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APOL - Q1 2014 Apollo Education Group Inc Earnings Conference Call

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OVERVIEW:

APOL reported 1Q14 revenues of $856m and income from continuing operations of $99m or $0.87 per share. Expects FY14 net revenues to be $3.0-3.1b.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good afternoon, and welcome to the first quarter 2014 earnings release conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Please refrain from entering into the queue until those instructions are given.

(Operator Instructions)

This conference call is being recorded today, January 7, 2014, and may not be reproduced in whole or in part without permission from the Company. There will be a replay of this call available through January 17 beginning approximately two hours after we conclude today. The replay number is 855-859-2056, or 404-537-3406, internationally. The conference ID for the replay is 21105114. I would now like to turn the call over to Beth Coronelli, Vice President of Investor Relations. Ms. Coronelli, please go ahead.

Beth Coronelli - *Apollo Group - VP of IR*

Thank you for joining us today to discuss our first quarter results. Participating on the call are Greg Cappelli, Chief Executive Officer of Apollo Education Group and Brian Swartz, Senior Vice President and Chief Financial Officer. Greg will update you on our initiatives and strategy, and Brian will discuss the first quarter financials and outlook.

As we discuss our results today, unless noted otherwise, we will be comparing the first quarter of fiscal 2014 which ended November 30, 2013, to the first quarter of fiscal 2013. I'd also like to remind you that this conference call contains forward-looking statements with respect to the future performance and financial condition of Apollo Education Group that involves risks and uncertainties. Various factors could cause actual results of the Company to be materially different from any future results expressed or implied by such forward-looking statements including changes in the competitive landscape, regulatory changes and unexpected expenses or challenges in integrating acquired businesses. These and other factors are discussed under Risk Factors and elsewhere in our 2014 Form 10-K filed with the SEC which is available on our website at www.apollo.edu. The Company disclaims any obligation to update any forward-looking statements made during the call.

Additionally during the call we may refer to non-GAAP financial measures which are intended to supplement but not substitute for the most directly comparable GAAP measures. Our press release, which contains financial and other quantitative information to be discussed today, as well as the reconciliation of the GAAP to non-GAAP measures, is also available on our website. And with that, I will turn it over to Greg.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thank you, Beth, and good afternoon, everyone. I hope you all, first of all, had a really nice holiday season and you're off to a great new year.

There is a lot happening at Apollo Education Group. This is a dynamic industry. It continues to evolve. And while we have a tremendous amount of work to reach our ambitious goals over the next few years, I have to say, there's a lot of excitement internally at Apollo. We've made the Apollo mission, the vision and strategy very clear to our employees. We've realigned much of Apollo Group and University of Phoenix in the past 12 to 18 months, and we're on the offense and growing our international business, and we're becoming a much more efficient organization overall.

From a financial standpoint in the first quarter, I was generally pleased with our revenue and operating performance of $856 million and EPS of $0.87 a share, or $1.04 per share excluding special items. We continue to prioritize our investments for long-term student success which we believe will lead to healthy shareholder value creation over time. And in just a moment, Brian's going to take you through more of the financial details, as well as our outlook.

I'd like to take the next few minutes to talk about the progress we've made with respect to our strategic plan, which as you know, includes differentiating our institutions, diversifying our Company through our global initiatives and through the introduction of new products and services. And last but not least, our focus on operational excellence.

First, we're working to establish differentiated career connected education offerings at University of Phoenix and all of our schools globally. As we create bridges between education and careers, improving completion and career outcomes is a paramount objective. We're doing this by providing a variety of pathways to support career preparation and leveraging the latest technologies, new delivery models and other innovations to provide education and training that connects more directly to employability.

We're listening to our students and understand that working adults, are interested in acquiring tangible skills right now to compete more effectively in today's labor force. They want a more effective way to learn that leads, frankly, to better careers. And whether it could be degree seeking, non-degree or certificate based programs, for some students this means greater support and a high touch experience, while for others it means fewer bells and whistles and a more self-paced or self-directed experience. In either case, we're in the process of developing additional programs which we think will help our students demonstrate their competencies through their journey as a student. And in turn, this should help them demonstrate value within the marketplace sooner than upon degree completion.

We're also focused on simplicity of use. Functionality, flexibility, teaching quality and an enhanced overall experience. As an example, we recently rolled out new stackable certificates in healthcare and business with the option to support or transition into a degree program. Our goal is to provide an excellent academic experience for students that also meets the needs of employers for qualified, engaged employees. Employers, after listening to many of them across the nation, they want to ensure higher education is responsive to their human capital needs as they seek graduates who can add value and help their companies thrive. As we broaden our services and relationships with more than 2,500 corporate partners, we're developing academic programs correlated more directly to the skills that these employers are looking for to fill their critical jobs.

We're also recalibrating the instructional design process to better match our program content to industry standards. This means continually reassessing our programs and eliminating the programs that don't fit today's workforce needs. We're establishing new programs in areas tied to in demand jobs and also working to ensure our team has a strong set of solutions when they meet with employers, bringing the corporations opportunities for their employees across the Apollo Education Group network. This includes degree programs in one of University of Phoenix's eight colleges, or from Western International University, an engaging cohort course in innovation, or meeting their corporate needs in other areas of the world through Apollo Global.

The goal is to leverage the capabilities across our institutions to expand these important relationships. Let me summarize here. We want to be the partner to Fortune 1000 companies with a global presence, so as they develop new products and services, they feel secure knowing that Apollo can deliver high quality human capital to support their growth initiatives worldwide.

Now, in line with our differentiation strategy, we're focused more on delivering educational experiences that prepare students directly for their field of choice. To support offering targeted segments, University of Phoenix has structurally realigned to focus on managing and operating its distinct colleges more individually to address the specific needs of the markets they serve. With accountability for driving performance at the college and program level, our college leaders are directly dedicated to academic quality, retention, leading product and marketing innovation and creating an enhanced student experience within each school at the University of Phoenix.

Our alignment by college is intended to improve student outcomes. Again, retention and completion are our top priorities. We know that if students don't progress, they'll have difficulty achieving their career aspirations. Supporting this effort, we're redesigning our curricula, including modifying the structure of our entry courses and implementing improved support systems. As we've shared previously, this includes increasing our use of full-time faculty for first year courses, making improvements in our orientation program and expanding the use of adaptive learning.

Our Phoenix Scholarship Reward Program is also designed to help students achieve milestones and reward their success as they progress through their programs. While we did see some positive movement and early indications that our retention initiatives are gaining traction, it's still early. We've only recently made some of the larger changes within the structure of our organization that we think can move the needle more significantly in fiscal year '15 and beyond.

Significant change in retention and completion rates requires a long-term, sustained effort. Make no mistake, we are totally committed to engaging and supporting our students through their journey to graduation, ensuring that they have the support they need to succeed. Improvements in retention and outcomes is obviously first and foremost, the right thing to do for our students, but as can you imagine, it also has an outsized impact on our financial performance and on our long-term shareholder returns.

Another important cornerstone of the strategy is diversification, which for Apollo Education Group really comes through Apollo Global, Lightspeed, West, and our other entities within the organization. First and foremost, Apollo Global continues to improve operationally. It's well-structured now, they have a very strong management team in place, and they're ready of to expand their reach.

Let me just briefly touch on our key entities within Global. First, quickly on BPP in the UK, at over 50% of revenue of Global, it's our largest Apollo Global subsidiary. Their business has stabilized, and we continue to gain market share in certain key areas. We're now seeing growth again at BPP. We had strong fall intake supported by outstanding graduate employment rates at 96% for law and business undergraduate. I'm really pleased to announce that BPP was awarded recently the Best Higher Education Provider and Best Professional Education Provider in the United Kingdom by Education Investor, judged by leaders in business, government and the respective body of UK Universities. It's a tribute to the BPP team.

Second, at ULA in Mexico, with healthy enrollment growth and strong improvement in retention, we continue to experience favorable operating and financial results. Because of the success we've seen recently with our new learning centers, we are actually beginning to increase the pace and rollout of new centers throughout the region. ULA is relatively small when compared to Apollo overall, but it's also a great example of how Apollo Global can enter a new market without a tremendous amount of financial capital, leverage our core capabilities from other regions, design smart strategies for growth, and now demonstrate success through proper execution.

Let me just touch on India and our new Bridge School of Management. I just had the opportunity to visit our brand-new locations and also spend time with our outstanding partner, HT Media. India, as you know, is a complex market, but I was so impressed with how our team there has learned from our experiences in the US, as well as our other areas of the world where we operate. They've taken best practices, they've worked with leading companies prior to opening their doors and are just beginning to enroll students into our first two postgraduate certificate programs. We know it will take time and great care while rolling out our school system in India, but I must say that with roughly 500 million kids under the age of 25, this country has an incredible opportunity to enhance their position in the world through higher education because there is significant need for education and training.

And then just finally on the global front, aligned with our strategy to broaden our global reach, we're pleased to welcome Open Colleges Australia to Apollo Education Group within Apollo Global. Open Colleges is a strong fit to support our global expansion strategy, really for a number of reasons. First, they share our commitment to academic quality, service and connecting education to careers. Serving adult learners with more than 130 courses including nationally recognized qualifications, they offer online programs in accounting, finance, IT, healthcare, design and education.

Second, they operate in a strong growth market. There is significant growth opportunity in the Australian education and training market to serve working learners. Open Colleges has increased enrollment dramatically. We expect to continue to see strong growth in the coming years, and in three to five years, based on current market opportunity, we estimate that there's a 20% to 25% growth range opportunity annually. With their focus on operational excellence, we're pleased to work with the strong team at Open Colleges, to integrate best practices across our entire global network. This was a really important part in deciding whether to acquire Open Colleges. Last, they fully support a diversification strategy and provide a platform for Apollo Global to operate and expand in Asia Pacific.

In summary, with respect to Apollo Global, we do see the opportunity to expand into a number of other key countries this year where we've been building relationships for years. We understand that it's incumbent upon us to use your capital carefully and appropriately while demanding long-term shareholder value creation.

Also supporting our diversification strategy, our innovation group, Apollo Lightspeed, is creating products and services within higher education that leverage our core strengths and capabilities, including a new version of Innovator's Accelerator, which will launch in the second quarter. Watch for other new developments in the near-term as Lightspeed leverages the insights, assets, and experiences Apollo Education Group has developed over the decades to create new market opportunities.

The final component of our strategy is driving operational excellence. We're working to build a stronger Apollo Education Group, realigning to operate more efficiently and create a more nimble organization. As we announced during the quarter, I'm very pleased that Mitch Bowling has joined our team as Chief Operating Officer of Apollo Education Group. Mitch comes to us from Comcast. He has a proven and experienced track record in operations, and we're really excited to have him in place and on the job.

I want to thank Curt Uehlein, who stepped up for us the past six months and did just a phenomenal job on the operations front. He helped us implement and drive our new linked goal system, and he was instrumental in helping us achieve the efficiencies at Apollo this year. Curt will now be focusing most of his attention back to Apollo Global, which is his passion, and frankly, the reason we have so much confidence in the future growth prospects of Apollo Global.

Our initiatives to improve effectiveness and efficiencies support our broader strategy to allocate resources, enhance long-term value for our students and in turn, the organization. As an example, we're working to reduce certain operational costs such as optimizing marketing spend and realigning our support structure. Our goal is to redirect resources and invest in initiatives that improve student outcomes and retention, as well as to enhance the long-term value proposition and student experience overall. Brian's going to share more detail, including an update on our 2014 cost savings targets. We're confident in our strategy to differentiate, diversify and build a stronger Apollo Education Group with focus on operational excellence. And with that, I'd like to turn it over to our CFO, Brian Swartz.

Brian Swartz - *Apollo Group - SVP and CFO*

Thank you, Greg. Happy New Year, everyone, and good afternoon. I plan to review our first quarter financial results, and then I'll share our updated financial outlook for 2014.

During the first quarter, we reported revenue of $856 million, down 19% year-over-year. The decrease was primarily the result of an 18% decline in enrollment at the University of Phoenix to 263,000 students. For new enrollments, the University reported roughly in line with our expectations, a year-over-year decline of 23%, to 41,700 students. First quarter revenue per student was down about 3% year-over-year, and the University discounts as a percentage of revenue were approximately 8%. Both were impacted by the University's pricing initiatives implemented in the first quarter to support college affordability and improve our value proposition to students. As a reminder, we simplified the pricing for lower division students and increased the use of targeted scholarships and discounts, including the Phoenix Scholarship Reward Program, which enables certain students to receive up to $10,000 off their degree. We continue to expect revenue per student to be in the negative 2% to 4% range for fiscal year 2014 and discounts as a percentage of revenue to be approximately 9%.

For the first quarter, income from continuing operations was $99 million, or $0.87 per share. Our first quarter results included restructuring and other charges of $32 million, roughly half of which was related to our previously announced workforce reductions and the remaining half related to lease costs associated with the University of Phoenix campus closures. As we continue to execute on our cost optimization activities, we have slightly increased our estimate of restructuring charges primarily to include the closure of certain administrative facilities and to reflect updated employee severance costs. In addition to the restructuring charges recognized in the first quarter, we expect to incur an additional $35 million of charges associated with the plans we have announced to date with approximately half of these charges expected to be incurred in 2014. Excluding special items, our first quarter operating margin expanded by 100 basis points to 23.6%, compared to 22.6% in the prior year. Income from continuing operations was approximately $202 million, and EPS was $1.04 per share.

Turning to our operating expenses. Excluding special items, we experienced year-over-year declines in substantially all expense line items, and expect to continue this trend through the remainder of 2014. These decreases were primarily driven by savings from our ongoing efficiency and restructuring activities, as well as reduced costs associated with lower enrollment levels. Excluding special items and our costs that are more variable in nature, which primarily represent faculty and are roughly 14% of revenue, our operating cost decreased approximately $135 million in the first quarter. We are pleased to report we are increasing our 2014 cost savings target by an additional $25 million and expect to decrease our annual fixed operating expenses by at least $325 million from our 2013 cost base.

We continue to invest heavily in the faculty and the learning experience for our students to enhance student outcomes. At the same time, we expect instructional and student advisory expenses to decline year-over-year as we realize efficiencies from the recent realignment of our graduation teams to focus on the eight colleges within the University of Phoenix, lower lease expense from the campus closures, and decreased technology costs as we move from development to deployment on a number of our major platform implementations. We anticipate general and administrative expenses to decrease year-over-year in 2014 when compared to 2013, even though the first quarter was up slightly due to certain corporate IT initiatives.

With respect to marketing expenses, we expect the full year 2014 to decline in actual dollars as we continue to reallocate marketing spend while supporting brand awareness and improving student progression which Greg discussed earlier. Share based compensation was $12 million in the first quarter. For the full year 2014, we expect share based compensation to be around $45 million.

Bad debt expense as a percentage of revenue was 1.6% in the first quarter versus 3.2% in the prior year. The decline was primarily due to ongoing process improvements and lower enrollments. For 2014, we expect our full year bad debt expense as a percentage of revenue to be approximately 2%. Our effective tax rate was 41.4% for the quarter, excluding the impact of Open Colleges and any discrete items, we anticipate our tax rate to be about the same for the full year 2014.

Turning to the balance sheet and our cash flows. We continue to maintain a very well capitalized balance sheet and generate healthy cash flows. At quarter end, unrestricted cash and cash equivalents and marketable securities which have an average maturity of less than a year totaled approximately $1 billion. Our outstanding debt was $76 million. Our free cash flow in the first quarter was $95 million compared to $183 million in the prior year. Our free cash flow decreased, principally due to lower operating income and higher cash outflows attributable to our restructuring activities. We expect our free cash flow for 2014 will be negatively impacted by cash outflows from our restructuring activities of approximately $90 million, and we anticipate capital expenditures to be around 3% as a percentage of revenue.

Consistent with our strategy, we continue to evaluate all investment opportunities to generate high returns on invested capital by allocating capital to differentiate the University of Phoenix, diversify and expand our operations both domestically and globally and as appropriate, return capital to shareholders. Since the end of last fiscal year, we have repurchased close to $25 million of stock at an average price of about $26 per share. Also, as Greg mentioned earlier, in December, to further our global diversification strategy, we closed on the acquisition of a 70% interest in Open

Colleges Australia for a purchase price of $98 million, plus contingent future payments at current exchange rates of up to $47 million. Open Colleges financial results will begin to be included in our second quarter and will be reflected in the Apollo Global segment.

Before I discuss our business outlook, I want to provide an update on changes to the University of Phoenix enrollment operating metrics. As expected, the simplification of the University of Phoenix lower division pricing structure has impacted our mix. In the first quarter, while total new enrollment was down about 23%, our Associates were down close to 30% and our Bachelors were down about 20%. We expect this trend to continue. Accordingly, reporting by degree level will become less relevant in the future, and we therefore plan to eliminate this separate reporting beginning in the second quarter.

Now I'd like to spend a minute to talk about our business outlook to provide additional color as to what is included in our outlook. First, we expect the Open Colleges transaction to be slightly dilutive to GAAP based earnings in fiscal year 2014 and accretive to 2015, given the strong historical growth of this operation and more importantly, cash flow value accretive over time. With respect to 2014, based on Open Colleges' seasonality, as well as the transaction and integration costs expected in the second quarter, our outlook is now weighted slightly more heavily towards the second half of the fiscal year.

Second, with respect to our outlook, we have assumed improving year-over-year rates of decline in the University of Phoenix new enrollments as 2014 progresses. And finally, we continue to expect to end 2014 with about 230,000 students at the University of Phoenix. Our updated financial outlook is net revenue of $3.0 billion to $3.1 billion and operating income excluding special and restructuring charges of $400 million to $450 million.

With respect to new enrollment trends, although it's our lowest enrollment month of the year, the December year-over-year decline was modestly better than the first quarter rate of decline. Additionally, our lead flow in the first quarter was slightly ahead of our expectations, which we expect to help maintain momentum as we progress through the second quarter. As I mentioned in the outlook discussion earlier, we do expect to see improvement in the year-over-year rates of decline in new enrollments for the remainder of the year. To support this, we maintain our focus on executing our strategy, attracting new students through differentiated programs that lead to careers, and as our top priority, working to improve completion and career outcomes. With that, let me turn the call over to the operator to open the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Jeff Volshteyn with JPMorgan. Your line is open.

Jeff Volshteyn - *JPMorgan - Analyst*

Thank you for taking my question. I wanted to ask on Open Colleges. Could you give us general framework, how much revenue does the Company generate, at least before you've acquired it? How much does it contribute within your guidance, as well as revenues, as well as operating income contribution?

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, Jeff, it's Brian. First of all, the acquisition overall to Apollo Group is not material. The updated outlook that I provided does include an estimate of their impact to our fiscal '14 results, both on the revenue side and on the profit side. We really like this business because it's very capital efficient and has some very high growth characteristics and expect it to be very value accretive over the long term.

Jeff Volshteyn - *JPMorgan - Analyst*

Anything around the multiples that you've paid for it?

Brian Swartz - *Apollo Group - SVP and CFO*

We're not commenting further on multiples. What I will he tell you is because of -- and I mentioned this, because of the timing of transaction costs and some other integration costs, in the second quarter we do expect it to impact our second quarter financial results more significantly, and therefore, it will be adjusted in the second half of the year, the deal cost and other transaction costs.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

And Jeff, not to downplay multiple, we look at every metric, do a tremendous amount of work with our team when we're looking at bringing anything into Apollo. But honestly, from our perspective, there's so much that has to go into being the right fit. The management team in this case is superb, they've done it before, they're proven. It's a great fit. It provides a pathway into other areas of Asia for us.

The programs were right down the center of the plate for us. It's capital efficient, as Brian said, and they're growing at a very high rate right now. We obviously expect that to normalize over the next three to five years. But again, we look at it as, multiple's important, but when I think about it from a cash flow perspective, this cash flow perspective over time, it needs to be able to clearly hurdle the bar to create value for us in global, and we all felt that this was a great candidate to do that.

Jeff Volshteyn - *JPMorgan - Analyst*

Fair enough. Let me follow up with a question on nonrecurring items. So, I think you said that about half of the $35 million is going to be in 2014. Is that correct? Is that what's excluded in your guidance?

Brian Swartz - *Apollo Group - SVP and CFO*

I'm sorry, Jeff, are you referring to the restructuring charges?

Jeff Volshteyn - *JPMorgan - Analyst*

Right, right.

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, so in the first quarter, we recognized about $32 million of restructuring charges. We expect about $35 million more with most of that occurring in fiscal '14, but all of those numbers consistent with prior ways we provided our financial outlook are excluded from the operating income range that we provided.

Jeff Volshteyn - *JPMorgan - Analyst*

Right, and then in first quarter in the $32 million, how much of it -- is most of it cash?

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, most of it was cash, because -- and there's detail in our 10-Q. About half of it was severance related. The other half was the ongoing University of Phoenix campus closures that we announced over a year ago. The severance component for the cash, much of that impacted cash flow in Q1.

Jeff Volshteyn - *JPMorgan - Analyst*

Thank you so much.

Operator

The next question comes from the line of Jeff Silber with BMO Capital Markets. Your line is open.

Jeffrey Silber - *BMO Capital Markets - Analyst*

Thanks so much. I know this might be difficult to do, but can you tell us what your guidance might have been had you not made the Open College transaction? I'm specifically focused on the operating income line.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Jeff, I'll just -- I'll turn it over to Brian in a second. I'll just say, we brought up the bottom of the range because of the confidence we have in the business right now. And the range that we put out. There are some seasonality and timing differences with Open Colleges as well that are having some impact on how we look at the quarters and how they'll play out. Obviously it is not a very significant amount of revenue or operating profit at this point but I'll let Brian take it from there.

Brian Swartz - *Apollo Group - SVP and CFO*

Yes. Just to provide perhaps a little bit more color, we were very pleased with our Q1 performance on the profit side. As you saw in my remarks, we did increase our cost targets for fiscal '14 by $25 million. So, without Open Colleges, which I did mention would be dilutive, slightly dilutive to our fiscal '14 results, we have started the year very, very well, I think we all feel good about the prospects of that. And as Greg mentioned, we did increase the lower end of the range because what we think is the best range today for the future performance over the next three quarters.

Jeffrey Silber - *BMO Capital Markets - Analyst*

All right, great. And I know this question gets asked every quarter, so I'll ask it this time. What are your thoughts about accelerating your share repurchase and/or paying a dividend?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Yes, good question. Obviously, an important part of the discussion whenever we talk about capital allocation, we're looking for opportunities to move the whole enterprise value of the Company, as we've talked about on this call. But also realize that levering shareholder returns is an important part of creating value as well, and we think that there's an opportunity to do both, as long as the business is healthy. I feel good about the amount of operating profit and cash flow we're going to generate this year.

You can see that we have started to repurchase some shares again, sometimes there's some timing issues around that that are important to consider on our part. But what I can tell you at this point is that it's going to be an important part of our discussion going forward, and you can expect to hear more from us on that front on a quarterly basis.

Jeffrey Silber - *BMO Capital Markets - Analyst*

Appreciate the color. Thanks so much.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thanks, Jeff.

Operator

The next question comes from Jeff Meuler with Baird. Your line is open.

Jeff Meuler - *Robert W. Baird & Co. - Analyst*

Three for three on the Jeffs this afternoon.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Three Jeffs (laughter).

Jeff Meuler - *Robert W. Baird & Co. - Analyst*

Thanks for taking the question. Greg, I think you probably spent about 10 or 15 minutes talking about all of the initiatives that you guys have to improve the value prop, improve the educational offering. I'm guessing there's a fairly small number of prospective students on the call. What are you guys doing to get that message out to students? And then when you've seen an improvement in lead flow, you've seen a lessening in the rate of starts decline in December, how much of that can you attribute more to a direct result of getting this message out there in the market versus other factors? Thank you.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Jeff, let me take a shot at answering that maybe a little differently. From my perspective, and again, we've consistently said, look, we're going to focus a tremendous amount of our time, effort, capital on making sure that we do the best job we can, once we enroll a student at keeping them. And look, that's a big statement. There's a lot to that, as you well know, and it's a long-term proposition to get it to where we want to go. We think there is tremendous amount of value to be created with where we want to go with the student experience and keeping a person all the way through to graduation while giving them opportunities along the way to go to the marketplace and showcase the value they're getting every step of the way. So, it starts with that relationship of employers, students, teachers and faculty and working with them throughout that entire process. From my perspective, that's where it starts.

Now, again, I think about acquiring a student in terms of ROI, right. What does it take to improve the ROI? It's the way you spend your capital, right? It's the way you deliver your messaging to the marketplace. Once you deliver that message to the marketplace, it better resonate, which for us, we're talking with students around the country, we're talking to employers around the country. We think we truly get it, that they want something that resonates with their career and they want to get value along the way. They don't want to wait two, four, six years to be able to show that. That needs to come through. You need to put a great product on the field.

You know we've been doing a tremendous amount with realignment, be it colleges, not just having one price point with the University of Phoenix, but also West which can compete at a different price point, as a different value proposition than our Global entities. That message in its whole needs to get communicated effectively to the marketplace and frankly, to drive students for us that are going to retain. Whatever you see in any one quarter in terms of our share, right, in digital or search or whatnot, I'm not down-playing that. That's important. But sometimes what you don't see underneath the covers there is what we're doing to make sure that we're spending wisely and getting students in that we'll retain. That's critically important to us, and that's where you're going to see continued huge focus. I think once that's completed, the front end will take care of itself more smoothly and the University of Phoenix will be able to grow again.

Jeff Meuler - *Robert W. Baird & Co. - Analyst*

Okay. And then could you just maybe talk about with the revamped cost structure, is there a change to how we should think about the fixed versus variable cost structure of the business? I think the numbers that you guys are quoting as variable expenses have been pretty similar over the last 12 months, and you've taken a lot of costs out of the business. And I'm wondering this in the context of you may be operating at a kind of permanently level -- permanently lower level of total enrollment, but with students that are retaining longer. So, how should we think about the revamped cost structure playing into what the profitability of the business can look like in that context?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

I want Brian to answer that, but I want to tell you what we challenge the organization with over a year ago, which is we want to be a more efficient, nimble, fast moving and competitive organization to deal with the changed environment, a changed marketplace. We know that there's still a huge amount of demand overall, overall in the country and globally, but we need to be able to react quicker. And part of that quickness is efficiencies within the business. I want to talk to that first, and then Brian, have you address it more specifically.

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, Jeff, the economics, the way to think about how the revenue or costs flow through the model really haven't changed much. If you think about purely variable or very -- directly variable -- what I'll refer to as true variable, right? They're truly costs which sit within the instructional line and really represent faculty. They used to represent 13% of revenue. That's up to about 14% now because we do continue to invest in that area. All the cost savings targets that we've referred to in the past is everything outside of those reductions. So, if revenue comes down, about 14% of that would be reduced cost directly variable and then the cost targets that we referred to are everything else. I think we've reduced that everything else bucket, which is principally fixed costs.

There are some semi fixed costs in there that come out over time, but they're not directly variable. I think those are down roughly 20% over the last two years. It's hundreds of millions of dollars of costs. I think it's approaching -- it's north of $600 million of costs in the last two years.

Jeff Meuler - *Robert W. Baird & Co. - Analyst*

Thanks, guys.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thank you.

Operator

The next question comes from Jerry Herman with Stifel Nicolaus. Your line is open.

Jerry Herman - *Stifel Nicolaus - Analyst*

Thanks, good afternoon, everybody. Greg, hoping you can give more color on retention. You said it's early, but can you give us a progress report? Obviously, it's a major emphasis for you guys. But help us, if you will, to decipher if those trends should continue for the rest of the year, and you know the way we measure it.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

I do. And look, I'm pleased to say that we had real retention improvement this quarter. What I want to caveat that with is -- and by the way, we're doing specific things and have been to get that improvement. But I think as we've talked in the past on this call, there are some larger, more major initiatives that we're working with at Apollo Group as a whole to try and get our graduation rates back to where they were over a decade ago, which were, frankly, industry-leading in some cases. To do that, this has been the realignment within the universities themselves. We have examples of bringing them up substantially in other markets, whether it's in Mexico or at BPP. So, I am pleased.

We have gotten some. To me, it's the tip of the iceberg, and it's a little bit hard to measure exactly where it's coming from. We have put in more full time faculty. We have changed the sequences of courses. We have given tools and support systems to our enrollment advisors that they didn't have before. So again, I'm happy with it.

Too early to declare victory. But we are determined to try to move the needle at a higher level going forward. It's not going to happen overnight. This is a five-year process, probably to get it where we want it to be, but it's substantial. I think when we do that, it changes everything about the image, the perception of the University of Phoenix, the truth of the quality of it internally and it will directly impact the front end as well, the ROI on that marketing spend.

Jerry Herman - *Stifel Nicolaus - Analyst*

Speaking of --

Brian Swartz - *Apollo Group - SVP and CFO*

Brian, let me add, if I could. The way I know you and many others calculate the retention, it's up roughly about 140 basis points, the persistence calculation that's done through the enrollment models. Most of that was as a result of true retention, not graduates for the quarter, and as Greg mentioned, we're very, very pleased with that. If that persists, we would clearly expect to see further improvements in what we refer to internally as kind of cohort retention, right? For what percentage of students are completing their first, second third and fourth courses, and so on, and ultimately graduation rates. But those are very much lagging indicators. Obviously, the persistence improvement is very nice this quarter. If that continues, we would absolutely expect to see the improvement in the cohort retention over time, which is our number one priority as a Company.

Jerry Herman - *Stifel Nicolaus - Analyst*

And just to talk a little about the front end of the pipeline, you mentioned lead flow being up, and different variation, I guess, of Jeff's question. That's interesting in light of the decline in marketing. Could you talk about perhaps relevance in sources of those leads or what you're seeing that might be important there?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

I mean, I think that we're pleased that we're getting some better lead mix to areas that for us generally and historically have meant more to retention aside students that -- any time you get students coming more directly to your own web pages and websites so they can do their own research and we can assess them and whatnot, that's a good thing. The lead flow, even though we've been taking a rather substantial amount for us out of marketing, again, it's tricky because we know the risk there is that potentially the absolute number of students that enroll isn't where Wall Street thought it would be or frankly, outside investors. But to us, it's all about measuring the quality of the person that comes in on a number of different scales, or a number of different areas, I should say, so that we make sure it's the best fit, and that's not as easy to do as it sounds. So, we're intently focused on that. We've got really good people in the digital area and marketing area and advertising area that work with us, but I'd say we're in the early innings of where we want to be there, which is good. It means we have a lot of opportunity in front of us, but it is not where I want it to be today.

Brian Swartz - *Apollo Group - SVP and CFO*

And Jerry, it's Brian. Just to make sure my comments were clear. Our lead flow in Q1 was ahead of our expectations and plan. It was still down year-over-year. It's just our plan was -- we beat our plan.

So, what we're trying to do, as Greg mentioned is, as we've talked about, reduce our marketing spend, optimize that spend so that we're identifying leads from channels, from students that are more likely to be successful at our university. So, the leads in Q1 were down year-over-year, but they were down less than we had planned, we had beat our plan. Which is good, because it helps us to have momentum as we persist through Q2, particularly in the coming weeks here which is a very important period for our.

Jerry Herman - *Stifel Nicolaus - Analyst*

Great, guys, I'll turn it over. Thanks.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thanks, Jerry.

Operator

Next question comes from Corey Greendale with First Analysis. Your line is open.

Corey Greendale - *First Analysis Securities - Analyst*

Good afternoon.

Brian Swartz - *Apollo Group - SVP and CFO*

Hi, Corey.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Hi, Corey.

Corey Greendale - *First Analysis Securities - Analyst*

I hope for all your sakes that none of you are in Chicago right now.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

It is not 50 below and freezing here in Phoenix, I'm sorry to tell you that, Corey, because I know where you're sitting right now.

Corey Greendale - *First Analysis Securities - Analyst*

Any sympathy is appreciated.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Good luck.

Corey Greendale - *First Analysis Securities - Analyst*

First, Greg, I wanted to ask you about brand. On previous calls, I think you've said that you view University of Phoenix as a premium brand. Wondering now, there's been some additional scholarships, some things you're doing with the model, where do you see Phoenix as being in that spectrum of premium to value, and where do you believe market perceptions are of the brand?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

It's a great question. And I think what we want to have is a strategy that's based on -- a price strategy in place that's strong. And the way I think about that is we don't have to be all things to all people through University of Phoenix, right? They have a value proposition. They've gone out and listened to their segment of the market and employers and students that are interested, and there's a certain amount of service that comes along with it. And there's certain things that you need to do if you want to have the aspirational goals we do on the retention front and completion front, and there's a price for that. And there's work being done in all those areas.

But we have more than just one vehicle, so if somebody is really interested in coming to school at $250 a credit hour, and a really neat, interesting, more self service and self paced model, they can do so with Western International University now for us. And there's still pilots going on there and they're working on their model to perfect it. I really like it. I think it's going to be terrific. And we said two, three quarters ago, we're not going to turn it on all at once. But there are different ways that we're coming to the market with price value solutions so that one of our institutions like Phoenix doesn't have to be everything to everyone and frankly, that's probably where we ran into some programs historically by trying to accomplish that. So, long way to go there, but I feel good that we have options and that we're trying to make sure that we're pricing both of these importantly. We're not just going to follow, if someone drops a price by 10% or 15% or 20% in a market at any time, don't expect us to just follow suit. We'll price it to where we think we can get students we want and stay and complete their programs, and frankly, that can be -- that can create value for them and for us.

Corey Greendale - *First Analysis Securities - Analyst*

And given that you've got the two different models and different brands now, what -- can the two institutions work together so that you can optimize both from the students' perspective, making sure the students who would benefit more from the higher touch or those who would benefit from the lower price get to the right institution, so that you maximize value for shareholders as well?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

I think you hit the nail right on the head, and I want to come clean about something on this call. We have not done a good job on that at Apollo Education Group historically. We are in the process of making sure we do a much better job because, again, think of what we want to do.

We have a big B to C component, you know that, from a really important B to B component. And again, we continue to meet with lots of CEOs and presidents and management teams coast to coast. We want to be their partner, and to be their partner, you have to understand what they're looking for. If company X is going to build a new product line and add 2,000 jobs, they're going to look to you if you can do it, whether it's a degree, whether it's a certificate or just some programs that they need in certain areas. And we want to be able to provide that solution to them so that they look to Apollo no matter where we are, US, or frankly, now globally, to be able to support them at a high quality level. All that plays into that valuation, that value proposition.

Corey Greendale - *First Analysis Securities - Analyst*

Just one more quick one, as long as I'm getting you to come clean on things. A strategic question on the Asia-Pac, can you help clarify a little bit, how much is the Asia-Pac expansion plan from Open Colleges and how much are you going to be doing additional acquisitions in Asia-Pac?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

We bought OCA because of the wonderful job and their proven track record, what they're doing, frankly, in Australia. But we also know that there's opportunities outside of Australia in that region that we are very interested in, that we've been studying and getting to know players in and I think they can help us in that area. We already have some initiatives underway that potentially we'll talk about in the not too distant future, but I think this management team only enhances our ability to get bigger in the region.

If there's one thing I've learned, having started Apollo Global with the team, some of the team here five, six years ago, you have got to have a very good, solid management team in place in any of the regions that you're operating in. It has to be stable. If you have that, the demand globally for higher education, whether it's degree or nondegree, is really quite spectacular. But that comes first. To answer your question, I think it will enhance some of the initiatives that we have in place on the rest of Asia-Pac. That's a place you need to be in the world if you're serious about being a global player in higher education.

Corey Greendale - *First Analysis Securities - Analyst*

Thanks very much.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thank you, Corey.

Operator

The next question comes from Sara Gubins with Bank of America Merrill Lynch. Your line is open.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Hi, thanks. Good afternoon. Following up on one of Corey's questions in thinking about kind of the brand and pricing as part of that, as you think about revenue per student, is the current thinking it will be down 3%, 4% this year, but then it will probably flatten out? Or do you see the scholarship plan as really the first step in a continued decline in revenue per student, but perhaps balanced out by better retention?

THOMSON REUTERS

Brian Swartz - *Apollo Group - SVP and CFO*

Yes Sara, it's Brian. For this year, we do expect revenue in student, it's between 2% and 4%, it was about 3% in Q1, down year-over-year. We expect the year to be between 2% and 4%. Part of that is the scholarship program, part of that is actually the price synchronization of the undergraduates, Associates and Bachelors programs as well. I think as you think about the future, our number one goal is retention. We can offer scholarships similar to what we have in place now, our Phoenix Rewards Scholarship, that will drive improved retention, and the improved retention should more than offset, at least from a financial point of view and a returns point of view, any impact to revenue per student.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. Is there potential to see greater as we go forward?

Brian Swartz - *Apollo Group - SVP and CFO*

It could, we just need to see how the program evolves. The program might evolve into something slightly different. It's still very, very early in that program. We just, as you know, rolled it out this past quarter, and much of the advertising just recently went into market in the last six weeks. So, we are committed to providing the right affordability features for our students, our prospective students, particularly if they're tied to retention initiatives. That's good for them and obviously that's good for us financially.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

And Sara, just to address something that came up a little earlier. Honestly, even though we were building it, we really didn't have another option for our students, nor did we tell them about another option. If somebody came in as a University of Phoenix student or prospect, there just was no avenue to say, look, if that's not right for you for a certain reason, there's other opportunities too. That's really branded -- there's been a lot of work that's gone in to preparing to do it, but it's just beginning right now. So, we'll learn a lot over the next six to nine months, and we'll have a lot more to say about it. But I have a feeling that it's really going of to be important for us to execute well on that to address some of the things you're speaking to.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay, and then turning to the cost side, could you tell us a little bit more about where the incremental $25 million in savings comes from? And beyond the cost cuts of this year, how do you think about the potential to go further in future years. And not necessarily from a quantitative perspective, but even just from a qualitative perspective, if you could talk to us about the areas that you would look beyond what you've already been able to identify.

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, Sara. The incremental -- the increase in the overall cost target, the $25 million, it comes from a variety of areas, and many of them we've talked about previously. It's just executing in a more effective way towards those. Much of it, the realignment that Greg talked about, of our advisors at the University of Phoenix by college versus by campus, we do expect -- we realize we do expect more efficiencies out of their ability to service students in a high quality way.

Our technology spend we have taken down pretty significantly already. A lot of that is just due to the fact that we're rolling out a lot of our system that were previously in development, which is a very expensive process, and into deployment, whether it's our learning platform or service platforms, some of our corporate back office systems like our financial and HR systems, the campus closures, which we obviously talked a lot about in the last four or five quarters, at the University of Phoenix, those are still going on. All of those areas are contributing to just additional efficiencies that the operating teams in our business have done a phenomenal job at capturing.

In terms of the future, depending on how things unfold, we feel very good that to the extent we have to lower the cost structure even more, there are capabilities and areas we can do that in. And even if we don't have to, we're going to always be very focused on operational excellence, as Greg has talked about on this call. I believe that the costs can come down or continue to come down if they need to, depending what happens with the business.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

If you look at great companies and industries over time, they continually find ways to become more efficient, And I think with Mitch, we've challenged Mitch, and Collete Temmink, our new Chief Administrative Officer, who've got great experience in these areas. Whereas there used to be 3% to 5% price, let's find that inefficiencies without taking away anything, in fact, improving the student experience. And there are ways that you do that through automation and self service and technologies that we haven't employed yet, business process simplification which is something that we're more and more focused on. So, to answer your long-term question, I think there's opportunities there.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Thank you.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thank you.

Operator

The next question comes from Paul Ginocchio with Deutsche Bank. Your line is open.

Paul Ginocchio - *Deutsche Bank - Analyst*

Thank you. Just got a few modeling questions. On the first one, it sounds like conversion in the November quarter is a little bit worse than expected. Sounds like leads were better, but new enrollment was slightly worse than the last quarter. So, does that imply conversions with slightly below your expectations in November? Thanks. Then I've got a couple follow-ups.

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, Paul, when you say conversion, new enrollments for the quarter were down 23%, as I stated. That was roughly in line with our expectations and actually our comments on the October call. So, lead --

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Paul Ginocchio - *Deutsche Bank - Analyst*

I thought you had said it was going to be the same or slightly better.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Yes, within a percent, it roughly is the same.

Paul Ginocchio - *Deutsche Bank - Analyst*

Okay, okay. So, there wasn't a weaker conversion, because you said leads were better, so I just --

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Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

And we did it by -- while taking a substantial amount of money out of marketing. Again, remember what we're going for. We want to juice that number. As I said last quarter, any -- which we will not do, by the way. In any given quarter, so it can be a little bit better. That's possible in this industry. We're not doing that.

We're focused on a longer term game plan. We're happy with where it's at right now. Our lead flow is slightly improved in the quarter from where we thought it would be. But again, lead flow is just a word. It's the quality of that, it is what results from that that we're focused on. We have the ability to influence that number, but we're going to make sure that we're doing it in a way that is consistent with our retention and long-term outcomes focus.

Paul Ginocchio - *Deutsche Bank - Analyst*

Okay. And then on persistence and revenue per student, should we -- it was a really nice persistence improvement year on year. Is that what we should expect each quarter? Will it moderate? Just maybe a little bit of color on that. Then the revenue per student fell off quite quickly. Is this -- it sounds like it's stabilizing here, it sounds like it's not going to get worse. We've got -- we sort of fully -- it's fully feathered in all the changes you made in pricing?

Brian Swartz - *Apollo Group - SVP and CFO*

Let me start with the revenue per student question, then I'll come back to persistence. Revenue per student was down 3% in the quarter. We had indicated that it would be down between 2 and 4 for the year. We still expect that. Most of that change, as I mentioned, Paul, earlier, is really related to the price synchronization of the undergraduate students at the University of Phoenix in Associates and Bachelors. Some of that is the scholarship program. So that's -- we basically came in right at the midpoint, and we expect that to continue for the next three quarters.

Paul Ginocchio - *Deutsche Bank - Analyst*

Right, Brian. So, it was -- so those -- all those price changes were fully captured in the quarter. There's no more additional incremental coming through?

Brian Swartz - *Apollo Group - SVP and CFO*

Nothing that's planned at this point, no.

Paul Ginocchio - *Deutsche Bank - Analyst*

Okay.

Brian Swartz - *Apollo Group - SVP and CFO*

And then the persistence question, we were very pleased with where Q1 came in. The persistence, as you know, is impacted by both grad, it's also impacted by level of new enrollment in any given quarter, obviously. The way we look at retention internally is on a cohort basis, the way I explained. Very pleased with the persistence number. Most of persistence improvement was not from grads, but from lower attrition in the student body, which is also good. If that continues, that would be an indicator that we're improving our cohort retention over time, which is our goal and our number one priority.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

And Paul, we don't expect a straight line there. We understand that. We've got to understand retention much better over the past several years. But I think we understand what it's going to take to get really meaningful moves. So, we consider it sort of in the first inning right now with a lot of hard work in front of us. But the goal is there and the direction is there internally, right, to execute and get this done over time.

Brian Swartz - *Apollo Group - SVP and CFO*

Paul, I mentioned this in my script. Also to help you with the modeling, because I know that's the nature of your questions. We do still expect to end fiscal '14 with roughly 230,000 students at the University of Phoenix. So, that will help put some book ends on your financial model.

Paul Ginocchio - *Deutsche Bank - Analyst*

Yes. Just finally, is there any way you could give us any color on the growth of West, either it starts by month or something that just -- something we can get a feel for what's going on there?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Yes, I would, I mean, we're all very excited about it. But the issue right now, and this is intentional, is through pilots, what we're doing is we're looking at things like the upfront fees and other areas that we're working with to just ensure before anything is turned on to a greater extent, right, that the entire process is where it needs to be so that the team there, led by Tracy Lorenz, is doing a fantastic job, feels like, okay, we're ready to go here. And we gave them that latitude from a capital perspective at the Apollo Group to make sure they're comfortable with the entire new system that they put in place, which was a big deal, to get that right first. So, I think it's coming along.

I think they're seeing -- they've seen some things that they want to tweak and change, which they're doing. And they've seen some other things that they're really happy about and pleased about. There's no doubt in my mind that when that's rolled out, that we're going to get growth at Western International University for the right reasons.

Now, it is very small with respect to the Apollo Education Group, so obviously, take that into consideration with my remarks and what's going to the needle over time. They understand the work that needs to go into it. We're very supportive. We think that with the work that we're doing centrally at Apollo Group also engaging Phoenix that frankly, the importance to us is we're going to have another opportunity and option for students who for some reason, do not want to attend the University of Phoenix. Still a lot of work going into it, and Paul, as soon as I can give you a definitive answer on the ramp, we will do that.

Paul Ginocchio - *Deutsche Bank - Analyst*

Great, and for now, those numbers aren't in the degreed enrollment, new enrollment; correct?

Brian Swartz - *Apollo Group - SVP and CFO*

That's correct. All the operating statistics are only the University of Phoenix.

Paul Ginocchio - *Deutsche Bank - Analyst*

Thank you very much.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thanks, Paul.

Operator

The next question comes from Peter Appert with Piper Jaffray. Your line is open.

Peter Appert - *Piper Jaffray & Co. - Analyst*

Thanks. So, just want to run this by you. To get to the 230 by the end of the year, we're assuming persistence could continue to be up pretty nicely. I think that would suggest that the declines in starts will remain fairly significant for another several quarters. Is that fair?

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, Peter, it's Brian. What we commented on is that we, as part of that outlook, that we'll end the year with about 230,000 students. You'll make your assumptions on persistence and retention improvements, and that we do expect the rate of decline in new enrollments to improve as the year progresses. Outside of being much more quantitative than that, that's what we've outlined is the assumptions behind our financial outlook.

Peter Appert - *Piper Jaffray & Co. - Analyst*

How about, Brian, just any help in terms of just how the phasing of it might go then?

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, we just -- we have a couple of very big weeks in front of us here, even this month. As I mentioned, the December -- for this quarter, Q2, December's our softest month of the year and roughly about 20% of just a quarterly new enrollment. We need to see how the next few weeks and couple of months unfold.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

We've got inputs, right, that we're expecting to result in data, right? But this is a big -- January's a big month. So, we're going to try to execute and deliver, and we'll update you on the next quarter.

Brian Swartz - *Apollo Group - SVP and CFO*

Peter, I do want to point out some comments that I made, just to make sure they're clear, because I know these are financial questions. My comments on Open Colleges and the impact on Q2, that business will be slightly dilutive, as I mentioned, on a GAAP basis for fiscal '14. And much of that dilution will occur in Q2, just because of the timing of acquisition costs and transaction costs. It could be $0.05 or so in Q2, which means Q3 and Q4 will be seasonally better than what we normally see at Apollo Education Group than you have in prior years.

Peter Appert - *Piper Jaffray & Co. - Analyst*

One other thing. Many questions about the cost dynamic margin implications. I think it's noteworthy, the success you've had in improving margins here in the context of how challenging the revenue environment is, obviously. I'm wondering, Brian, if that gives you some added confidence to quantify for us where the bottom end margins might be and if perhaps we've seen the bottom end margins at this point.

Brian Swartz - *Apollo Group - SVP and CFO*

It's a very good question, Peter, and it's something we talk a lot about, Greg and I and Mitch and the whole operating team. We are focused on making investments for the long term. We talked about a lot of those areas, much of -- there's a lot of investment going on. Most of our investment hit our P&L and our margin line. It doesn't end up on our balance sheet the way some other companies do. We need to see how the business fundamentals unfold, how quickly we grow some of our non-University of Phoenix subs, which clearly will impact that. We're very mindful of the margin, and our goal is to expand the margins over time.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Peter, let me say it a little differently. We've given ourselves an opportunity to have expanding margins, right? Now, we need to deliver on a going forward on our top line plan. But we've done what we need to do and continue to do what we need to do to be an efficient organization to give ourselves a much better opportunity, right, without as much top line to have improving margins. Peter?

Peter Appert - *Piper Jaffray & Co. - Analyst*

Yes. Thank you.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Okay. Thank you very much.

Brian Swartz - *Apollo Group - SVP and CFO*

Thanks, Peter.

Operator

The next question comes from Suzi Stein with Morgan Stanley. Your line is open.

Suzi Stein - *Morgan Stanley - Analyst*

Hi. I'm just wondering if you could maybe talk about how big you think Apollo Global could be five years from now. Do you imagine this becoming a much bigger part of your portfolio?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Yes.

Suzi Stein - *Morgan Stanley - Analyst*

Okay. And then if you could maybe talk a little bit, just about what you're seeing competitively? Are you seeing any notable response from students from some of the pricing actions that we've seen in the market? Are you hearing sort of qualitatively that students are not choosing University of Phoenix specifically because of some -- of what some of your competitors are doing?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

You know, Suzi, it's a good he question. Not really. Honestly, I think there are so many options for students. Many of them look the same. We did something interesting here and took every single possible communication, major communication to students and literally put them all on top of each other. And there's so much overlap, the same message, the same type of delivery, the same type of either four walls and a chalkboard or simplified online capability. These are things that 10 years ago, yes, made a big difference. We did it. But it's helped us understand where we need to differentiate and how to get a message across differently that we think can help us make a difference going forward.

But as far as price is concerned, in itself, it's one variable. I think you have to be in the game on price, right, especially right now when we're hopefully recovering in the US. But again, we look at that as an option to serve students differently. If you look at how many different models there are in the US with colleges charging up to $100,000 a year in some cases, down to $50 a credit hour at some community colleges, maybe the product isn't very good or the service isn't very good down there. But there are some people that that appeals to, they just want the rock bottom price.

We've got a couple of different ways in the US now to serve the market, although one of them, as I said earlier, we still have to turn on fully, and we're getting there. We've got some ways to serve corporations that are good partners of ours globally where we've learned things about price in different markets. The price in the UK for us is very different than the price in Mexico, which is different than the price in India and some of the other markets that we're working on, like Australia. We need to be in the game, but I don't think it should be a reason why, just because someone puts a promotion in place, right, or does something dramatic for a short period of time, that it means that the University of Phoenix can't compete for the student that they want. More than anything, reputation matters, and that's what we're trying to build to the level we think that University of Phoenix deserves to be at, along with all of our institutions.

Suzi Stein - *Morgan Stanley - Analyst*

Thank you.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thanks, Suzi.

Operator

The next question comes from Trace Urdan with Wells Fargo.

Trace Urdan - *Wells Fargo Securities, LLC - Analyst*

I really do have to say thank you for taking my question. You guys are troopers. I wanted to go back, just with my first question, I wanted to go back one more time to this question about the improvement that you guys are seeing starting in December. And if you think about it as a combination of the market, a combination of sort of your message resonating with the market and then some amount of improvement in techniques that always happens sequentially, and keeping in mind, Greg, your comment about not doing the cheap and dirty and grabbing up leads that aren't going to be the ones you want.

What do you think is going on out there? Do you feel like the message that you've been communicating is starting to seep in and resonate, or do you feel like the market's coming back? To what do you attribute the improvement and how much visibility do you feel like you have into that kind of inflection? And I know you've been asked this four or five times already.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Yes, no, look, you for a long period of time have been out to a lot of schools and in a lot of classrooms and done a lot of diligence. The marketplace to me feels like it will improve some with the economy. I know it always used to seem like the opposite. But there was such a dramatic period of time when the headlines were how much debt was out there and presidential candidates talking about 50% plus can't find jobs. And then the majority of institutions in the United States of America really weren't focused on your solid career. While you were in school, it might have been a resume writing program.

So much that's going on and changing that I feel like for us, it probably isn't the market at this point. It's probably some of the things that we're doing. But it's early innings for us, which is good and bad. I'd like to see more right now, but I think what we try to do is figure out, what do we need to be reputationally? Where do we need to be positioned? How do we need to live alongside corporations and then in the B to C land. How does it tie in to be a global partner? Those are things that can differentiate you, really, in the marketplace.

It doesn't happen overnight. It's not a present to Wall Street in one quarter. You make the investments you need to, and it happens over time. I feel like we're focused on the right things to be able to drive improvements. Maybe not even quarterly, but certainly annually and over time, in that front end enrollment number. We have intentionally not pushed and pushed and pushed up front to show you a certain amount of improvement in any given quarter. You know that's possible in this industry, but what we want to do is put a great product in place.

We want every college at the University of Phoenix to understand their marketplace, their competition, demand capital dollars for capital and investment because they see great opportunities, know every corporation and partner out there that's important to them. The programs that they need to have in place, the employment opportunities, be talking to customers and to students every single day of the week. It's a new day for not only Phoenix, but our institutions, and we're learning from each other globally. So, that's a long way of saying, I'd love to tell you it's just the marketplace or it's one or two things we're doing. I think at the end of the day I'm being honest with you, we've got to put, and we are in the process of trying to put, a great product that's competitive into the marketplace. Not just on price because that's the only way to compete.

Trace Urdan - *Wells Fargo Securities, LLC - Analyst*

I completely appreciate that. And I am a big believer in the long-term ability of that product that you describe to own a substantial part of the market. My question has more to do with the fact that you guys see some gradual improvement in the starts through the end of this year. And I'm trying to figure out what it is that you're seeing that is driving you, A, to have enough confidence to give us a year-end target, and is it tactical? Is it the stuff that you're doing mechanically that you can see is starting to work better so you feel like, okay, I can count on that? Are you hearing from your students when they many come in, like, yes, where are my red socks? I want to be part of that network, I want in. I'm trying to get a little bit of comfort with your comfort.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

To be honest with you, I think it's components of all that.

Trace Urdan - *Wells Fargo Securities, LLC - Analyst*

Okay.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

It's a little bit of everything that we're doing. None of us are satisfied with it, because we know there's a lot more to do. But I -- we've been working hard over the past couple years to try to reposition the brand, and there's a little bit of that eking out. There's a little bit of it as all these corporate relationships we've been building, you know what? They're sending us more students. There's pieces of it and components that I think, just to answer your question more specifically, I see what you're after now, that matter and that are playing into it. I just -- we're trying to be very open and honest that, it's early and it's not enough to go on to call a specific direct, this is what it's going to be by the end of the year. But we're pleased with the direction that it's going.

Trace Urdan - *Wells Fargo Securities, LLC - Analyst*

Okay, last question. You know that we hate to lose metrics here as you guys consolidate the degree reporting. I'm wondering if it's a process of holding management accountable for performance by school, whether you might start to think about breaking your enrollment or your financials down by that measure maybe, by something else that gives us a little bit of insight?

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Trace, it truly isn't -- there's no coverup here. It's not how we will manage the business going forward. We don't say we're going to put so many dollars into -- we want this many Associates, this many Bachelors or this many Doctoral students. And there has been a very significant realignment at the University of Phoenix. We will, of course, always provide the new enrollments, total enrollments, color around retention, and we'll, even if there's questions about it, try to provide color around, if you want it, if it's important, how's Associates versus Bachelors, nobody else does it. But we'll be glad to try to provide some color. It's just the tables and the charts and whatnot, yes, we are rethinking that piece of it and disclosure going forward, but we'll always try to be transparent and helpful on what's happening within the business.

Trace Urdan - *Wells Fargo Securities, LLC - Analyst*

Since it sounds like you're going to be holding management accountable by college, it would be great if we could get a little bit more insight into what those colleges look like, because I'm not sure we have that.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

We appreciate the thoughts there.

Trace Urdan - *Wells Fargo Securities, LLC - Analyst*

Okay. All right. Just my advertisement over with. I'll let you go. Thank you.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thanks, Trace. Appreciate it.

Operator

The next question comes from Tim Connor with William Blair. Your line is open.

Tim Connor - *William Blair & Company - Analyst*

Thanks, I think I might be betting nine, so I'll keep it quick. With regard to the breakout of new enrollment by degree, it looks like Masters new enrollment trends were a little weaker than last quarter. Any specifics on why and then any consideration to increasing scholarship usage in this area?

Brian Swartz - *Apollo Group - SVP and CFO*

Yes, it's Brian. It was a bit weaker year-over-year than it was in the last year. We actually do have a scholarship program that's available to certain partners, corporate partners at the Masters level, the graduate level, but the broader based scholarships that we talked about are really available at the undergraduate level. The University of Phoenix team will constantly look at that, and if they think it makes sense, we'll certainly be talking about it. As of now, there aren't any specific plans for a broader rollout at the graduate level, but obviously the graduate students are an area of focus for us as well.

Tim Connor - *William Blair & Company - Analyst*

Okay. Thank you.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

Thank you.

Operator

There are no further questions at this time. I'll turn the call back to our presenters.

Greg Cappelli - *Apollo Group - CEO, Apollo Education Group*

All right. Thank you very much, operator. I want to thank everybody for taking the time to participate in this call. We are looking forward to talking with you and updating you again next quarter. I would like to thank all our employees for their tremendously diligent and hard work through a year which we're seeing a lot of exciting change within Apollo Group, both domestically and globally. And again, look forward to talking to you all and seeing you all, some of you soon. Thanks so much.

Operator

This concludes today's conference call. You may now disconnect.

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