservable inputs under the fair value measurement standards. We believe the most critical assumptions and estimates in determining the estimated fair value of the RDI reporting unit, include, but are not limited to, the following:

- Amounts and timing of expected future cash flows. The assumptions used in determining the expected future cash flows consider various factors such as historical operating trends, particularly in student enrollment, the political environment the reporting unit operates in, anticipated economic and regulatory conditions, accreditation status and reasonable expectations for planned business, and long-term operating strategies and initiatives. We use our business plans and projections as the basis for expected future cash flows.

- Discount rate. The discount rate is based on our assumption of a prudent investor's required rate of return for assuming the risk of investing in a particular company in a specific country. We assumed a discount rate of 17 percent to reflect the relevant risks of the RDI reporting unit. The discount rate could increase by more than 10% of the discount rate currently utilized, and the reporting unit would continue to have fair value in excess of carrying value.

- Terminal growth rate. 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. We assumed a terminal growth rate of 3 percent to reflect our expectations of long-term inflation and growth of the reporting unit. The terminal growth rate assumption could decline to a zero growth environment and the reporting unit would continue to have fair value in excess of carrying value.

The market-based approach included a combination of fair values determined from (1) a comparable transactions approach using observable market transactions within the industry; and (2) a guideline company approach using publicly traded companies with similar operating and investment characteristics of the reporting unit to develop a multiple which is then applied to the operating performance of the reporting unit to determine fair value.

We utilized an equal weighting of 50 percent for the income approach and 50 percent for the market approach in determining the fair value of the RDI reporting unit. The income and market approaches yielded similar resulting fair values and the application of different weighting methodologies would not have had a significant impact on the results of the step-one impairment test.

We believe that the assumptions used in the goodwill impairment tests are consistent with a reasonable market participant view while employing the concept of highest and best use of the asset.

Finite-lived intangible assets that are acquired in business combinations are recorded at fair market value on their acquisition date and are amortized on a straight-line basis to reflect the economic useful life of the asset. As of December 31, 2014 and 2013, we did not have any indefinite-lived intangible assets.

The Company reviews its intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered not recoverable, a potential impairment loss would be recognized to the extent the carrying amount of the assets exceeds the fair value of the assets. Fair value is generally determined using a discounted cash flow approach.

Accounting for income taxes. We are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax obligations based on expected taxable income, statutory tax rates and tax credits allowed in the various jurisdictions in which we operate. Tax laws require certain items to be included in our tax returns at different times than the items are reflected in our results of operations. Some of these differences are permanent, such as expenses that are not deductible in our tax returns, and some are temporary differences that will reverse over time. Temporary differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets. We must assess the likelihood that our deferred tax assets will be realized and establish a valuation allowance to the extent necessary. Significant judgment is required in evaluating our tax positions, and in determining our income tax expense, our deferred tax assets and liabilities, and any valuation allowance recorded against our net deferred tax assets.

We record income taxes using the asset and liability approach. Under this approach, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the book and tax basis of assets and liabilities. We measure deferred tax assets and liabilities using the enacted statutory tax rates that are expected to apply in the years in which the temporary differences are expected to be recovered or paid.

At December 31, 2014, the Company has net operating loss carryforwards of $14.1 million for UK income tax purposes, which do not expire.

We regularly assess the likelihood that our deferred tax assets will be recovered in the future. A valuation allowance is recorded to the extent we conclude a deferred tax asset will not more-likely-than-not be realized. We consider all positive and negative evidence related to the realization of the deferred tax assets in assessing the need for a valuation allowance. If we determine we will not realize all or part of our deferred tax assets, adjustments to the deferred tax assets are charged to earnings in the period such determinations were made.

During 2012, the Company concluded that it was more-likely-than-not that its UK deferred tax assets would not be fully realized, a position we continue to assert. During 2014, the valuation allowance was increased by $0.3 million primarily as a result of net operating losses in our UK subsidiary.

The accounting estimate for valuation allowances against deferred tax assets is a critical accounting estimate because judgment is required in assessing the likely future tax consequences of events that have been recognized in our financial statements or tax returns. Our accounting for deferred tax consequences represents our best estimate of future events. A valuation allowance established or revised as a result of our assessment is recorded through income tax expense in our consolidated statements of income. Changes in our current estimates due to unanticipated events, or other factors, could have a material effect on our financial condition and results of operations.

At December 31, 2014, our net deferred tax liability was $3.1 million. The valuation allowance of $2.5 million primarily relates to our UK deferred tax assets not expected to be utilized in the future.

We are subject to U.S. federal income tax and multiple state jurisdictions, as well as UK corporation tax and Hong Kong profits tax. During 2014, both an Internal Revenue Service (IRS) income tax audit for the 2010 tax year and a New York state income tax audit for tax years 2008-2010 were completed without significant findings. No other income tax audits are ongoing or pending as of December 31, 2014.

For U.S. federal and UK corporation tax purposes, the statute of limitations remains open on tax years from 2011. For Hong Kong, the statute of limitations is 6 years and for state purposes, the statute of limitations varies by jurisdiction, but is generally from 3 to 5 years.

We record a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. As of December 31, 2014, we had $38 thousand of total gross unrecognized tax benefits. Of this total,

$25 thousand (net of the federal benefit on state issues), represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods.

We continue to recognize interest and penalties related to uncertain tax positions in income tax expense. We recognized $2 thousand, $5 thousand, and $16 thousand in interest and penalties related to uncertain tax positions in income tax expense during the years ended December 31, 2014, 2013, and 2012, respectively.

The Company does not anticipate any significant increases or decreases in unrecognized tax benefits within the next twelve months. In the fourth quarter of 2014, the statute of limitations expired on approximately $13 thousand in unrecognized tax benefits related to state issues from tax years 2010-2011. In the fourth quarter of 2015, the statute of limitations will expire on approximately $11 thousand in unrecognized tax benefits related to state issues from tax years 2008-2012.

Results of Operations
Year-Ended December 31, 2014 Compared to Year-Ended December 31, 2013
The following selected financial data table should be referenced in connection with a review of the discussion of our results of operations for the year-ended December 31, 2014 compared to the year-ended December 31, 2013.

	Year-Ended December 31, $ (in thousands)		$ Change	% Change	% of Revenue		
	2014	2013	2014 vs. 2013		2014	2013	2014 vs. 2013
Revenues	$421,967	$415,623	$6,344	1.5 %	100.0 %	100.0 %	— %
Costs and expenses:							
Instructional costs and services	185,503	183,757	1,746	1.0	44.0	44.2	(0.2)
Marketing and promotional	99,790	102,198	(2,408)	(2.4)	23.7	24.6	(0.9)
Admissions advisory	28,042	27,103	939	3.5	6.6	6.5	0.1
General and administrative	41,847	42,688	(841)	(2.0)	9.9	10.3	(0.4)
Lease amendment charges	2,690	—	2,690	100.0	0.6	—	0.6
Total costs and expenses	357,872	355,746	2,126	0.6	84.8	85.6	(0.8)
Operating income	64,095	59,877	4,218	7.0	15.2	14.4	0.8
Other income (expense), net	(725)	(179)	(546)	305.0	(0.2)	—	(0.2)
Income before income taxes	63,370	59,698	3,672	6.2	15.0	14.4	0.6
Income tax expense	25,427	24,495	932	3.8	6.0	5.9	0.1
Effective tax rate	40.1 %	41.0 %					
Net income	$37,943	$35,203	$2,740	7.8 %	9.0 %	8.5 %	0.5 %

Revenues. Capella University revenues comprised approximately 96 percent of total consolidated revenues for the years ended December 31, 2014 and 2013. The increase in revenues in 2014 compared to 2013 was primarily related to average tuition price increases of 2.6 percent implemented in July 2014 and an increase in the quarterly average total Capella University enrollments of 0.6 percent during 2014 compared to 2013. The overall increase was partially offset by a larger proportion of bachelor's and certificate learners who generate less revenue per learner than our master's or doctoral learners, and an increase in tuition grants and discounts to support our initiatives to improve learner success.

Instructional costs and services expenses. Instructional costs and services expenses increased compared to the same period in the prior year primarily due to increased instructional costs related to our doctoral programs, continued investment in course and program development, and increased headcount. The increase was partially offset by the prospective reallocation of share-based compensation expense related to awards granted to certain of our executives and members of our Board of Directors as general and administrative in 2014 as well as a decrease in depreciation expense as a result of certain internally developed assets becoming becoming fully depreciated in 2013.

Marketing and promotional expenses. Marketing and promotional expenses, and marketing and promotional expenses as a percent of revenues, decreased compared to the prior year primarily due to efficiencies gained in our marketing efforts through utilization of a more balanced approach as we continue to optimize our relationship-based and brand marketing model, lower production-related expenses in 2014 compared to 2013 attributable to the prior year's new advertising campaign, and lower depreciation expense as a result of certain assets becoming fully depreciated in early 2014. This overall decrease was partially offset by additional employee expenses driven by increased headcount.

Admissions advisory expenses. Admissions advisory expenses, and admissions advisory expenses as a percent of revenues, increased compared to the prior year primarily due to increased enrollment services headcount to support higher Capella University inquiry volume and new enrollments.

General and administrative expenses. General and administrative expenses, and general and administrative expenses as a percent of revenue, decreased compared to the prior year primarily as a result of reduced headcount along with decreased non-Capella University business development costs. This decrease was partially offset by the prospective change in classification of approximately $1.1 million of share-based compensation expense from instructional costs and services and marketing and promotional to general and administrative in 2014, increased participation in monitoring and shaping government regulations, as well as an increase in human resources contract staff.

Lease amendment charges. On April 3, 2014, we accepted notice to activate an amendment to our current lease for our premises at 225 South Sixth Street in Minneapolis, Minnesota. Pursuant to the amendment, in June 2014, we returned 54,940 square feet of our previously leased space of 426,165 square feet. We recorded a charge of $2.6 million during the year-ended December 31, 2014 in connection with this amendment. We also consolidated other leased office space resulting in an additional charge of $0.1 million during the year-ended December 31, 2014.

Other income (expense), net. The higher other net expense amount in 2014 compared to 2013 was primarily due to the $0.5 million increase in fair value of the RDI contingent consideration liability which was paid during the quarter ended June 30, 2014 as a result of the awarding of Taught Degree Awarding Power (TDAP), and management fees related to a limited partnership investment.

Income tax expense. The decrease in our effective tax rate compared to the prior year 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.

Year-Ended December 31, 2013 Compared to Year-Ended December 31, 2012
The following selected financial data table should be referenced in connection with a review of the discussion of our results of operations for the year-ended December 31, 2013 compared to the year-ended December 31, 2012.

	Year-Ended December 31, $ (in thousands)		$ Change	% Change	% of Revenue		
	2013	2012	2013 vs. 2012		2013	2012	2013 vs. 2012
Revenues	$415,623	$421,890	$(6,267)	(1.5)%	100.0%	100.0%	—%
Costs and expenses:							
Instructional costs and services	183,757	191,947	(8,190)	(4.3)	44.2	45.5	(1.3)
Marketing and promotional	102,198	100,809	1,389	1.4	24.6	23.9	0.7
Admissions advisory	27,103	30,151	(3,048)	(10.1)	6.5	7.1	(0.6)
General and administrative	42,688	39,600	3,088	7.8	10.3	9.4	0.9
Total costs and expenses	355,746	362,507	(6,761)	(1.9)	85.6	85.9	(0.3)
Operating income	59,877	59,383	494	0.8	14.4	14.1	0.3
Other income (expense), net	(179)	(45)	(134)	297.8	—	—	0.0
Income before income taxes	59,698	59,338	360	0.6	14.4	14.1	0.3
Income tax expense	24,495	23,047	1,448	6.3	5.9	5.5	0.4
Effective tax rate	41.0%	38.8%					
Net income	35,203	36,291	(1,088)	(3.0)	8.5	8.6	(0.1)
Net loss attributable to noncontrolling interest	—	186	(186)	(100.0)	—	—	—
Net income attributable to Capella Education Company	$35,203	$36,477	$(1,274)	(3.5)%	8.5%	8.6%	(0.1)%

Revenues. Capella University revenues comprised approximately 96 percent and 97 percent of total consolidated revenues for the years ended December 31, 2013 and 2012, respectively. The decrease in revenues in 2013 compared to 2012 was primarily related to a decrease in the quarterly average total Capella University enrollments of 2.0 percent during 2013 compared to 2012, a larger proportion of bachelor's and certificate learners who generate less revenue per learner than our master's or doctoral learners, and an increase in tuition grants and discounts to support our initiatives to improve learner success. Capella University tuition increases in 2013 averaged approximately three percent and were implemented in July 2013.

Instructional costs and services expenses. Instructional costs and services expenses, and instructional costs and services expenses as a percent of revenue, decreased compared to the same period in the prior year primarily due to a decrease in depreciation expense as a result of our enterprise resource planning system becoming becoming fully depreciated in the prior year, decreased capitalized project costs, and a reduction in bad debt expense in 2013 compared to 2012. This overall decrease was partially offset by increased bonus expense and an increase in expenses related to our diversification efforts.

Marketing and promotional expenses. Marketing and promotional expenses, and marketing and promotional expenses as a percent of revenues, increased compared to prior year primarily due to increased investments in RDI's marketing platform, depreciation expense as a result of investments in strategic initiatives throughout 2012, and information technology investments related to improving the visitor center. These increases were partially offset by efficiencies gained in our Capella University marketing efforts through utilization of a more balanced approach as we continue to optimize our relationship-based and brand marketing model.

Admissions advisory expenses. Admissions advisory expenses, and admissions advisory expenses as a percent of revenues, decreased compared to prior year primarily due to higher information technology expenses in the prior year associated with enterprise wide foundational upgrades and strategic initiatives, increased staff productivity, and lower depreciation.

General and administrative expenses. General and administrative expenses, and general and administrative expenses as a percent of revenue, increased compared to the prior year primarily as a result of the prior year reversal of the Office of Inspector General (OIG) audit accrual for our estimated total amount of Title IV funds not returned for learners who withdrew without providing official notification of approximately $1.0 million, including interest, but not including fines and penalties; and increased bonus and compensation expense.

Other income (expense), net. The higher other net expense amount in 2013 compared to 2012 was primarily due to reduced interest income levels as a result of continuing declines in interest rates in the marketable securities markets.

Income tax expense. The increase in our effective tax rate from 2012 to 2013 was primarily due to an increase in the valuation allowance established on foreign net deferred tax assets primarily related to net operating losses, and a decrease in interest earned from tax-exempt securities.

Quarterly Results and Seasonality

The following tables set forth certain unaudited financial and operating data each quarter during the years ended December 31, 2014 and 2013. The unaudited information reflects all adjustments, which include only normal and recurring GAAP adjustments, necessary to present fairly the information shown.

	First	Second	Third	Fourth	Total
	(in thousands, except enrollment and per share data)				
2014					
Revenues	$105,596	$104,832	$103,097	$108,442	$421,967
Operating income	15,143	15,464	13,176	20,312	64,095
Net income attributable to Capella Education Company	8,817	9,044	7,757	12,325	37,943
Net income attributable to Capella Education Company per common share:					
Basic	$0.71	$0.74	$0.63	$1.01	$3.09
Diluted	$0.70	$0.72	$0.62	$0.99	$3.03
Total enrollment	35,889	35,791	35,220	36,309	36,309
2013					
Revenues	$105,242	$103,693	$100,703	$105,985	$415,623
Operating income	15,175	17,465	10,510	16,727	59,877
Net income attributable to Capella Education Company	8,755	10,422	6,010	10,016	35,203
Net income attributable to Capella Education Company per common share:					
Basic	$0.71	$0.84	$0.48	$0.81	$2.84
Diluted	$0.70	$0.83	$0.48	$0.79	$2.80

Total enrollment	36,405	36,003	34,503	35,432	35,432

Our revenues and operating results normally fluctuate as a result of seasonal variations in our business, principally due to changes in enrollment. The Capella University learner population varies as a result of new enrollments, graduations and learner

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attrition. The sequential quarterly increase in enrollments has typically been the greatest in the fourth quarter of each respective year, which corresponds with a traditional Fall school start. The larger relative increases in enrollments in the fourth quarter have resulted in larger sequential increases in Capella University revenue during the fourth quarter than in other quarters. A significant portion of our general and administrative expenses does not vary proportionately with fluctuations in revenues, resulting in larger relative increases in operating income in the fourth quarter relative to increases between other quarters. In addition, we typically implement tuition increases at the beginning of an academic year, which coincides with the start of the third quarter of each fiscal year. We expect quarterly fluctuations in operating results to continue as a result of these seasonal patterns.

Liquidity and Capital Resources

Liquidity

We financed our operating activities and capital expenditures during the years ended December 31, 2014, 2013, and 2012 primarily through cash provided by operating activities. Our cash, cash equivalents, and current portion of marketable securities were $123.6 million and $142.4 million at December 31, 2014 and 2013, respectively. Our cash, cash equivalents, and marketable securities decreased primarily due to increased cash used in investing and financing activities related to dividend payments, share repurchases, and capital expenditures as well as lower cash provided by operating activities and general business activities.

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 has a term of five years ending September 30, 2016. As of December 31, 2014, 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.

On July 15, 2011, we acquired 100% of the share capital of RDI for £7.9 million (approximately $12.6 million), net of cash acquired. In connection with the agreement, we were required to make an additional payment of £4.0 million to the former shareholders of RDI when RDI was granted TDAP. On April 14, 2014, RDI received notice from the British government of being awarded TDAP. Pursuant to the terms of the acquisition agreement, upon achievement of TDAP on May 12, 2014, we made an additional payment of £4.0 million (approximately $6.9 million) to the former shareholders of RDI.

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 for the year-ended December 31, 2014 was $65.2 million, compared to $69.3 million for the year-ended December 31, 2013. The decrease was primarily due to a decrease in cash from accounts payable and accrued liabilities due to the general timing of vendor invoices as well as a decrease in accrued compensation due to the timing of payroll, and a decrease in depreciation and amortization. The overall decrease was partially offset by an increase in net income driven by the return to positive total enrollment growth and an increase in income taxes payable as a result of the timing and amount of estimated quarterly tax payments.

Net cash provided by operating activities for the year-ended December 31, 2013 was $69.3 million, compared to $64.8 million for the year-ended December 31, 2012. The increase was primarily due to an increase in cash from accounts payable and accrued liabilities due to the timing of vendor invoices and television marketing, and an increase in cash provided by income taxes payable as a result of the timing and amount of estimated quarterly payments, offset by a decrease in depreciation and amortization and net income.

Investing Activities

Cash used in investing activities is primarily related to investments in property and equipment and maturities or purchases of marketable securities. Net cash used in investing activities was $60.9 million and $33.3 million for the year-ended December 31, 2014 and December 31, 2013, respectively. Net cash provided by investing activities was $17.1 million for the year-ended December 31, 2012.

Cash used in investing activities for the year-ended December 31, 2014 consisted primarily of purchases of marketable securities and capital expenditures related to investments in property and equipment, which were partially offset by maturities of marketable securities. Net purchases and maturities of marketable securities represented a cash outflow of $38.9 million and $14.5 during the years ended December 31, 2014 and December 31, 2013, respectively.

We believe the credit quality and liquidity of our investment portfolio as of December 31, 2014 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. However, 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 $20.6 million, $18.7 million, and $23.3 million for the years ended December 31, 2014, 2013, and 2012, respectively. Capital expenditures in 2014 primarily consisted of investments in IT infrastructure and marketing initiatives, expenditures related to continuing to expand FlexPath, as well as investments in learner success and academic quality initiatives. The increase in capital expenditures for the year-ended December 31, 2014 compared to the prior year is primarily driven by additional investments in expanding our FlexPath program offerings and enhancements to our visitor center. We expect our capital expenditures in 2015 will be approximately five percent of revenues, and we expect to be able to fund these capital expenditures with cash generated from operations.

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

Financing Activities

Net cash used in financing activities was $34.4 million, $5.2 million, and $50.7 million for the years ended December 31, 2014, 2013, and 2012, respectively. In 2014, we used cash to repurchase $17.3 million of common stock under our share repurchase program, compared to $9.0 million and $51.4 million in 2013 and 2012, respectively. Cash used to repurchase common stock increased $8.3 million in 2014 compared to 2013 and decreased $42.5 million in 2013 compared 2012. Additionally, we paid total cash dividends of $17.3 million during the year-ended December 31, 2014.

Contractual Obligations

The following table sets forth, as of December 31, 2014, the aggregate amounts of our significant contractual obligations and commitments with definitive payment terms due in each of the periods presented, in thousands:

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating leases [a]	$25,120	$8,116	$12,127	$4,877	$—
Purchase obligations [b]	9,632	8,749	883	—	—
Total contractual obligations	$34,752	$16,865	$13,010	$4,877	$—

(a) Minimum lease commitments for our headquarters, RDI's office space, and miscellaneous office equipment.
(b) Purchase obligations include commitments for marketing related and service contracts.

Due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2014, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, $38 thousand of unrecognized tax benefits have been excluded from the contractual obligations table above.

Due to the uncertainty with respect to the timing of future borrowings associated with our credit facility, we are unable to make reasonably reliable estimates of any commitment fees charged on the unused portion of the credit facility. Therefore, the maximum estimated commitment fee of $0.4 million per annum is excluded from the contractual obligations table above.

As of December 31, 2014, the Company has a commitment to invest up to $3.5 million in a limited partnership investment over the next ten years. Due to the uncertainty with respect to the timing of future cash flows associated with the limited partnership investment, we are unable to make reasonably reliable estimates of the period in which such additional investments may take place. Therefore, $3.5 million of potential limited partnership investment commitments have been excluded from the contractual obligations table above.

Regulation and Oversight

We are subject to extensive regulation by federal and state governmental agencies and accrediting bodies. In particular, the Higher Education Act (HEA) and the regulations promulgated thereunder by the Department of Education subject us to significant regulatory scrutiny on the basis of numerous standards that schools must satisfy to participate in Title IV programs.

Off-Balance Sheet Arrangements

Other than the contractual obligations above, we do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Impact of Inflation

We believe that inflation has not had a material impact on our results of operations for the years ended December 31, 2014, 2013, or 2012. There can be no assurance that future inflation will not have an adverse impact on our operating results and financial condition.

Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-15, Disclosure of Uncertainties about an Entities Ability to Continue as a Going Concern, which is included in Accounting Standards Codification (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 guidance will be effective for the Company's interim and annual reporting periods beginning January 1, 2017. The standard allows the Company to transition to the new model using either a full or modified retrospective approach, and early adoption is not permitted. The Company is currently evaluating the impact this standard will have on its business practices, financial condition, results of operations, and disclosures.

In March 2013, the FASB issued ASU No. 2013-05, Foreign Currency Matters. This update addresses diversity in practice regarding the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investments in a foreign entity. In addition, the standard addresses diversity in practice for the treatment of business combinations achieved in stages involving a foreign entity. The guidance was effective for the Company's interim and annual reporting periods beginning January 1, 2014, and applied prospectively. The adoption of this guidance did not have a material impact on the Company's financial condition, results of operations, or 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 financial condition, results of operations, or disclosures.

Item 7A. 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 as of December 31, 2014 and December 31, 2013 were rated A- or higher 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. 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 December 31, 2014, a 10% increase or decrease in interest rates would not have a material impact on our future earnings, fair values, or cash flows.

Foreign Currency Exchange Risk

We use the U.S. dollar as our reporting currency. The functional currencies of our foreign subsidiaries are generally the local currencies. Accordingly, our 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 (loss);
- 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, as well as gains and losses from foreign currency transactions. These items are recorded in other income (expense), net in the consolidated statements of income.

In fiscal year 2014, we recorded $169 thousand in net foreign currency translation losses that are included in other comprehensive income. These losses are primarily the result of the general strengthening of the U.S. dollar relative to foreign currencies during fiscal year 2014. We have not used derivative contracts to hedge foreign currency exchange rate fluctuations.

Item 8. Financial Statements and Supplementary Data
CAPELLA EDUCATION COMPANY
Index to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Capella Education Company

We have audited the accompanying consolidated balance sheets of Capella Education Company as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2014. Our audit also included the financial statement schedule listed in the index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Capella Education Company at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Capella Education Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 19, 2015 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP
Minneapolis, Minnesota
February 19, 2015

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

	As of December 31, 2014	2013
ASSETS		
Current assets:		
Cash and cash equivalents	$94,003	$124,097
Marketable securities, current	29,619	18,342
Accounts receivable, net of allowance of $6,558 at December 31, 2014 and $7,091 at December 31, 2013	17,902	16,919
Prepaid expenses and other current assets	9,007	10,548
Deferred income taxes	2,809	2,846
Total current assets	153,340	172,752
Marketable securities, non-current	43,430	17,740
Property and equipment, net	37,246	39,993
Goodwill	16,961	16,969
Intangibles, net	1,927	2,795
Other assets	1,453	—
Total assets	$254,357	$250,249
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$6,832	$7,939
Accrued liabilities	23,410	33,164
Dividends payable	4,622	4,346
Income taxes payable	709	—
Deferred revenue	11,718	10,736
Total current liabilities	47,291	56,185
Deferred rent	2,440	3,221
Other liabilities	3,698	2,541
Deferred income taxes	5,894	6,283
Total liabilities	59,323	68,230
Shareholders' equity:		
Common stock, $0.01 par value: Authorized shares — 100,000; Issued and Outstanding shares — 12,243 at December 31, 2014 and 12,361 at December 31, 2013	122	124
Additional paid-in capital	112,417	104,546
Accumulated other comprehensive loss	(335)	(114)
Retained earnings	82,830	77,463
Total shareholders' equity	195,034	182,019
Total liabilities and shareholders' equity	$254,357	$250,249

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

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

	Year-Ended December 31,		
	2014	2013	2012
Revenues	$421,967	$415,623	$421,890
Costs and expenses:			
Instructional costs and services	185,503	183,757	191,947
Marketing and promotional	99,790	102,198	100,809
Admissions advisory	28,042	27,103	30,151
General and administrative	41,847	42,688	39,600
Lease amendment charges	2,690	—	—
Total costs and expenses	357,872	355,746	362,507
Operating income	64,095	59,877	59,383
Other expense, net	(725)	(179)	(45)
Income before income taxes	63,370	59,698	59,338
Income tax expense	25,427	24,495	23,047
Net income	37,943	35,203	36,291
Net loss attributable to noncontrolling interest	—	—	186
Net income attributable to Capella Education Company	$37,943	$35,203	$36,477
Net income attributable to Capella Education Company per common share:			
Basic	$3.09	$2.84	$2.77
Diluted	$3.03	$2.80	$2.76
Weighted average number of common shares outstanding:			
Basic	12,286	12,391	13,156
Diluted	12,535	12,566	13,220
Cash dividend declared per common share	$1.42	$0.35	$—

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

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

	Year-Ended December 31,		
	2014	2013	2012
Net income	$37,943	$35,203	$36,291
Net loss attributable to noncontrolling interest	—	—	186
Net income attributable to Capella Education Company	37,943	35,203	36,477
Other comprehensive income (loss):			
Foreign currency translation loss	(169)	(110)	(54)
Unrealized gain (loss) on available for sale securities, net of tax	(52)	18	(275)
Comprehensive income attributable to Capella Education Company	$37,722	$35,111	$36,148

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

CAPELLA EDUCATION COMPANY
Consolidated Statement of Shareholders' Equity
(In thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
Balance at December 31, 2011	13,882	$ 139	$ 103,900	$ 307	$ 58,253	$ 162,599
Exercise of stock options	34	—	628	—	—	628
Share-based compensation	—	—	4,880	—	—	4,880
Tax shortfall realized from share-based compensation arrangements	—	—	(598)	—	—	(598)
Issuance of restricted stock, net	20	—	(41)	—	—	(41)
Accretion of noncontrolling interest	—	—	486	—	(582)	(96)
Repurchase of common stock	(1,543)	(15)	(11,539)	—	(39,864)	(51,418)
Net income attributable to Capella Education Company	—	—	—	—	36,477	36,477
Unrealized losses on marketable securities, net of tax	—	—	—	(275)	—	(275)
Foreign currency translation adjustments	—	—	—	(54)	—	(54)
Balance at December 31, 2012	12,393	$ 124	$ 97,716	$ (22)	$ 54,284	$ 152,102
Exercise of stock options	98	1	3,451	—	—	3,452
Share-based compensation	—	—	5,330	—	—	5,330
Tax shortfall realized from share-based compensation arrangements	—	—	(521)	—	—	(521)
Issuance of restricted stock, net	38	—	(107)	—	—	(107)
Repurchase of common stock	(168)	(1)	(1,323)	—	(7,641)	(8,965)
Cash dividends declared	—	—	—	—	(4,383)	(4,383)
Net income attributable to Capella Education Company	—	—	—	—	35,203	35,203
Unrealized gains on marketable securities, net of tax	—	—	—	18	—	18
Foreign currency translation adjustments	—	—	—	(110)	—	(110)
Balance at December 31, 2013	12,361	$ 124	$ 104,546	$ (114)	$ 77,463	$ 182,019
Exercise of stock options, net	118	1	5,598	—	—	5,599
Share-based compensation	—	—	5,129	—	—	5,129
Tax benefit realized from share-based compensation arrangements	—	—	159	—	—	159
Issuance of restricted stock, net	46	—	(626)	—	—	(626)
Repurchase of common stock	(282)	(3)	(2,389)	—	(14,907)	(17,299)
Cash dividends declared	—	—	—	—	(17,669)	(17,669)
Net income attributable to Capella Education Company	—	—	—	—	37,943	37,943
Unrealized gains on marketable securities, net of tax	—	—	—	(52)	—	(52)
Foreign currency translation adjustments	—	—	—	(169)	—	(169)
Balance at December 31, 2014	12,243	$ 122	$ 112,417	$ (335)	$ 82,830	$ 195,034

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

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

	Year-Ended December, 31		
	2014	2013	2012
Operating activities			
Net income	$37,943	$35,203	$36,291
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for bad debts	14,848	15,132	17,310
Depreciation and amortization	23,798	25,877	29,255
Amortization of investment discount/premium	1,843	768	692
Impairment of property and equipment	277	229	1,150
Loss on disposal of property and equipment	69	52	81
Share-based compensation	5,129	5,330	4,880
Excess tax benefit from share-based compensation	(547)	(310)	(69)
Deferred income taxes	(317)	(1,463)	(3,584)
Payment of contingent consideration	(906)	—	—
Changes in operating assets and liabilities			
Accounts receivable	(15,843)	(16,141)	(14,979)
Prepaid expenses and other current assets	(754)	1,787	2,586
Accounts payable and accrued liabilities	(3,582)	4,578	(6,296)
Income tax payable	3,000	(1,826)	(4,306)
Deferred rent	(781)	(929)	(65)
Deferred revenue	1,011	1,062	1,882
Net cash provided by operating activities	65,188	69,349	64,828
Investing activities			
Capital expenditures	(20,584)	(18,728)	(23,278)
Proceeds from the sale of property and equipment	—	—	303
Investment in partnership interest	(1,453)	—	—
Acquisition of noncontrolling interest	—	—	(1,576)
Purchases of marketable securities	(64,308)	(22,426)	(13,887)
Maturities of marketable securities	25,415	7,885	55,545
Net cash provided by (used in) investing activities	(60,930)	(33,269)	17,107
Financing activities			
Excess tax benefit from share-based compensation	547	310	69
Net proceeds from exercise of stock options	5,599	3,452	628
Payment of dividends	(17,256)	—	—
Repurchases of common stock	(17,299)	(8,965)	(51,418)
Payment of contingent consideration	(5,945)	—	—
Net cash used in financing activities	(34,354)	(5,203)	(50,721)
Effect of foreign exchange rates on cash	2	—	29
Net increase (decrease) in cash and cash equivalents	(30,094)	30,877	31,243
Cash and cash equivalents at beginning of year	124,097	93,220	61,977
Cash and cash equivalents at end of year	$94,003	$124,097	$93,220
Supplemental disclosures of cash flow information			
Income taxes paid	$23,061	$27,486	$30,947
Non-cash investing and financing activities:			
Purchase of equipment included in accounts payable and accrued liabilities	$863	$775	$472
Declaration of cash dividend to be paid	$4,587	$4,383	$—

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

CAPELLA EDUCATION COMPANY
Notes to Consolidated Financial Statements
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 and markets, develops and delivers programs worldwide via its offices and partners across Asia, North America, Africa and Europe. Sophia provides a social teaching and learning platform that integrates education with technology. On April 16, 2012, the Company acquired the remaining interest in Sophia which is now a wholly owned subsidiary as of that date. Capella Learning Solutions (CLS) is a subsidiary created in 2013 that provides online training solutions and services to corporate partners which are delivered through Capella'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 on October 31.

Certain reclassifications have been made to the accrued liabilities table as of December 31, 2013 in Note 7 to align with current reporting methods.

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

Revenue Recognition
The Company’s revenues primarily consist of tuition. Tuition revenue is deferred and recognized as revenue ratably over the period of instruction. If a learner withdraws or drops a course, the Company follows the University refund policy, which generally is: 100 percent refund through five days, 75 percent refund from six to twelve days, and zero percent refund for the remainder of the period. The refund policy varies slightly for learners within certain states due to state rules or regulations. The Company does not recognize revenue for learners who enroll but never engage in the courseroom. Refunds are recorded as a reduction of revenue in the period that the learner withdraws from a course. When the University is required to return funds distributed under Title IV Programs of the Higher Education Act (Title IV or Title IV Programs) to the Department of Education, the learner is not released from his or her payment obligation.

Colloquia tuition revenue is recognized over the length of the colloquia, which ranges from three to 42 days.

Deferred revenue in any period represents the excess of tuition and fees received as compared to tuition and fees recognized as revenue in the consolidated statements of income and is reflected as a current liability on our consolidated balance sheets.

The Company also enters into arrangements to provide program development and management consulting services to other third parties to establish or expand their training and educational programs. These arrangements often include the delivery of multiple products and services, primarily including hosting the training, providing maintenance and support, and other professional services. For arrangements that involve multiple elements, the Company recognizes revenue for delivered elements when they have stand-alone value to the customer, they have been accepted by the customer, and for which there are only customary refund or return rights. Arrangement consideration is allocated to the deliverables based on the relative selling price of each element. The selling price used for each deliverable is based on vendor-specific objective evidence (VSOE) of fair value if available, third-party evidence (TPE) of fair value if VSOE is not available, or estimated selling price if neither VSOE nor TPE is available. Estimated selling price is determined in a manner consistent with that used to establish the price to sell the deliverable on a standalone basis. Revenue is recognized for each element in a manner consistent with the nature of the product or service delivered.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability, failure or refusal of our learners to make required payments. The Company determines the allowance for doubtful accounts amount based on an analysis of our accounts receivable portfolio and historical write-off experience, and current economic conditions, recoveries and trends. Bad debt expense is recorded as an instructional costs and services expense in the consolidated statements of income. The Company generally writes off accounts receivable balances once the account is deemed to be uncollectible, which typically occurs after outside collection agencies have pursued collection efforts. The Company recorded bad debt expense of $14.8 million, $15.1 million, and $17.3 million for the years ended December 31, 2014, 2013, and 2012, respectively.

Cash and Cash Equivalents

The Company considers all highly liquid marketable securities with maturities of three months or less at the time of purchase, and variable rate demand notes, to be cash equivalents. The variable rate demand notes contain a feature allowing the Company to settle the instrument with the issuer on a daily or weekly basis at the Company's discretion. As a result, these securities are highly liquid and are classified as cash and cash equivalents. Cash equivalents are carried at fair value.

Marketable Securities

Management determines the appropriate designation of marketable securities at the time of purchase and reevaluates such designation as of each balance sheet date. All of the Company’s marketable securities are designated as available-for-sale as of December 31, 2014 and 2013.

Available-for-sale marketable securities are carried at fair value as determined by quoted market prices or other inputs either directly or indirectly observable in the marketplace for identical or similar assets, with unrealized gains and losses, net of tax, recognized as a component of accumulated other comprehensive income (loss) within shareholders’ equity. Management reviews the fair value of the portfolio at least monthly, and evaluates individual securities with fair value below amortized cost at the balance sheet date for impairment. In order to determine whether impairment is other than temporary, management evaluates whether the Company intends to sell the impaired security and whether it is more likely than not that the Company will be required to sell the security before recovering its amortized cost basis.

If management intends to sell an impaired debt security, or it is more likely than not the Company will be required to sell the security prior to recovering its amortized cost basis, an other-than-temporary impairment is deemed to have occurred. The amount of an other-than-temporary impairment related to a credit loss, or securities that management intends to sell before recovery, is recognized in earnings. The amount of an other-than-temporary impairment on debt securities related to other factors is recorded consistent with changes in the fair value of all other available-for-sale securities as a component of accumulated other comprehensive income (loss) within shareholders’ equity.

The cost of securities sold is based on the specific identification method. Amortization of premiums, accretion of discounts, interest, dividend income and realized gains and losses are included in other income (expense). The contractual maturity date of available-for-sale securities is based on the days remaining to the effective maturity. The Company classifies marketable securities as either current or non-current assets based on management’s intent with regard to usage of those funds, which is dependent upon the security's maturity date and liquidity considerations based on current market conditions. If management intends to hold the securities for longer than one year as of the balance sheet date, they are classified as non-current.

Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The Company classifies assets and liabilities recorded at fair value under the fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed market assumptions. The fair value measurements are classified under the following hierarchy:

- Level 1 – Observable inputs that reflect quoted market prices (unadjusted) for identical assets and liabilities in active markets;

- Level 2 – Observable inputs, other than quoted market prices, that are either directly or indirectly observable in the marketplace for identical or similar assets and liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets and liabilities; and
- Level 3 – Unobservable inputs that are supported by little or no market activity that are significant to the fair value of assets or liabilities.

Concentration of Credit Risk
Financial instruments, which potentially subject the Company to credit risk, consist primarily of cash equivalents, marketable securities and accounts receivable.

Management believes the credit risk related to cash equivalents and marketable securities is limited due to the adherence to an investment policy that requires marketable securities to have a minimum Standard & Poor’s rating of A minus (or equivalent) at the time of purchase. All of the Company’s cash equivalents and marketable securities as of December 31, 2014 and 2013 consist of investments rated A- or higher 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 equivalents and marketable securities.

Management believes that the credit risk related to accounts receivable is mitigated due to the large number and diversity of learners that principally comprise the Company’s customer base. The Company’s credit risk with respect to these accounts receivable is mitigated through the participation of a majority of the learners in federally funded financial aid programs.

Approximately 77%, 78%, and 79% of Capella University's revenues (calculated on a cash basis) were collected from funds distributed under Title IV Programs for the years ended December 31, 2014, 2013, and 2012, respectively. The financial aid and assistance programs are subject to political and budgetary considerations. There is no assurance that such funding will be maintained at current levels.

Extensive and complex regulations govern the financial assistance programs in which Capella University's learners participate. Capella University's administration of these programs is periodically reviewed by various regulatory agencies. Any regulatory violation could be the basis for the initiation of potential adverse actions, including a suspension, limitation, or termination proceeding, which could have a material adverse effect on the Company.

If the University were to lose its eligibility to participate in federal student financial aid programs, the learners at the University would lose access to funds derived from those programs and would have to seek alternative sources of funds to pay their tuition and fees. See Note 14 for further information on the regulatory environment in which the Company operates.

Property and Equipment
Property and equipment are stated at cost. Computer software is included in property and equipment and consists of purchased software, capitalized web site development costs and internally developed software. Capitalized web site development costs consist mainly of salaries and outside development fees directly related to web sites and various databases. Web site content development is generally expensed as incurred. Internally developed software represents qualifying salary and consulting costs for time spent on developing internal use software. The Company capitalizes certain costs associated with internally developed software, primarily consisting of the direct labor associated with creating the internally developed software. Software development projects generally include three stages: the preliminary project stage (all costs are expensed as incurred), the application development stage (certain costs are capitalized and certain costs are expensed as incurred), and the post-implementation/operation stage (all costs are expensed as incurred). The costs capitalized in the application development stage include the costs of designing the

application, coding, installation of hardware, and testing. The capitalization of software requires judgment in determining when a project has reached the application development stage and the period over which the Company expects to benefit from the use of that software.

Depreciation is calculated using the straight-line method, over the following estimated useful lives:

Computer equipment	3 to 7 years
Furniture and office equipment	5 to 7 years
Computer software	3 to 5 years

Leasehold improvements are amortized on a straight-line basis over the related lease term or estimated useful life, whichever is shorter.

The Company reviews its fixed assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are considered not recoverable, a potential impairment loss is recognized to the extent the carrying amount of the assets exceeds the fair value of the assets. The Company recorded impairment charges of $0.3 million, $0.2 million, and $1.2 million during the years ended December 31, 2014, 2013, and 2012, respectively. The impairment charges primarily consist of course retirements, and the write-off of previously capitalized internal software development costs related to abandoned software projects. These charges are recorded in the Consolidated Statements of Income and classified as instructional costs and services, marketing and promotional, admissions advisory, or general and administrative expense based on the primary function with which the asset was associated.

Income Taxes

The Company uses the asset and liability method to compute the differences between the tax basis of assets and liabilities and the related financial amounts. The Company has deferred tax assets and liabilities that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets are subject to periodic recoverability assessments. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that more likely than not will be realized. The Company considers all positive and negative evidence relating to the realization of the deferred tax assets in assessing the need for a valuation allowance.

The Company records a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The Company accounts for uncertainty in income taxes using a two-step approach for evaluating tax positions. Step one, recognition, occurs when the Company concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination. Step two, measurement, is only addressed if the position is more likely than not to be sustained. Under step two, the tax benefit is measured as the largest amount of benefit, determined on a cumulative probability basis, which is more likely than not to be realized upon ultimate settlement. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

Contingencies

The Company accrues for costs associated with contingencies including, but not limited to, regulatory compliance and legal matters, when such costs are probable and reasonably estimable. Contingent liabilities are adjusted as further information is obtained, circumstances change, or contingencies are resolved. The Company bases these accruals on management’s estimate of such costs, which may vary from the ultimate cost and expenses associated with any such contingency.

Intangible Assets

Finite-lived intangible assets that are acquired in business combinations are recorded at fair market value on their acquisition date and are amortized on a straight-line basis over the economic useful life of the asset. As of December 31, 2014 and 2013, the Company does not have any indefinite-lived intangible assets.

The Company reviews its intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the asset. If such assets are not recoverable, a potential impairment loss is recognized to the extent the carrying amount of the assets exceeds the fair value of the assets. Fair value is generally determined using a discounted cash flow approach.

Goodwill

Goodwill represents the excess of the purchase price of an acquired business over the fair value assigned to the underlying assets acquired and assumed liabilities. At the time of an acquisition, the Company allocates the goodwill and related assets and liabilities to its respective reporting units. The Company identifies its reporting units by assessing whether the components of its operating segment constitute businesses for which discrete financial information is available and management regularly reviews the operating results of those components. The Company assesses goodwill for impairment at least annually on the first day of 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.

The Company's goodwill impairment test includes an option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the Company concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount based on the qualitative assessment, or that a qualitative assessment should not be performed for a reporting unit, the Company proceeds with performing a two-step quantitative goodwill impairment test. In the first step, the Company compares the fair value of the reporting unit to the carrying value of its net assets. If the fair value of the reporting unit exceeds the carrying value of the net assets of the reporting unit, goodwill is not impaired and no further testing is required. If the carrying value of the net assets of the reporting unit exceeds the fair value of the reporting unit, the Company performs a second step to determine the implied fair value of the goodwill and compares it to the carrying value of the goodwill. An impairment loss is recognized to the extent the implied fair value of the goodwill is less than the carrying amount of the goodwill.

The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis, including determining whether to perform the optional qualitative assessment and determining the fair value of the reporting unit during the two-step test. The goodwill testing process includes the use of industry accepted valuation methods, management review and approval of certain criteria and assumptions and engaging third-party valuation specialists to assist with the analysis.

Foreign Currency Translation

The United States (U.S.) dollar is the functional currency of the Company’s entities operating in the U.S. The functional currency of the Company’s entities operating outside the U.S. is the currency of the primary economic environment in which the entity generates and expends cash, which is generally the local currency. The assets and liabilities of these operations are translated to U.S. dollars using exchange rates in effect at the balance sheet dates. The resulting translation adjustments and the effect of exchange rate changes on intercompany transactions of a long-term investment nature are included in shareholders’ equity as a component of accumulated other comprehensive income (loss). Income and expense items are translated monthly at the average exchange rate for that period. The Company reports gains and losses from foreign exchange rate changes related to intercompany receivables and payables that are not of a long-term investment nature, as well as gains and losses from foreign currency denominated transactions, in the Consolidated Statements of Income.

Advertising

The Company expenses all advertising costs as incurred, other than production-related advertising costs primarily attributable to television commercials, which are capitalized as a prepaid expense when paid and subsequently expensed at the time of first airing. Advertising costs for 2014, 2013, and 2012 were $73.0 million, $78.1 million, and $82.4 million, respectively, which are included within marketing and promotional expenses in our Consolidated Statements of Income.

Net Income Attributable to Capella Education Company per Common Share

Basic net income attributable to Capella Education Company 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, vesting of restricted stock units, 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 attributable to Capella Education Company per common share calculation.

	Year-Ended December 31, 2014	2013	2012
Numerator:			
Net income attributable to Capella Education Company	$37,943	$35,203	$36,477
Denominator:			
Denominator for basic net income attributable to Capella Education Company per common share - weighted average shares outstanding	12,286	12,391	13,156
Effect of dilutive stock options, restricted stock, and market stock units	249	175	64
Denominator for diluted net income attributable to Capella Education Company per common share - weighted average shares outstanding	12,535	12,566	13,220
Basic net income attributable to Capella Education Company per common share	$3.09	$2.84	$2.77
Diluted net income attributable to Capella Education Company per common share	$3.03	$2.80	$2.76

Options to purchase 0.2 million, 0.5 million, and 0.6 million common shares, were outstanding but not included in the computation of diluted net income per common share in 2014, 2013, and 2012, respectively, because their effect would be antidilutive.

Comprehensive Income

Comprehensive income includes net income and all changes in the Company’s equity during a period from non-owner sources, which for the Company consists of unrealized gains and losses on available-for-sale marketable securities, net of tax, and foreign currency translation gains and losses.

Share-Based Compensation

The Company measures and recognizes compensation expense for share-based payment awards made to employees and directors, including employee stock options, restricted stock units (RSUs), and market stock units (MSUs) based on estimated fair values of the share award on the date of grant.

- Stock options and restricted stock units. To calculate the estimated fair value of stock options on the date of grant, the Company uses the Black-Scholes option pricing model. The Black-Scholes option pricing model requires the Company to estimate key assumptions such as the expected term, volatility, risk-free interest rate and dividend yield to determine the fair value of stock options, based on both historical information and management judgment regarding market factors and trends.

The Company recognizes share-based compensation expense for stock options and restricted stock unit awards using the straight-line method over the period that the awards are expected to vest, which is also the service period, net of estimated forfeitures. The Company estimates expected forfeitures of share-based awards and recognizes compensation cost only for those awards expected to vest.

In estimating expected forfeitures for stock options and restricted stock units, the Company analyzes historical forfeiture and termination information and considers how future rates are expected to differ from historical rates. The Company ultimately adjusts this forfeiture assumption to actual forfeitures. Any changes in the forfeiture assumptions do not impact the total amount of expense ultimately recognized over the vesting period. Instead, different forfeiture assumptions only impact the timing of expense recognition over the vesting period. If the actual forfeitures differ from management estimates, additional adjustments to compensation expense are recorded.

- Market stock units. To calculate the estimated fair value of MSUs on the date of grant, the Company uses Monte Carlo simulations. The Monte Carlo simulations are based on the expected average market price of the Company's common stock for a defined number of calendar days prior to the stated vesting date to estimate the expected number of MSUs that will convert into common shares at the vesting date. Management's key assumptions include volatility, risk-free interest rates, and dividend yields.

The Company recognizes share-based compensation expense for MSU awards using the straight-line method, over the period that the awards are expected to vest. Compensation cost related to an award with a market condition will be recognized regardless of whether the market condition is satisfied, provided that the requisite service has been provided.

Recent Accounting Pronouncements
In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-15, Disclosure of Uncertainties about an Entities Ability to Continue as a Going Concern, which is included in Accounting Standards Codification (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 guidance will be effective for the Company's interim and annual reporting periods beginning January 1, 2017. The standard allows the Company to transition to the new model using either a full or modified retrospective approach, and early adoption is not permitted. The Company is currently evaluating the impact this standard will have on its business practices, financial condition, results of operations, and disclosures.

In March 2013, the FASB issued ASU No. 2013-05, Foreign Currency Matters. This update addresses diversity in practice regarding the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investments in a foreign entity. In addition, the standard addresses diversity in practice for the treatment of business combinations achieved in stages involving a foreign entity. The guidance was effective for the Company's interim and annual reporting periods beginning January 1, 2014, and applied prospectively. The adoption of this guidance did not have a material impact on the Company's financial condition, results of operations, or 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 financial condition, results of operations, or disclosures.
3. Marketable Securities
The following is a summary of available-for-sale securities, in thousands:

	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

	As of December 31, 2013				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)		Estimated Fair Value
Tax-exempt municipal securities	$30,422	$46	$—		$30,468
Corporate debt securities	5,615	3	(4	)	5,614

Total	$36,037	$49	$(4	) $36,082

The unrealized gains and losses on the Company’s investments in municipal and corporate debt securities as of December 31, 2014 and 2013 were caused by changes in market values primarily due to interest rate changes. All of the Company's securities in an unrealized loss position as of December 31, 2014 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 for the years ended December 31, 2014, 2013, and 2012.

The following table summarizes the remaining contractual maturities of the Company's marketable securities, in thousands:

	As of December 31, 2014	As of December 31, 2013
Due within one year	$29,619	$18,342
Due after one year through five years	43,430	17,740
Total	$73,049	$36,082

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

	Years Ended December 31,		
	2014	2013	2012
Maturities of marketable securities	$25,415	$7,885	$55,545
Total	$25,415	$7,885	$55,545

The Company did not record any gross realized gains or gross realized losses in net income during the years ended December 31, 2014, 2013, and 2012. Additionally, there were no proceeds from sales of marketable securities prior to maturity during the years ended December 31, 2014, 2013, and 2012.

4. 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 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	$—

Description	Fair Value Measurements as of December 31, 2013 Using 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	$47,796	$47,796	$—	$—
Money market funds	57,066	57,066	—	—
Variable rate demand notes	19,235	19,235	—	—
Marketable securities:				
Tax-exempt municipal securities	30,468	—	30,468	—
Corporate debt securities	5,614	—	5,614	—
Total assets at fair value on a recurring basis	$160,179	$124,097	$36,082	$—
Liabilities:				
Accrued liabilities:				
RDI contingent consideration	$6,304	$—	$—	$6,304
Total liabilities at fair value on a recurring basis	$6,304	$—	$—	$6,304

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 years-ended December 31, 2014 and 2013.

Level 3 Measurements

RDI Contingent Consideration

In connection with the 2011 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 will enable RDI to independently validate its own degrees going forward 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 Accounting Standards Codification 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 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:

	Year-Ended December 31, 2014	2013

Balance, beginning of year	$6,304	$6,252
Increase in RDI contingent consideration liability	547	52
Payment of RDI contingent consideration liability	(6,851)	—
Balance, end of year	$—	$6,304

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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 year-ended December 31, 2014 and 2013. The fair value of the RDI contingent consideration liability was recorded in accrued liabilities within the consolidated balance sheet as of December 31, 2013.

The cash payment made to settle the RDI contingent consideration liability is recorded as cash used in operating activities and cash used in financing activities in the consolidated statement of cash flows during the year-ended December 31, 2014. The portion of the payment recorded as cash used in operating activities represents the accumulated change in fair value of the contingent consideration liability between the acquisition date of July 15, 2011 and the payment date of May 12, 2014, and the portion of the payment recorded as financing activities represents the initial fair value of the liability recorded at the July 15, 2011 acquisition date.

5. Property and Equipment

Property and equipment consist of the following, presented in thousands:

	As of December 31,	
	2014	2013
Computer software	$134,249	$130,870
Computer equipment	34,757	44,050
Furniture and office equipment	13,248	13,563
Leasehold improvements	1,252	1,311
	183,506	189,794
Less accumulated depreciation and amortization	(146,260)	(149,801)
Property and equipment, net	$37,246	$39,993

Depreciation expense for the years ended December 31, 2014, 2013, and 2012 was $22.9 million, $24.0 million, and $27.4 million, respectively. Included in these amounts is amortization of capitalized internally developed software of $15.3 million, $15.0 million, and $17.5 million for the years ended December 31, 2014, 2013, and 2012, respectively.

Computer software includes approximately $28.1 million and $28.5 million of unamortized internally developed software as of December 31, 2014 and 2013, respectively.

6. Goodwill and Intangible Assets

Goodwill
Goodwill represents the excess of the purchase price over the fair value assigned to the assets acquired and liabilities assumed. The carrying amount of goodwill as of December 31, 2014 was $17.0 million and recorded under the RDI reporting unit, as a result of the acquisition of RDI in July 2011.

The following table presents changes in goodwill for the years ended December 31, 2014 and 2013, in thousands:

Balance as of December 31, 2012	$16,970
Effects of foreign currency exchange rates	(1)
Balance as of December 31, 2013	16,969
Effects of foreign currency exchange rates	(8)
Balance as of December 31, 2014	$16,961

The Company completed its goodwill impairment test for the RDI reporting unit using the first day of the fourth quarter of 2014 as the assessment date, and did not identify any impairment charges for the year-ended December 31, 2014. The Company chose not to perform the qualitative assessment and instead performed step one of the quantitative goodwill impairment test using a combination of an income-based approach and a market-based approach to determine the fair value.

The income approach consisted of a discounted cash flow model that included probability weightings of projected future cash flows for the RDI reporting unit, calculating a terminal value, and discounting such cash flows by a risk-adjusted rate of return. The market approach included a combination of fair values determined from (1) comparable transactions approach using observable market transactions within the industry; and (2) the guideline company approach using publicly traded companies with similar operating and investment characteristics of the reporting unit to develop a multiple which was then applied to the operating performance of the reporting unit to determine fair value. The determination of fair value of the RDI reporting unit 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 its RDI reporting unit, include, but are not limited to, the amounts and timing of expected future cash flows, the discount rate, terminal growth rates, selection of comparable market multiples in both the comparable transaction and guideline company approaches, and application of weighting factors when a combination of valuation methods are used. The assumptions used in determining the expected future cash flows consider various factors such as historical operating trends particularly in student enrollment, the political environment the reporting unit operates in, anticipated economic and regulatory conditions, accreditation status and reasonable expectations for planned business 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 in a specific country. 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 the assumptions used in the goodwill impairment tests are consistent with a reasonable market participant view while employing the concept of highest and best use of the asset.

Finite-Lived Intangible Assets
Changes in the carrying amount of intangible assets are as follows, in thousands:

	Student Relationships	Validation Partner Relationships	Trademark and Trade Name	Learning Model	Internally Developed Software	Total
Net Carrying Amount as of December 31, 2012	$1,498	$1,876	$610	$519	$171	4,674
Amortization	(1,240)	(328)	(70)	(141)	(100)	(1,879)
Net Carrying Amount as of December 31, 2013	258	1,548	540	378	71	2,795
Amortization	(258)	(329)	(70)	(140)	(71)	(868)
Net Carrying Amount as of December 31, 2014	$—	$1,219	$470	$238	$—	$1,927

The Company amortizes its intangible assets on a straight-line basis. The estimated useful lives of the intangible assets range from two to ten years. The weighted average useful life of the Company’s finite-lived intangible assets that are not fully amortized as of December 31, 2014 is four years.

The following table presents future amortization expense for intangible assets as of December 31, 2014, in thousands:

2015	539
2016	498
2017	399
2018	303
2019	70
2020 and thereafter	118
Total	$1,927

7. Accrued Liabilities

Accrued liabilities consist of the following, in thousands:

	As of December 31, 2014	As of December 31, 2013
Accrued compensation and benefits	$7,482	$10,333
Accrued instructional	4,361	5,043
Accrued vacation	1,234	1,040
Accrued invoices	8,238	7,240
RDI contingent consideration	—	6,304
Other	2,095	3,204
Total	$23,410	$33,164

"Other" in the table above 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 year-ended December 31, 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 which resulted in an additional charge of $0.1 million during the year-ended December 31, 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 December 31, 2014, in thousands:

2015(1)	$8,116
2016	6,177
2017	5,950
2018	4,877
2019	—
2020 and thereafter	—
Total	$25,120

(1) Includes $1.9 million lease termination payment related to the April 3, 2014 lease amendment.

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 to rent 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 an offset to deferred rent, in accrued liabilities or long-term liabilities, as appropriate.

Total rent expense, related taxes, and operating expenses under operating leases for the years ended December 31, 2014, 2013, and 2012, was $12.3 million, $12.4 million, and $12.2 million, respectively.

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 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 $0.3 million, $0.3 million, and $0.3 million in other expense, net, for the years ended December 31, 2014, 2013, and 2012, 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 December 31, 2014 and December 31, 2013 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 December 31, 2014 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 December 31, 2014, all of which was part of its publicly announced program, is presented below, in thousands:

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	253,631
Residual authorization	$32,031

The following table summarizes shares repurchased, in thousands:

Year-Ended December 31,

	2014	2013
Shares repurchased	282	168
Total consideration, excluding commissions	$17,287	$8,958

As of December 31, 2014, the Company had purchased an aggregate of 5.6 million shares under the program's outstanding authorizations at an average price per share of $44.94 totaling $253.6 million.

Dividends

During the year-ended December 31, 2014, the Company declared the following cash dividends, presented below in thousands except per share amounts:

Declaration Date	Record Date	Payment Date	Dividend per Share	Total Dividend Amount
February 20, 2014	March 26, 2014	April 10, 2014	$0.35	$4,382
May 6, 2014	June 11, 2014	July 10, 2014	$0.35	$4,354
August 7, 2014	September 10, 2014	October 10, 2014	$0.35	$4,346
December 10, 2014	December 24, 2014	January 15, 2015	$0.37	$4,587

During the three months ended December 31, 2014, the dividend of $0.37 per outstanding share of common stock declared on December 10, 2014 was recorded as a reduction to retained earnings. Of the total dividend amount, $4.6 million is attributable to shares of common stock outstanding as of the record date and restricted stock units expected to vest in the next twelve months. This amount is classified as dividends payable in the Company's consolidated balance sheets as of December 31, 2014. The remaining balance is attributable to 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 December 31, 2014. 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

Share-Based Incentive Plans

On May 6, 2014, the Company implemented a stock incentive plan (the 2014 Plan) that allows for incentive stock options, non-qualified stock options, stock appreciation rights (SARs), restricted stock awards (RSAs), stock unit awards, and other stock-based awards to be granted to employees, directors, officers, and others. The 2014 Plan authorized the issuance of 480,000 shares of the Company's common stock, plus 830,888 shares that remained available for future grants under the 2005 Stock Incentive Plan (the 2005 Plan) on the effective date of the 2014 Plan. Upon effectiveness of the 2014 Plan, no further awards will be made under the 2005 Plan. As of December 31, 2014, the maximum number of shares of common stock reserved under the 2014 Plan was approximately 1.3 million, of which 1.3 million shares were available for grant.

The Board of Directors establishes the terms and conditions of all grants, subject to the 2014 Plan and applicable provisions of the Internal Revenue Code (the Code). Under the 2014 Plan, options must be granted at an exercise price not less than the fair market value of the Company's common stock on the grant date. The options expire on the date determined by the Board of Directors, but may not extend more than ten years from the grant date. The options generally become exercisable over a four year period. Restricted stock units (RSUs) generally vest over a three year period. Canceled options and RSUs become available for reissuance under the 2014 Plan. Upon an exercise of stock options, the Company issues new shares.

The Company also has issued stock options under the discontinued 2005 Plan. Stock options, restricted stock units, and market stock units issued pursuant to the 2005 Plan are still outstanding. However, unexercised options that are canceled upon termination of employment are not available for reissuance under the 2005 Plan.

Share-Based Compensation Expense

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

	Year-Ended December 31,		
	2014	2013	2012
Instructional costs and services	$729	$1,568	$1,433
Marketing and promotional	270	629	468
Admissions advisory	52	54	48
General and administrative	4,078	3,079	2,931
Share-based compensation expense included in operating income	5,129	5,330	4,880
Tax benefit from share-based compensation expense	1,722	1,964	1,818
Share-based compensation expense, net of tax	$3,407	$3,366	$3,062

Effective in 2014, the Company evaluated the allocation of share-based compensation among its operating expense categories and determined reallocation of expenses related to certain executives and directors was necessary to best align with the Company's organizational structure. Prior to 2014, share-based compensation expense related to awards granted to certain executives and members of the Company's Board of Directors was allocated among all of the Company's operating expense categories. Effective in 2014, the Company is prospectively including all share-based compensation expense related to awards granted to these individuals as general and administrative expense.

The following table summarizes additional information regarding share-based compensation arrangements for the years presented, in thousands:

	Year-Ended December 31,		
	2014	2013	2012
Net proceeds from stock options exercised	$5,599	$3,452	$628
Intrinsic value of stock options exercised	2,127	1,915	515
Tax benefit (shortfall) realized from share-based compensation arrangements	159	(521)	(598)

As of December 31, 2014, total compensation cost related to nonvested service-based stock options, RSUs, and MSUs to be recognized in future periods was $6.5 million. The weighted average period over which this expense will be recognized is 1.9 years. The fair value of stock options and RSUs vested during the years ended December 31, 2014, 2013 and 2012, was $4.7 million, $4.3 million, and $3.5 million, respectively.

Service-Based Stock Options

The following table summarizes stock option activity for the year-ended December 31, 2014:

	Plan Options Outstanding		
	Incentive	Non-Qualified	Weighted-Average Exercise Price per Share
	(in thousands, except per share data)		
Balance, December 31, 2013	13	603	$ 48.84
Granted	—	120	64.82
Exercised	(9)	(109)	47.22
Forfeited or expired	—	(21)	50.71
Balance, December 31, 2014	4	593	$ 52.31

The aggregate intrinsic value in the table below represents the total pre-tax intrinsic value (the difference between the Company’s closing stock price on the last day of the year and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2014. The amount of aggregate intrinsic value will change based on the fair market value of the Company’s stock.

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	Number of Shares	Weighted-Average Exercise or Purchase Price per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
	(in thousands, except per share and contractual term data)			
Balance, December 31, 2014	597	$ 52.31	5.80	$15,592
Vested and expected to vest, December 31, 2014	571	$ 52.43	5.69	$14,891
Exercisable, December 31, 2014	280	$ 57.79	3.57	$6,249

The fair value of the Company's service-based stock options was estimated as of the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Year-Ended December 31,		
	2014	2013	2012
Weighted-average exercise price (1)	$64.82	$32.26	$40.48
Expected life (in years) (2)	4.53	4.47	4.39
Expected volatility (3)	41.76 %	46.38 %	48.83 %
Risk-free interest rate (4)	1.37 %	0.74 %	0.73 %
Dividend yield (5)	2.16 %	— %	— %
Weighted-average fair value of options granted	$19.52	$12.46	$16.23

(1) The weighted-average exercise price is equal to the Company's weighted-average stock price as of the grant date during each of the respective years.

(2) The Company’s expected life on options granted during the years ended December 31, 2014, 2013 and 2012 is based upon its historical stock option exercise, forfeiture, and expiration activity.

(3) The expected volatility assumption for the years ended December 31, 2014, 2013 and 2012 is based upon the Company’s historical stock price for a period commensurate with the expected life of the options.

(4) The risk-free interest rate assumption is based upon the U.S. Treasury zero coupon yield curve on the grant date for a maturity similar to the expected life of the options.

(5) The dividend yield assumption is based on our history and expectation of regular dividend payments. The Company initiated a quarterly cash dividend in the fourth quarter of 2013. Prior to this time, the Company had not historically paid dividends and did not have any plans to do so.

Restricted Stock Units

The following table summarizes RSU activity for the year-ended December 31, 2014:

	Number of Shares	Weighted-Average Grant Date Fair Value per Share
	(in thousands, except per share data)	
Balance, December 31, 2013	161	$ 40.66
Granted	52	63.13
Vested	(56)	44.70
Canceled	(6)	45.86
Balance, December 31, 2014	151	$ 46.64

The aggregate intrinsic value in the table below represents the total pre-tax intrinsic value of RSUs on December 31, 2014. The amount of aggregate intrinsic value will change based on the fair market value of the Company’s stock.

	Number of Shares	Weighted-Average Remaining	Aggregate Intrinsic Value

		Contractual Term	
	(in thousands, except contractual term data)		
Balance, December 31, 2014	151	1.05	$11,626
Vested and expected to vest, December 31, 2014	140	1.01	$10,754

Market Stock Units

The following table summarizes MSU activity for the year-ended December 31, 2014:

	Number of Shares	Weighted-Average Grant Date Fair Value per Share
	(in thousands, except per share data)	
Balance, December 31, 2013	104	$ 24.13
Granted	—	—
Vested [1]	—	—
Canceled	—	—
Balance, December 31, 2014	104	$ 24.13

(1) The vesting of MSUs is subject to the achievement of the 90-day average closing price of the Company's common stock at the end of the defined service period. The shares vested is calculated using the 90-day average closing price of the Company's common stock as of December 31, 2018.

The aggregate intrinsic value in the table below represents the total pre-tax intrinsic value of MSUs on December 31, 2014. The amount of aggregate intrinsic value will change based on the fair market value of the Company's stock.

	Number of Shares	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
	(in thousands, except contractual term data)		
Balance, December 31, 2014	104	3.35	$8,002
Vested and expected to vest, December 31, 2014	104	3.35	$8,002

11. Income Taxes

The components of income tax expense are as follows, and presented in thousands:

	Year-Ended December 31,		
	2014	2013	2012
Current income tax expense:			
Federal	$24,133	$24,480	$25,182
State	1,611	1,478	1,445
Foreign	—	—	4
Deferred income tax expense:			
Federal	(341)	(1,429)	(2,533)
State	79	(44)	(185)
Foreign	(55)	10	(866)
Income tax expense	$25,427	$24,495	$23,047

The following presents a reconciliation of income tax computed at the U.S. statutory rate to the effective income tax rate:

	Year-Ended December 31,		
	2014	2013	2012
Statutory rate	35.0 %	35.0 %	35.0 %
State income taxes	2.7	2.5	2.3
Foreign taxes	0.9	1.3	1.0
Valuation allowance	0.6	2.4	1.1
Tax-exempt interest	(0.1)	(0.1)	(0.5)

Other	1.0	(0.1)	(0.1)
Effective income tax rate	40.1 %	41.0 %	38.8 %

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The following table presents significant components of the Company’s deferred income tax assets and liabilities as of December 31, 2014 and 2013, in thousands:

	Year-Ended December 31, 2014	2013
Deferred income tax assets:		
Net operating loss carryforwards	$3,102	$2,957
Allowance for doubtful accounts	3,402	3,251
Accrued liabilities	1,823	2,198
Share-based compensation	4,993	4,833
Accumulated other comprehensive loss	14	—
Other	17	1
Deferred income tax assets	13,351	13,240
Deferred income tax liabilities:		
Prepaid expenses	(1,441)	(1,376)
Accumulated other comprehensive income	—	(16)
Property and equipment	(12,078)	(12,489)
Intangible assets	(388)	(597)
Other	—	(27)
Deferred income tax liabilities	(13,907)	(14,505)
Net deferred tax liability before valuation allowance	(556)	(1,265)
Valuation allowance	(2,529)	(2,172)
Net deferred tax liability	$(3,085)	$(3,437)

The net operating loss carryforwards in the table above represent $14.1 million of UK net operating losses, which do not expire.

The Company regularly assesses the likelihood that its deferred tax assets will be recovered in the future. A valuation allowance is recorded to the extent the Company concludes a deferred tax asset will not more-likely-than-not be realized. The Company considers all positive and negative evidence related to the realization of the deferred tax assets in assessing the need for a valuation allowance. If the Company determines it will not realize all or part of its deferred tax assets, adjustments to the deferred tax asset are charged to earnings in the period such determinations were made.

During 2012, the Company concluded that it was more-likely-than-not that its UK deferred tax assets would not be fully realized, a position the Company continues to assert. During 2014, the valuation allowance increased by $0.3 million primarily as a result of net operating losses in the Company's UK subsidiary.

The Company's accounting for deferred tax consequences represents its best estimate of future events. A valuation allowance established, or revised, as a result of the Company's assessment is recorded through income tax expense in the Consolidated Statements of Income. Changes in current estimates due to unanticipated events, or other factors, could have a material effect on the Company's financial condition and results of operations.

The Company did not have unremitted earnings from its international subsidiaries due to an earnings and profits deficit balance in the foreign jurisdiction during the years ended December 31, 2014 or 2013. Therefore, the Company did not establish deferred tax liabilities for unremitted earnings at December 31, 2014 or 2013.

The Company is subject to U.S. federal income tax and multiple state jurisdictions, as well as UK corporation tax and Hong Kong profits tax.

During 2014, both an Internal Revenue Service (IRS) income tax audit for the 2010 tax year and a New York state income tax audit for tax years 2008-2010 were completed without significant findings. No other income tax audits are ongoing or pending as of December 31, 2014.

For U.S. federal and UK corporation tax purposes, the statute of limitations remains open on tax years from 2011. For Hong Kong, the statute of limitations is six years and for state purposes, the statute of limitations varies by jurisdiction, but is generally from three to five years.

As of December 31, 2014, the Company had $38 thousand of total gross unrecognized tax benefits. Of this total, $25 thousand (net of the federal benefit on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect its effective income tax rate in future periods.
The following table reconciles the beginning and ending amount of unrecognized tax benefits, in thousands:

	Year-Ended December 31,		
	2014	2013	2012
Balance at January 1	$42	$75	$425
Additions for tax positions of current year	—	12	6
Additions for tax positions of prior years	9	—	14
Reductions for tax positions of prior years	—	—	—
Settlements	—	—	2
Reductions due to lapse of the applicable statute of limitations	(13)	(45)	(372)
Balance at December 31	$38	$42	$75

The Company does not anticipate any significant increases or decreases in unrecognized tax benefits within the next twelve months. In the fourth quarter of 2014, the statute of limitations expired on approximately $13 thousand in unrecognized tax benefits related to state issues from tax years 2010-2011. In the fourth quarter of 2015, the statute of limitations will expire on approximately $11 thousand in unrecognized tax benefits related to state issues from tax years 2008-2012.

The Company continues to recognize interest and penalties related to uncertain tax positions in income tax expense. The Company recognized $2 thousand, $5 thousand, and $16 thousand in interest and penalties related to uncertain tax positions in income tax expense during the years ended December 31, 2014, 2013, and 2012, respectively.

12. Acquisitions and Other Investments

During the year-ended December 31, 2014, the Company made a cost method investment of $1.5 million in a limited partnership, with a commitment to invest up to an additional $3.5 million over the next ten years. The partnership invests in innovative companies in the healthcare field. The Company's investment comprises less than 3.0% of the total partnership interest and is classified as other assets in the consolidated balance sheets as of December 31, 2014.

Sophia Learning, LLC
The Company acquired a majority ownership interest in Sophia in 2010. On April 16, 2012, the Company acquired the remaining interest in Sophia for approximately $1.6 million in an arms-length transaction. The Company began accounting for Sophia as a wholly owned subsidiary beginning in the second quarter of 2012 when the noncontrolling interests were acquired.

13. Accumulated Other Comprehensive Income (Loss)

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

	As of December 31,		
	2014	2013	2012
Foreign currency translation	$(311)	$(142)	$(32)
Unrealized gains (losses) on marketable securities, net of tax	(24)	28	10
Accumulated other comprehensive income (loss)[1]	$(335)	$(114)	$(22)

(1) Accumulated other comprehensive income (loss) is net of $14 thousand, $17 thousand, and $6 thousand of taxes as of December 31, 2014, 2013, and 2012, respectively. The unrealized gains and losses on the Company’s marketable securities were primarily caused by changes in market values as a result of interest

rate changes.

There were no reclassifications out of accumulated other comprehensive income (loss) to net income for the years ended December 31, 2014, December 31, 2013 and December 31, 2012.

14. Regulatory Supervision and Oversight

Political and budgetary concerns 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 2008. Additionally, Congress reviews and determines appropriations for Title IV programs on an annual basis through the budget and appropriations processes. As of December 31, 2014, programs in which the University's learners participate are operative and sufficiently funded.

15. Other Employee Benefit Plans

The Company sponsors an employee retirement savings plan, which qualifies under Section 401(k) of the Internal Revenue Code. The plan provides eligible employees with an opportunity to make tax-deferred contributions into a long-term investment and savings program. All employees over the age of 18 are eligible to participate in the plan. The plan allows eligible employees to contribute up to 100% of their annual salary, subject to IRS annual limits. The plan allows the Company to make discretionary contributions; however, there is no requirement that it do so. The Company matches 100% on the first 2%, and 50% on the next 4%, of the employee contributions. Employer contributions and related expenses were $4.5 million, $4.7 million, and $4.5 million for the years ended December 31, 2014, 2013, and 2012, respectively.

In May 2005, the Company adopted the Capella Education Company Employee Stock Purchase Plan, referred to as the ESPP. The Company has reserved an aggregate of 0.5 million shares of its common stock for issuance under the ESPP. The ESPP permits eligible employees to utilize up to 10% of their salary to purchase the Company’s common stock at a price of no less than 85% of the fair market value per share of the Company’s common stock at the beginning or the end of the relevant offering period, whichever is less. The compensation committee of the Board of Directors will administer the ESPP. The Company had not implemented this plan as of December 31, 2014.

16. Quarterly Financial Summary (Unaudited)

The following unaudited consolidated interim financial information presented should be read in conjunction with other information included in the Company’s consolidated financial statements. The following unaudited consolidated financial information reflects all adjustments necessary for the fair presentation of the results of interim periods. The following tables set forth selected unaudited quarterly financial information for each of the Company’s last eight quarters:

	First	Second	Third	Fourth	Total
	(in thousands, except per share data)				
2014					
Revenues	$105,596	$104,832	$103,097	$108,442	$421,967
Operating income	15,143	15,464	13,176	20,312	64,095
Net income attributable to Capella Education Company	8,817	9,044	7,757	12,325	37,943
Net income attributable to Capella Education Company per common share:					
Basic	$0.71	$0.74	$0.63	$1.01	$3.09
Diluted	$0.70	$0.72	$0.62	$0.99	$3.03
Cash dividend declared per common share	$0.35	$0.35	$0.35	$0.37	$1.42
2013					
Revenues	$105,242	$103,693	$100,703	$105,985	$415,623
Operating income	15,175	17,465	10,510	16,727	59,877
Net income attributable to Capella Education Company	8,755	10,422	6,010	10,016	35,203

Net income attributable to Capella Education Company per common share:					
Basic	$0.71	$0.84	$0.48	$0.81	$2.84
Diluted	$0.70	$0.83	$0.48	$0.79	$2.80
Cash dividend declared per common share	$—	$—	$—	$0.35	$0.35

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

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Item 9A. Controls and Procedures

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”)). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (a) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and (b) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding disclosures.

Management’s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2014. In conducting its evaluation, our management used the criteria set forth by the framework in "Internal Control—Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on that evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2014.

Our internal control over financial reporting as of December 31, 2014 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13-a15(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, our internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Capella Education Company

We have audited Capella Education Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Capella Education Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Capella Education Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Capella Education Company as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014, and our report dated February 19, 2015 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Minneapolis, Minnesota
February 19, 2015

Item 9B. Other Information

None.

PART III

Certain information required by Part III is incorporated by reference from our definitive Proxy Statement for the 2014 Annual Meeting of Shareholders (the “Proxy Statement”), which will be filed with the SEC pursuant to Regulation 14A within 120 days after December 31, 2014. Except for those portions specifically incorporated in this Form 10-K by reference to our Proxy Statement, no other portions of the Proxy Statement are deemed to be filed as part of this Form 10-K.

Item 10. Directors, Executive Officers, and Corporate Governance

Executive Officers of the Registrant

Set forth below is certain information concerning our executive officers and persons chosen to become executive officers:

Name	Age	Position
J. Kevin Gilligan	60	Chief Executive Officer
Scott L. Kinney	53	President, Capella University
Steven L. Polacek	55	Senior Vice President and Chief Financial Officer
Renee L. Jackson	48	Vice President, General Counsel

J. Kevin Gilligan joined our company in 2009 to serve as our Chief Executive Officer and a member of our board of directors. On February 23, 2010, he was appointed Chair of our Board of Directors. Mr. Gilligan was previously the chief executive officer of United Subcontractors, Inc., a nationwide construction services company, from 2004 until February 2009. United Subcontractors voluntarily filed for Chapter 11 bankruptcy on March 31, 2009 and emerged from the bankruptcy proceedings on June 30, 2009. From 2001 to 2004, Mr. Gilligan served as president and chief executive officer of the Automation and Control Solutions Group of Honeywell International, a diversified technology and manufacturing company. From 2000 to 2001, Mr. Gilligan served as president of the Home and Building Control Division of Honeywell International. He also served as president of the Solutions and Services Division of Honeywell International from 1997 to 1999 and as vice president and general manager of the North American Region of the Home and Building Control Division from 1994 to 1997. Mr. Gilligan is a member of the board of directors for Graco Inc., a publicly held manufacturer and supplier of fluid handling equipment, and from September 2004 until February 2009 was a member of the board for ADC Telecommunications, Inc., a publicly held global supplier of network infrastructure. Mr. Gilligan earned a B.A. from Boston College.

Scott L. Kinney joined our company in January 2012 as Capella University President. Prior to joining Capella, he served as president of West Education Group at Thomson Reuters Corporation from 2010 until 2011. Previously, Mr. Kinney served as president of FindLaw at Thomson Reuters Corporation from 2004 to 2007. Prior to that, he was an executive vice president at CBS MarketWatch from 1998 until 2004 and worked at The Boston Consulting Group from 1989 until 1998. Mr. Kinney earned an A.B. from Dartmouth College and an M.B.A. from the Stanford University Graduate School of Business.

Steven L. Polacek joined our company in 2010 as Senior Vice President and Chief Financial Officer. Prior to joining Capella, he served as senior vice president and chief financial officer at Hutchinson Technology Incorporated from March 2010 until September 2010, a publicly traded global technology leader supplying critical components to the disk drive industry and new technologies to improve the quality of health care. Previously, Mr. Polacek was senior vice president, chief administrative officer and chief financial officer at Minneapolis-based Opus Corporation from 2005 to 2009; served as partner from 2002 to 2005 with Deloitte & Touche LLP; and began his career with Arthur Andersen LLP in 1982, became partner in 1993, and was the managing partner of the Minneapolis office from 1995 to 2002. Mr. Polacek previously served on the board of directors for C. H. Robinson Worldwide, Inc., from 2007 through 2010. He earned his bachelor’s degree in accounting from the University of Nebraska—Lincoln.

Renee L. Jackson joined our company on December 1, 2014 as Vice President and General Counsel. Before coming to our company, Ms. Jackson was the general counsel of The Dolan Company, a nationwide provider of business information and professional services, from 2010 until December 2014. The Dolan Company and certain of its subsidiaries filed voluntary petitions for a prepackaged Chapter 11 bankruptcy in the US District Court for the District of Delaware on March 23, 2014. The company and its subsidiaries emerged from bankruptcy on June 12, 2014. From 2005 to 2010, Ms. Jackson served as associate general counsel of Fair Isaac Corporation, a leading analytics and software company serving companies worldwide in the financial, insurance, telecommunications and e-commerce industries. Before joining Fair Isaac Corporation, Ms. Jackson was a partner with Norton Rose Fulbright LLP, where she tried intellectual property and commercial cases and served as administrative partner of the firm's Minneapolis office. Ms. Jackson began her career at Dorsey & Whitney LLP in 1991. Ms. Jackson earned a B.S. from the University of Florida and a J.D. from the University of Minnesota Law School.

Incorporated into this item by reference is the information under “Election of Directors—Directors and Director Nominees,” “Election of Directors—Committees of Our Board of Directors,” “Election of Directors—Code of Business Conduct” and “Section 16(a) Beneficial Ownership Reporting Compliance” in our Proxy Statement. Information regarding our executive officers required by this item is set forth in Part I of this Annual Report on Form 10-K.

Item 11. Executive Compensation

Incorporated into this item by reference is the information under “Election of Directors—Compensation Committee Interlocks and Insider Participation” and “Executive Compensation” in our Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated into this item by reference is the information under “Equity Compensation Plan Information” and “Security Ownership of Certain Beneficial Owners and Management” in our Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Incorporated into this item by reference is the information under “Certain Relationships and Related Party Transactions” and “Election of Directors—Director Independence” in our Proxy Statement.

Item 14. Principal Accountant Fees and Services

Incorporated into this item by reference is the information under “Ratification of Independent Public Accounting Firm—Fees” and “Ratification of Independent Public Accounting Firm—Approval of Independent Registered Public Accounting Firm Services and Fees” and in our Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedule
(a) Documents filed as Part of this Annual Report on Form 10-K:
1. Consolidated Financial Statements:
Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of December 31, 2014 and 2013
Consolidated Statements of Income for the years ended December 31, 2014, 2013 and 2012
Consolidated Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012
Consolidated Statement of Shareholders' Equity for the years ended December 31, 2014, 2013 and 2012
Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012
Notes to Consolidated Financial Statements
2. Financial Statement Schedules:
Schedule II—Valuation and Qualifying Accounts
Other schedules are omitted because they are not required.
(b) Exhibits

Exhibit Number	Description	Method of Filing
2.1	Agreement, dated July 15, 2011, by and among John Holden and Others and Capella Education Company for the sale and purchase of the entire issued share capital of Resource Development International Limited (excluding schedules and exhibits, which we agree to furnish supplementally to the Securities and Exchange Commission upon request).	Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed with the SEC on July 15, 2011.
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 11, 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 19, 2006.
10.1*	Capella Education Company 2005 Stock Incentive Plan as amended.	Incorporated by reference to Exhibit 10.1 to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed with the SEC on June 3, 2005.
10.2*	Forms of Option Agreements for the Capella Education Company 2005 Stock Incentive Plan.	Incorporated by reference to Exhibit 10.2 to Amendment No. 2 to the Company's Registration Statement on Form S-1 filed with the SEC on August 29, 2006.
10.3*	Form of Restricted Stock Agreement for the Capella Education Company 2005 Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007.
10.4*		

	Form of Restricted Stock Unit Agreement (Employee) under the Capella Education Company 2005 Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 15, 2009.
10.5*	Form of Restricted Stock Unit Agreement (Non-Employee Director) under the Capella Education Company 2005 Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on May 29, 2009.

10.6*	Capella Education Company 2014 Equity Incentive Plan.	Incorporated by reference to Exhibit A to the Company's Definitive Proxy Statement for its 2014 annual meeting of shareholders filed with the SEC on March 24, 2014 (File No. 1-33140).
10.7*	Form of Restricted Stock Unit Award Agreement (Director) under the Capella Education Company 2014 Equity Incentive Plan.	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014.
10.8*	Form of Restricted Stock Unit Award Agreement (Section (16(b) Officer) under the Capella Education Company 2014 Equity Incentive Plan.	Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014.
10.9*	Form of Non-Statutory Stock Option Award Agreement (Section (16(b) Officer) under the Capella Education Company 2014 Equity Incentive Plan.	Incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2014.
10.10*	Capella Education Company Executive Severance Plan, as amended.	Incorporated by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the year-ended December 31, 2008.
10.11*	Capella Education Company Employee Stock Purchase Plan.	Incorporated by reference to Exhibit 10.12 to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed with the SEC on June 3, 2005.
10.12	Office Lease, dated as of February 23, 2004, by and between the Registrant and 601 Second Avenue Limited Partnership.	Incorporated by reference to Exhibit 10.22 to the Company's Registration Statement on Form S-1 filed with the SEC on April 18, 2005.
10.13	Memorandum of Lease, dated as of March 10, 2004, by and between the Registrant and 601 Second Avenue Limited Partnership.	Incorporated by reference to Exhibit 10.24 to the Company's Registration Statement on Form S-1 filed with the SEC on April 18, 2005.
10.14	First Amendment to Lease, dated as of May 16, 2006, by and between the Registrant and 601 Second Avenue Limited Partnership.	Incorporated by reference to Exhibit 10.36 to Amendment No. 2 to the Company's Registration Statement on Form S-1 filed with the SEC on August 29, 2006.
10.15	Letter Agreement, dated July 5, 2006, between the Registrant and ASB Minneapolis 225 Holdings, LLC	Incorporated by reference to Exhibit 10.37 to Amendment No. 2 to the Company's Registration Statement on Form S-1 filed with the SEC on August 29, 2006.
10.16	Second Amendment to Lease, dates as of March 17, 2008, by and between the Registrant and Minneapolis 225 Holdings, Inc.	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008.
10.17	Third Amendment to Lease, dates as of June 10, 2009, by and between the Registrant and Minneapolis 225 Holdings, Inc.	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009.
10.18	Fourth Amendment to Lease, dated as of May 14, 2010, by and between the Registrant and Minneapolis 225 Holdings, LLC.	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2010.
10.19	Fifth Amendment to Lease, dated as of August 29, 2011, by and between the Registrant and Minneapolis 225 Holdings, LLC.	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011.
10.20	Sixth Amendment to Lease, dated as of March 24, 2014 by and between the Registrant and Minneapolis 225 Holdings, LLC.	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 30, 2014.

10.21*	Amendment No. 1 to Capella Education Company 2005 Stock Incentive Plan.	Incorporated by reference to Exhibit 10.42 to Amendment No. 3 to the Company's Registration Statement on Form S-1 filed with the SEC on October 6, 2006.
10.22*	Capella Education Company Senior Executive Severance Plan, as amended.	Incorporated by reference to Exhibit 10.33 to the Company's Annual Report on Form 10-K for the year-ended December 31, 2008.
10.23*	Employment Agreement between Capella Education Company and J. Kevin Gilligan, dated January 20, 2009.	Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on January 23, 2009.

10.24*	Capella Education Company Incentive Bonus Plan	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011.
10.25	Credit Agreement dated September 30, 2011, among Capella Education Company, identified therein as the Borrower; Bank of America, N.A. as Administrative Agent; Merrill Lynch, Pierce, Fenner & Smith as the lead Arranger; and certain other lenders (the "Credit Agreement").	Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011.
10.26*	Form of Restricted Stock Unit Agreement (Director) (for use commencing in 2012) for the Capella Education Company 2005 Stock Incentive Plan	Incorporated by reference to Exhibit 10.26 to the Company's Annual Report on Form 10-K for the year-ended December 31, 2011.
10.27*	Form of Restricted Stock Unit Agreement (16(b) Officer) (for use commencing in 2012) for the Capella Education Company 2005 Stock Incentive Plan	Incorporated by reference to Exhibit 10.27 to the Company's Annual Report on Form 10-K for the year-ended December 31, 2011.
10.28*	Form of Non-Statutory Stock Option Agreement (16(b) Officer) (for use commencing in 2012) for the Capella Education Company 2005 Stock Incentive Plan	Incorporated by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K for the year-ended December 31, 2011.
10.29*	Capella Education Company Incentive Bonus Plan, as amended	Incorporated by reference to Exhibit 10.29 to the Company's Annual Report on Form 10-K for the year-ended December 31, 2011.
10.30*	2013 Form of Non-Statutory Option Agreement (Section 16(b) Officers)	Incorporated by reference to Exhibit 10.30 to the Company's Annual Report on Form 10-K for the year-ended December 31, 2012.
10.31*	Form of Market Stock Unit Agreement (Section 16(B) Officer) under the Capella Education Company 2005 Stock Incentive Plan	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013.
21	Subsidiaries of the Registrant.	Filed electronically.
23	Consent of Ernst & Young LLP.	Filed electronically.
31.1	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed electronically.
31.2	Certification of the 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)	XBRL Taxonomy Extension Definition Linkbase Document(1)

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

* Management contract or compensatory plan or arrangement.

(1) The XBRL related information in Exhibit 101 to this Annual Report on Form 10-K 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.

CAPELLA EDUCATION COMPANY
Schedule II—Valuation and Qualifying Accounts
Fiscal Years 2014, 2013, and 2012

	Beginning Balance	Acquisition	Additions Charged to Expense	Deductions[a]	Ending Balance
	(In thousands)				
Allowance for doubtful accounts for the years ended:					
December 31, 2014	$7,091	$—	$14,848	$(15,381)	$6,558
December 31, 2013	$6,231	$—	$15,132	$(14,272)	$7,091
December 31, 2012	$5,789	$—	$17,310	$(16,868)	$6,231

	Beginning Balance	Acquisition	Additions Charged to Expense [b]	Deductions	Ending Balance
	(In thousands)				
Valuation allowance for the year-ended:					
December 31, 2014	$2,172	$—	$357	$—	$2,529
December 31, 2013	$700	$—	$1,472	$—	$2,172
December 31, 2012	$—	—	700	—	$700

(a) Allowance for doubtful accounts deductions represent write-offs of accounts receivable.
(b) Valuation allowance addition includes establishment of and increases to valuation allowance on foreign net deferred tax assets primarily related to net operating losses.

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 (Registrant)
Date: February 19, 2015	/S/ J. KEVIN GILLIGAN J. Kevin Gilligan Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and as of the dates indicated.

SIGNATURES	TITLE	DATE
/s/ J. KEVIN GILLIGAN J. Kevin Gilligan	Chairman and Chief Executive Officer (Principal Executive Officer)	February 19, 2015
/s/ STEVEN L. POLACEK Steven L. Polacek	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 19, 2015
/s/ RITA D. BROGLEY Rita D. Brogley	Director	February 19, 2015
/s/ MATTHEW W. FERGUSON Matthew W. Ferguson	Director	February 19, 2015
/s/ MICHAEL A. LINTON Michael A. Linton	Director	February 19, 2015
/s/ MICHAEL L. LOMAX Michael L. Lomax	Director	February 19, 2015
/s/ JODY G. MILLER Jody G. Miller	Director	February 19, 2015
/s/ STEPHEN G. SHANK Stephen G. Shank	Director	February 19, 2015
/s/ DAVID W. SMITH David W. Smith	Director	February 19, 2015
/s/ JEFFREY W. TAYLOR	Director	February 19, 2015

Jeffrey W. Taylor

/s/ DARRELL R. TUKUA	Director	February 19, 2015
Darrell R. Tukua		

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