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APOL - Q2 2014 Apollo Education Group Inc Earnings Conference Call

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## OVERVIEW:

APOL reported 2Q14 revenues of \$679m and income attributable to APOL of \$14.6m or \$0.13 per share. Expects 2014 net revenues to be \$3.0-3.1b.



## CORPORATE PARTICIPANTS

**Beth Coronelli** *Apollo Education Group Inc - VP IR*

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

**Brian Swartz** *Apollo Education Group Inc - SVP and CFO*

## CONFERENCE CALL PARTICIPANTS

**Jason Anderson** *Stifel Nicolaus - Analyst*

**David Chu** *Bank of America Merrill Lynch - Analyst*

**Suzanne Stein** *Morgan Stanley - Analyst*

**Corey Greendale** *First Analysis Securities - Analyst*

**Paul Ginocchio** *Deutsche Bank - Analyst*

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

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

**Jeff Volshteyn** *JPMorgan - Analyst*

**Jeff Silber** *BMO Capital Markets - Analyst*

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

**Tim Connor** *William Blair & Company - Analyst*

**Phil Stiller** *Citigroup - Analyst*

## PRESENTATION

### Operator

Good afternoon and welcome to the Apollo Education Group's second-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 the queue until those instructions are given.

(Operator Instructions)

This conference call is being recorded today, April 1, 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 April 18, 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 7777523.

I would now like to turn the call over to Beth Coronelli, Vice President of Investor Relations. Mrs. Coronelli, please go ahead.

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**Beth Coronelli** - *Apollo Education Group Inc - VP IR*

Thank you. Thank you for joining us today to discuss our second-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 second-quarter financials and outlook. As we discuss our results today, unless noted otherwise, we will be comparing the second quarter of FY14, which ended February 28, 2014, to the second quarter of FY13.



I'd also like to remind you 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 contained in our quarterly reports and Form 10-K for FY13 filed with the SEC, which is available on our website at [www.Apollo.edu](http://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 be supplement but not substitute for the most directly comparable GAAP measures. Our press release, which contains the finance and other quantitative information to be discussed today, as well as a reconciliation of the GAAP to non-GAAP measures, is also available on our website. And with that, I will turn it over to Greg.

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

Alright, thank you, Beth. Good afternoon everyone. Today I'll share an update on our long-term strategic plan that's centered around differentiating University of Phoenix and all of our academic institutions, diversifying Apollo Education Group, and driving operational excellence throughout the entire Organization. I'm pleased to report that we continue to make progress in each of these areas so far in FY14.

But before I go further into that progress, let me just quickly review our financial results. In the second quarter we reported revenue of \$679 million and EPS of \$0.13 per share, or \$0.28 per share excluding the special items. We ended our second quarter with new degree enrollments at 32,500, that's about a 16.5% decrease over the prior year, and 250,300 in total enrollment, also down about 17% year over year. And although we are first and foremost focused on improving retention and outcomes, compared to the prior quarter we did see about a 600 basis point year-over-year rate of improvement in new enrollment decline, and we expect to get some additional improvement by the end of the fiscal year, and Brian will talk a little bit more about that in his section.

Now let me move into the progress we're making on our strategic plan. First, we do believe that in order to have long-term success in higher education today, we need to be able to effectively answer the question, why would somebody choose to enroll in University of Phoenix or any of our institutions at Apollo. Why would the largest employers in the world want to partner with Apollo Education Group to help solve their global human capital needs? It's not a simple one line answer to give you, but we strongly believe that one of the keys to attracting and retaining quality students is to ensure that we're providing a differentiated, modernized for today's economy and career-connected education that's aligned to the needs of both students and employers.

And here are a few examples of how we're getting there. First, we absolutely must continue to build strong relationships with the best employers globally. We are now approaching 3,000 relationships with corporations that trust Apollo Education Group to help educate and train their employees. Our goal is to better tailor our academic programs to address their human capital needs. Over the past quarter our teams have met with industry associations, leading companies, and thought leaders to explore opportunities to improve our educational offerings.

We're committed to helping employers as they work to hire engaged employees with the skills to fill their mission critical positions. I personally had the opportunity this past year to meet with CEOs and Senior Executives from coast to coast, and it's very clear to me that many still believe that educators in this country generally don't take the time or the initiative to understand their needs at different levels of their organizations. We're going to be trying to lead in this area going forward.

On the consumer side, our goal is to offer an academic experience that strongly resonates with students; it supports their career goals and provides the tools to help ensure they succeed. Now, as an example, we're adding about 20 new mostly certificate based programs in April at University of Phoenix alone, and plan to roll out approximately another 25 new programs by year's end. We've also recently launched 15 programs globally, including a new dentistry program at BPP.

Consistent with our effort to adapt to student-employer needs in the fastest possible manner, University of Phoenix is being realigned by individual college. This change allows the University to provide outstanding service, modernized curriculum, and excellent support to students to help them achieve their career goals. This has been one of the largest undertakings in the history of the University. Thousands of employees have been

retrained to support the new structure, and while it has without a doubt had some impact on near-term enrollment metrics, we're convinced that it will lead to a more competitive University going forward. Most importantly, we expect it to help achieve our number-one goal to significantly improve student outcomes over the next several years.

Each college will now be led by an Executive Dean in partnership with an Academic Dean. The college leaders are accountable for academic quality, retention, ensuring our programs connect to careers, fostering innovation, and creating an enhanced student experience. I'm pleased to say that we are seeing early signs of incremental improvement in persistence at the University of Phoenix. Persistence in the second quarter was up 90 basis points over the prior year, and up even more if you exclude the impact from graduations.

While this is a step in the right direction, we certainly understand that this is going to take a sustained effort over the next three to five years to hit our goals. There are sure to be some fits and starts along the way but we're totally committed to supporting this critically important initiative going forward. To lead this charge, as announced earlier today, the University of Phoenix Board of Trustees has named Tim Slottow as the new President of the University, effective in June. In the time I've gotten to know Tim, I'm confident with his experience in both public and private organizations, including his experience and tenure at the University of Michigan, he will serve as a strong leader in our efforts to continue to build upon the legacy of Dr. John Sperling. We're honored to have Tim as part of the University of Phoenix and the Apollo family.

Diversification is another key focus of our strategy, which for Apollo Education Group comes through Apollo Global, College of Financial Planning, Lightspeed, the Institute for Professional Development, and Western International University. During the quarter we continued to extend our reach through Apollo Global, while also continuing to improve operationally at Global.

I'll just comment on a few of the highlights this past quarter. First BPP in the UK, that's our largest Apollo Global sub, saw solid intakes this quarter, and we expect BPP will move to profitability this year. Also as we continue our focus on outcomes, our students have had great results recently in the BPP tax and accountancy segments.

Twice a year there are major exams completed for the Certified Investment Management Analyst certification. There are nine major modules and the students are judged nationally in the UK. BPP students had the highest test results in eight of the nine modules in the past test results, as judged against all CIMA certification providers in the UK.

In other areas of BPP we have increased our international recruiting for all schools. We expect to end the year with 12 times the number of international students we had three years ago. Also in the BPP Business School, the curriculum has been redesigned to align with employer needs. We expect revenue in the Business School to increase by approximately 30% this year.

Let me just switch to Mexico, our school ULA continues to lead all of our institutions with the highest retention gains throughout our system over the past few years. And we're incorporating some of the learnings from their initiatives into other areas of Apollo. We recently opened our 10th new center and expect to increase our working learner program by over 50% this year. And while still a relatively small program compared to our domestic business, we're encouraged by the response from students.

We're also pleased to report that it was announced today that ULA was awarded the University of Excellence designation, the highest possible level of accreditation awarded by the Mexican government. We're proud of the ULA team for all their outstanding efforts.

In Chile we're adding online programs to our traditional arts and communication school. Also, we expect to increase the revenue of our online technical education by about 40% this year.

Open Colleges Australia joined Apollo Global in December and the integration is going well. It's exceeded our early performance expectations by growing well into the double digits. Serving working learners there's a significant growth opportunity in the Australian education and training market, and with the strong team at Open Colleges, we're pleased to have them as part of the Apollo Global network.

Very quickly on India, Global's opened up two new locations so far this year and early indications are that we should be able to grow in this large and exciting market for years to come with our partner, HT Media, and we'll certainly keep you updated there.



We also see multiple opportunities to expand the Global network in other key geographic regions with rapidly growing education systems such as Asia, Africa, and South America. We're committed to using our capital only where we see the highest long-term returns for our shareholders.

Additionally as part of our diversification efforts, we're pursuing new opportunities for growth in higher education. We recently launched a new and exciting offering called Balloon through Apollo Lightspeed. Balloon is a global skills and learning marketplace. It's designed to connect employers, job data, course providers, and learners through an efficient supply chain.

We currently have nearly 15,000 courses from a variety of providers and a database of 146,000 career listings. Individuals are able to connect to online learning to acquire skills valued by technology companies. As this is an early stage start-up, it obviously comes with a greater degree of volatility and risk, but we're taking prudent steps prior to infusing additional capital in this area. And I must say that since launching Balloon we've received many inquiries from both individuals and employers as to how they can get involved. So we're excited. We're cautiously optimistic about the future of Balloon and excited about the future.

And just a final component of our strategy is driving operational excellence. This is something that can sound easy when you say it but it's very difficult to properly execute, and Apollo has enjoyed over three decades of rapid growth prior to the industry going through a pretty large change in the past few years. Our team has worked relentlessly to reshape Apollo operations, moving from an inefficient cost structure where changing course or strategy came slowly, to one that is now far more nimble, it's efficient, and effective, and poised to effectively compete in this rapidly evolving industry.

We have significantly reduced non-variable cost throughout all of the Apollo during the past couple of years. We're working to reduce cost on the front end while increasing investment in certain key areas of our academic institutions to improve the student experience. These areas include adaptive learning, new degreed and certificate based programs, and our new modernized and significantly upgraded online classroom, just to name a few.

Another area of focus is marketing where we are significantly reducing our total spend in FY14 in areas that we feel are really non-core now to Apollo or University of Phoenix. With that said, our lead flow has actually been running above our internal plan so far this year, and our cost per lead is down very significantly this fiscal year as well.

Financial aid is an area where we have an opportunity to significantly modernize and simplify the entire process at University of Phoenix. This has been a cumbersome, long, and manual process which has negatively impacted the student experience. We're in the process of building out a significantly easier to use platform for our students that will be streamlined and much more efficient for the University to administer. We expect the number of steps in this process to literally decrease by over half. While these changes increase efficiency, most importantly they improve service and are intended to increase student satisfaction.

We aren't just making the financial aid system easier, we've also invested in ensuring students are much more financially aware before they take on any debt, including our own built-in version of gainful employment which is already in place and helping students today. While financial aid is one example of our initiatives, Brian will provide additional financial detail on our overall efforts, which combined as compared to the 2012 cost base, are expected to result in non-variable cost savings of a minimum of \$675 million through the end of FY14.

Finally, I want to highlight a couple of issues on the legal and regulatory front. As we disclosed in our 10-Q today, we did receive a subpoena from the Office of the Inspector General from the Mid-Atlantic region seeking information relating to the northeast region of the University of Phoenix. As we've done previously, we intend to fully cooperate with the OIG in this case. In my opinion, Apollo now has some of the best legal, regulatory, and compliance personnel in the industry who give me confidence in our ability to operate properly and ethically in the higher education industry, not only domestically, but internationally as well.

Finally, regarding gainful employment. We share with the Department of Education the goal of ensuring students receive a quality education for their investment, and are fundamentally committed to providing appropriate student protections, including transparency which supports informed decision making. We're supportive of thoughtful and consistent policies and regulations that seek to protect students, but we do take issue with certain parts of the rule that could lead to unintended consequences if not further revised. As we did last time, we will continue to voice our



perspectives in a constructive manner on gainful employment and work with the administration to encourage the regulations apply equally and equitably to all students at all institutions.

To close, we're confident in our strategy. We're making significant progress to realign the focus on delivering differentiated career-connected offerings. We're also making meaningful strides to diversify Apollo Education Group and to build a more nimble organization centered on a culture of operational excellence. With that, I'll turn the call over to our CFO, Brian.

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Thanks, Greg. And good afternoon everyone. Today I plan to review our second-quarter financial results, provide a few other updates, and then share with you our updated business outlook for 2014.

During the second quarter, we reported revenue of \$679 million, down 19% year over year. The decrease was primarily the result of a 17% decline in enrollment at the University of Phoenix to approximately 250,000 students. For new enrollments, the University reported a year-over-year decline of 16.5% to 32,500 students, which as expected improved from the rate of decline in the first quarter.

Second-quarter revenue per student was down 5.6% year over year, primarily related to University's pricing initiatives, increased use of targeted discounts, and the timing of new enrollments to the latter half of the quarter. We expect FY14 revenue per student will be closer to the higher end of the previously provided range of negative 2% to 4%. In the second quarter, the University's discounts as a percentage of revenue were approximately 9%, and we expect it to remain at about the same level for the rest of the year.

In the second quarter, income attributable to Apollo was \$14.6 million or \$0.13 per share. Excluding special items which included restructuring, acquisition, contingent consideration and litigation charges, along with a tax benefit, our net income was approximately \$32 million and our EPS was \$0.28 per share. Additionally, our operating margin was 6.4%, compared to 8.1% in the prior year. Excluding the Open Colleges acquisition, the operating margin would have been about 8% this quarter, and I'll talk more about the Open Colleges acquisition in a few minutes.

Turning to our operating expenses. In the second quarter, as expected, we experienced year-over-year declines in all expense line items, excluding special items. As a reminder, our variable expenses are roughly 14% of revenue. The decreases in our operating expenses were primarily driven by savings from our ongoing cost optimization and restructuring activities. We expect to continue to decrease our 2014 annual non-variable operating expenses by a minimum of \$325 million from our 2013 cost base. For initiatives announced to date, excluding future interest accretion expense associated with leases at our closed facilities, we expect to incur roughly \$10 million of additional restructuring charges over the next several years as we vacate the facilities.

In the second quarter, we reduced our non-variable operating expenses by roughly \$110 million. And in the first half of 2014 we have reduced these costs by over \$250 million. The remaining estimated cost savings are expected to be realized fairly equally between the third and the fourth quarters of 2014. I do want to point out that due to the acquisition of Open Colleges, we expect to see some additional shift in the overall Apollo Education Group profits from the third quarter to the fourth quarter, which is primarily a timing issue this year and should normalize in future years.

While our total non-variable operating expenses were essentially flat during the first and second quarters of 2014, we anticipate these costs in total dollars to increase slightly on a sequential basis during the second half of the year. Again, this is due to the addition of Open Colleges as well as realizing a full year of savings associated with the University of Phoenix campus closures, which ramped in the second half of 2013. Additionally, we are continuing to invest to improve student outcomes and completion rates as well as achieve diversification at Apollo Education Group. Having said that, we continue to expect to see year-over-year decline in all expense line items in the second half of the year, with the exception of depreciation and amortization, which I'll talk about in a moment.

With respect to general and administrative expenses, second quarter decreased year over year, and we expect this trend to continue in the second half of 2014 as we continue to manage resources and gain efficiencies in our technology function. Bad debt expense as a percentage of revenue was 1.7% in the second quarter. For FY14, we expect our full-year bad debt expense as a percentage to revenue to be about 2%.



Now regarding depreciation and amortization. In the second half of 2014, we expect this line item to be higher year over year and higher than the first half of 2014 due to the amortization expense of about \$10 million associated with the Open Colleges acquisition. This will be partially offset by reduced depreciation from the closure of the University of Phoenix campus and administrative facilities.

With respect to the second-quarter income taxes, we have pretax income of \$5.9 million and recorded a \$6.3 million benefit, primarily due to a settlement with the IRS. For the remainder of the year, excluding special items, we expect our tax rate to be about 42%.

Turning to our balance sheet and cash flows. We continue to maintain a well-capitalized balance sheet and generate healthy cash flows. At quarter end, unrestricted cash and cash equivalents and marketable securities with an average maturity of less than a year, totaled approximately \$916 million. Our free cash flow for the second quarter was \$41 million, compared to \$67 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 continue to expect our free cash flow for FY14 to be negatively impacted by cash outflows from our restructuring activities of approximately \$90 million, or about \$30 million more than what it was in 2013. Despite the restructuring activities we're incurring now, we do expect to remain a very capital-efficient business, and in fact anticipate capital expenditures in 2014 as a percentage of revenue to be about 3%.

Before moving to our business and financial outlook, I'd like to update you on a couple of things. First, to provide some additional commentary with respect to Apollo Global's second-quarter financial performance and the Open Colleges acquisition. As a reminder, the Apollo Global segment includes the results of our BPP, ULA, and UNIACC operations, as well as Open Colleges, which we recently acquired in December.

Excluding Open Colleges' financial results and the impact of special items associated with the acquisition, we have substantially reduced Apollo Global's operating losses in the second quarter and year-to-date periods. We expect this trend to continue as these institutions are performing well.

We were pleased with Open Colleges' operating performance to date. In January and February, Open Colleges began its seasonally highest student enrollment period and they exceeded our initial expectations. We are excited about the market opportunity and its potential for long-term growth.

In the second quarter we finalized the purchase price allocation for Open Colleges. As a result of amortization expense and adjusting to US GAAP revenue recognition standards, we expect Open Colleges to be slightly dilutive to GAAP-based earnings in FY14 and likely through 2015. Now, it's important to note that what isn't impacted here is Open Colleges' cash flows, which is what we focus on from an operating perspective. We continue to expect Open Colleges to generate positive cash flow and cash flow growth going forward.

I would like to reiterate what I mentioned earlier, that during the next two quarters due to the acquisition of Open Colleges we expect to see some additional shift in the overall Apollo Education Group profits from the third to the fourth quarter, which is primarily a timing issue this year and should normalize in future years.

Moving on. Second, I'd like to talk about cohort default rate. I'm pleased to announce that the University of Phoenix draft 2011 three-year cohort default rate, which was just recently released by the Department of Education, declined 700 basis points to 19% from the prior-year rate of 26%. The 2011 three-year CDR is expected to be finalized in September of 2014. The success we are having in this critical area is due to many factors, including our commitment to and efforts around student protections, financial transparency, financial literacy training, and student orientation, just to name a few.

Based on this data, we anticipate the proposed programmatic CDR information used by the Department of Education to measure gainful employment to also benefit when the 2011 data is finalized. Overall, we're pleased with the progress here and we'll continue to work to improve in this area.

Now I'd like to spend a minute on our business outlook. Greg has already commented that student completion and student outcomes are our absolute top priority, and we will continue to drive improvement with many important initiatives focused on this key area.



With respect to new enrollment for the University of Phoenix, the rate of decline was down from the first quarter to the second quarter, and while we expect to see continued improvement by the end of the fiscal year, it's too difficult to predict whether that will happen during the third or fourth quarter, given the recent realignment by college at the University of Phoenix. I would like to reaffirm that we continue to expect to end the year with about 230,000 total students at the University of Phoenix.

Furthermore, we are maintaining our existing 2014 financial outlook, which is net revenue of \$3 billion to \$3.1 billion, and operating income excluding special items of \$400 million to \$450 million. With that, let me turn the call over to the operator to open the line for your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

The first question comes from Jason Anderson with Stifel. Your line is open.

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### Jason Anderson - Stifel Nicolaus - Analyst

Good evening, guys. Just a question on the new volume. Is there any way you could give us some color on the trends between your corporate side of the business, maybe your non-affiliated, even in some general color?

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### Greg Cappelli - Apollo Education Group Inc - CEO

Yes, sure. They're actually quite strong on the corporate side of the business. We keep adding good relationships every quarter and we're focused on with those sort of pipes being put in place to our corporate partners, which is terrific for us on the one hand because they're very supportive of the University of Phoenix and our schools.

But second, now what we're doing is we're working with them to understand how we can do more for them, aside from degree granting programs, which we are currently working with them on. Those are areas that range from certificate based programs to other kinds of training initiatives that they need to stay in the Apollo Education Group system as we work with them for their needs.

On the noncorporate side, our trends are improving but clearly not as strong, nor would I expect them to be right now, with the B2B side of the business.

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### Jason Anderson - Stifel Nicolaus - Analyst

And I know you don't typically do this. Any way you could give us some color on what percentage corporate is in total?

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### Greg Cappelli - Apollo Education Group Inc - CEO

We're looking at ways that we can do a better job of providing information on that as that grows to some size here. We don't have it right now for you to disclose but we're going to be working with ways to try to do a better job of that going forward.

**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Jason, it's Brian. It does continue to grow, and obviously we continue to add corporate accounts and the number of students affiliated with corporate accounts, but any further information we'll continue to work on and discuss in the future.

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**Jason Anderson** - *Stifel Nicolaus - Analyst*

Great. One more and I'll turn it over. But on the cost per start, it looks like you were flat to maybe down this quarter. Should we anticipate that continuing through the year?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Yes, there's a couple of things impacting that. First of all, at the University of Phoenix, because we continue to diversify and obviously now have the Open Colleges acquisition, in the consolidated results you obviously have the cost for the entire Apollo Education Group, yet we report the operating metrics solely for the University of Phoenix. So at the University of Phoenix level, what I can tell you is that they have continued to improve the cost per start, marketing, and admissions advisory, total cost per start.

At the Apollo Education Group, because of the timing of when certain expenses hit in some of the other businesses, you may not see as much of improvement, but it does not mean we're not making improvement at the core business, University of Phoenix. So hopefully that's helpful.

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**Jason Anderson** - *Stifel Nicolaus - Analyst*

Great. Thanks.

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

Thanks a lot.

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**Operator**

The next question comes from Sara Gubins with Bank of America-Merrill Lynch.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

This is David for Sara Gubins.

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

Hey, David.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

Can you tell me what lead flow and conversion rates looked like in the quarter?

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

Our lead flow has actually been pretty consistently strong, given our budget, where we put it this year. As I mentioned, we took a significant amount out of marketing. Again, consistent with our plan. I've been pleased with that.

What I would say is that there's going to be a little catch-up time and we knew this going into it with a very significant realignment to the college-based model at the University of Phoenix. Just a large number of people that have been repositioned, that have new bosses, that have jobs that might be more comprehensive than they were before, were repositioned or realigned. And we know that that will come with time. But all in all, pretty happy with the productivity of our enrollment advisors as well as the lead flow to this point.

I'll just say this as clearly as I can. We, as I've said in the past few quarters, our first and foremost primary goal is to improve retention and outcomes at the universities that we own so that when lead flow and enrollment on the front end does grow again, that we're retaining them for a much longer period of time. That will be number one, very good for the students, our reputation, and very good for us and our shareholders as well from a financial standpoint. So we know it will come, but we're working according to our plan through the pieces of the puzzle that we're putting in place.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

Okay. Thank you. And can you give us an update on starts by degree level?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Yes. Obviously we no longer report that as we talked about last quarter. What I can tell you is the trends that we had expected as a result of the pricing changes that we announced last fall continue. The Associates are down significantly, well into the double digits. And actually Bachelors are up in the high-single digits. So the trend did continue as we expected or developed as we expected, and that's why we stopped reporting by degree level.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

Sorry. Starts were not up double digits in Bachelors, right, they were just down less?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

No, they were actually, for Bachelors, they were actually up.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

They were up. Okay.

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Yes.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

Sorry, did you give a range?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

No, again, we're not giving the separate degree level reporting anymore but I can tell you, as I indicated on the last call, we thought Associates would go down dramatically which it did and Bachelors actually went up this quarter.

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

We're just not running the business -- we don't build the categories for revenue and expense, excuse me, and marketing as well, around trying to hit a certain number for each degree type category.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

Okay. Sure, sure. And last question. So retention improved but not as much as like the first quarter. I know you warned that it could be lumpy. Is there anything worth throwing out here --

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Actually, that's not a correct statement. Don't confuse persistence with retention.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

Sorry, persistence, right, right. How did retention look relative to 1Q?

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

Actually, persistence was up 90 basis points and retention was up considerably more than that.

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Just to give you a little more color on that too, persistence was up 90 on a per calculation if you exclude graduates. As Greg commented on this in his script, if you exclude the impact of graduates in that, it was actually up more than 90. And it would have been up more than it was in Q1 excluding graduates. So the trend's going in the right direction.

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

I want to be a little bit careful with that. We said last quarter I'm not expecting a trend completely up and to the right. There will be some fits and starts with it. But a very primary goal for us is to make very meaningful improvements over the next three to five years in retention and outcomes.

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**David Chu** - *Bank of America Merrill Lynch - Analyst*

Okay.

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

You can't just say that. You literally have to organize the Organization around that. Does that help answer your question? Operator?

**Operator**

The line is closed. I can reopen it if you'd like.

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

I think we opened -- hopefully we answered his question. I don't know why he got cut off. But if he has another question he certainly is welcome to come back into the queue.

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**Operator**

Our next question comes from Suzanne Stein with Morgan Stanley. Your line is open.

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**Suzanne Stein - Morgan Stanley - Analyst**

Can you talk about what you're seeing competitively in terms of pricing and just how you're thinking about your longer-term strategy on pricing?

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

Yes, absolutely, Suzi. It is absolutely part of the price value equation that we look at, the overall value to a student, and we constantly look at that. So our folks are in market evaluating price by program but also what we offer.

So if we're offering a certain level of service and it cost a certain amount of money to -- or expense in our case to offer it, we have to make sure that students value that, and that they want that. And we think that we're making progress in price, value. We have made some adjustments, you're aware of those over the past year, but we are studying it constantly. It does matter.

But there's just a whole number of other pieces in that value equation for students that we know from research that also matter, and that is first and foremost they want to know upfront that we're going to help them build a roadmap to connect whatever education they're getting to a career. They want to know that there's corporate relationships and employer relationships for us on the other end that are not only supporting us but helping ensure that our curriculum is modernized and where it needs to be so they don't need to be retrained.

I think what they really would like is to get value along the way so not to have to wait two, four, six years before they get their degree, which is completed, and then can say, look, I now have this value. That's why the thoughtful people at the University of Phoenix started to build the certificates that stack into degrees, and you'll see more and more of those come out. I think it's not as easy as just saying hey, we're going to put the price here and see if we get some results. It's part of the overall equation, but it's an important part and we will continue to ensure that we're being competitive in that area.

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**Suzanne Stein - Morgan Stanley - Analyst**

Okay. Would you be able to give some more detail on the certificate programs? Are these cash pay? What's the average revenue per student? What do you expect as far as persistence? What's the cost of acquiring them? Just something to help us better understand this part of the business.

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

Suzi, we're not giving that out this quarter. I do feel like it's a competitive area for us and that we are doing some really neat things there. What I will tell you is that we will try to give you a bit more detail going forward as enrollment in those certificate areas grows, which I think it will. I expect as we get more volume through them that the retention will be better in them, because you can see the light at the end of the tunnel.

And it's very clear the amount of work you have to do to have success in these types of programs, very clear that they tie into degrees and in some cases exactly what employers are looking for. So we'll try to be a bit more helpful going forward as they get in place and we get some volume through.

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**Suzanne Stein** - *Morgan Stanley - Analyst*

Okay. Can you comment on the subpoena that was disclosed?

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

Yes, absolutely. All I can say is that we received it. There's some language in the 10-Q that's very clear about it. It was for a region of the University of Phoenix. And it's with respect to the northeast. And it asks for information related to marketing, recruitment, enrollment, financial aid, the things that we would expect to get asked about in terms of the entire process of that area of the country. So we're going to -- we've got great people here. We're going to do what we need to do to comply and move forward.

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**Suzanne Stein** - *Morgan Stanley - Analyst*

Great. Thank you.

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

Thank you, Suzi. By the way, just to be clear, it goes back to 2007.

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**Operator**

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

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**Corey Greendale** - *First Analysis Securities - Analyst*

Good afternoon.

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

Hi, Corey.

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**Corey Greendale** - *First Analysis Securities - Analyst*

I'd like to understand a little bit better some of the implications of going to a structure where each of the colleges is managed separately. First of all, from a marketing standpoint, is marketing still managed centrally, and is messaging going to be different by college?



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

Yes, good question. Apollo marketing is centralized. And we have very capable people in that area and that role is up to Mitch Bowling, our Chief Operating Officer.

Now, the colleges themselves have marketing expertise within them and certainly will work with centralized marketing to make sure they're getting all the power of the Apollo Education Group behind them, with the relationships on a bigger scale, the global relationships.

But the whole key to this is for them to be more competitive, more modernized, more precise for what students are looking for, to always know what the employers are looking for and make sure that it's consistent with the curriculum that they are developing and putting into the marketplace, to know their market share, to understand their competitors to a T, and to deliver a great experience for a student. There is no hiding by college under one banner at University of Phoenix.

We've got great people that are in those positions. Bill Pepicello has done a great job in helping put this structure together. And we are very thankful for the work that he's done with his team. And we expect Tim to continue on that work as he comes in from University of Michigan.

**Corey Greendale** - *First Analysis Securities - Analyst*

And since you're obviously getting a lot of traction and expect to do a lot more on the employer side, one can envision if for example you're working with a large hospital system that there would be relevance to your healthcare school, the business school, the IT school, do you have like multiple people calling on different people at each organization or how are you coordinating that?

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

It is very well coordinated. There was a lot of research and a lot of work and a lot of thought put into this realignment before it was done. We knew that there would be some temporary disruption. We knew that we would need some people with capabilities that we didn't yet have in the system that have been and are continuing to be put in to the Organization.

So there's a lot of coordination. There won't be -- to answer your question directly, no, there shouldn't be confusion about who has the responsibility and the accountability. So in your example, which we actually have a real life situation like this where there is a healthcare system that the School of Nursing deals with and that should be a well coordinated initiative from the Executive Dean and the Academic Dean that are both in place working together. Does that answer your question?

**Corey Greendale** - *First Analysis Securities - Analyst*

A couple quick numbers questions for Brian, and I apologize if I'm not understanding this, but the \$10 million amortization of Open Colleges, is that \$10 million over the six months, the back half of the year, or \$10 million per quarter?

**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

It's \$10 million over the second half of the year. And there's some disclosure that would be helpful as well, Corey, you can read in the 10-Q that lays out the full impacts in future years as well on all the amortization expense from Open Colleges.

**Corey Greendale** - *First Analysis Securities - Analyst*

Okay. And then when you said the high end of their range revenue, I think you meant closer to negative 4% revenue per student?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

That's correct.

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**Corey Greendale** - *First Analysis Securities - Analyst*

Okay. Great. Thank you.

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

Thanks, Corey.

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**Operator**

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

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**Paul Ginocchio** - *Deutsche Bank - Analyst*

Thanks for taking my question. Just I think when you changed the pricing you sort of changed between the first two years of your -- of the Bachelors program. Is that leading to some changes in how you categorize Bachelors and Associates that would lead to the Bachelors being up and Associates being down more, or are you kind of giving us apples to apples from previously?

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

It's a good question. I think that wasn't the reason why we did -- what we wanted to do was take an artificial barrier away from students having the opportunity to become Bachelors students rather than having to go through an Associate program first. Turns out there's a lot of students that don't want that.

And we sort of put this barrier up over a 10 year period that didn't need to be there. You can be an Associate student at the University of Phoenix, but if what you really want is to become a Bachelor student, then you have an opportunity to do that without being penalized by price. And those are traditionally historically have been better retaining students for us as well.

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Just to elaborate, what we did was at the lower division level, kind of freshman, sophomore year, we have parity in pricing in the Associates programs and the Bachelors online programs, principally right now, it's in many of the ground locations. So then a student that comes to us that's interested in a Bachelors program, even though previously our Associates was substantially lower in price, they might have gone that route, gotten an Associate's degree, and then as you know many of them matriculated from Associates to Bachelors when they graduate, we have very high matriculation rates. Now a student could go into whatever program they want without regard to price. And so that's what we did and that's kind of what we've seen here.

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**Paul Ginocchio** - *Deutsche Bank - Analyst*

If I look at the average credit of an incoming new student, how's that look relative to a year ago? Is it up or down, and what does it look like relative to maybe a few years ago?



**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

It does move around obviously from quarter to quarter. At the Bachelors level, it's actually in Q1 at least, which is when we look at -- it's a full quarter is when a student is able to finish their first course, it's actually been pretty consistent. We haven't had dramatic changes in the last year, but obviously over a longer period of time it does move around.

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**Paul Ginocchio** - *Deutsche Bank - Analyst*

If I could just -- you talked about you don't know when the improvement in enrollment, I know new enrollment is not your focus, but did you make that comment that it may not improve this quarter because of what you're seeing quarter to date or --?

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

It's just -- no. Institutions I think in higher education who are at a minimum doing a good job, right, you know the industry grows, maybe it's a percent overall, and so it's taking market share. And I think we have an opportunity right now to probably have that start number for just -- if it were just that purpose to look better than it does today.

We've been down that road. We don't think -- we think there's a very natural path for that recovering and we are determined to do the base things right first, which I believe if we do, the enrollment will come along with it. We do expect to see some natural improvement. I don't know whether it's this quarter or next quarter. We're not going to comment on trends for the first few weeks of the quarter because they can move around.

So we weren't intentionally trying to say that. But we don't know whether it will be this quarter or next quarter. We do expect to get some throughout the year, the rest of the year.

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**Paul Ginocchio** - *Deutsche Bank - Analyst*

Great. I guess we'll just -- you'll give us an update at West at the Analyst Day.

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

Absolutely.

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**Paul Ginocchio** - *Deutsche Bank - Analyst*

Great, I can wait.

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**Operator**

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

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

So Greg, I'm sorry to dwell on this, just want to make sure I understand. Is the implication of what you're saying is that your expectation is the third-quarter start decline would be similar to what you saw in the second quarter in terms of year-to-year percentage?



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

It could be. It could be slightly better, we don't know yet. What I do know for sure is that it will move around during the quarter. If I were -- if we were trying to pinpoint a certain number to get it to, then I could give you a more exact answer. But we're not.

We took a very significant amount of chunk out of marketing in non-core areas. At least areas we consider to be no longer core, and believe that through the corporate partnerships and relationships as that grows, word of mouth and improvement, and what we're starting to see in terms of what the brand stands for, which is education to careers, which we were absolutely nowhere with a year and a half ago, we think it's going to come.

I think there is the opportunity to pinpoint a certain number and hit it and spend what you needed to hit it. We're just not doing that right now.

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Peter, it's Brian. Just to reiterate what I said so it is clear. The rate, the year-over-year rate improved in Q2 from Q1, obviously we're down about 17% in Q2 versus 23% in Q1. We do expect that to improve by the end of this year. To Greg's point, whether that happens in Q3, Q4, time will tell here, but we do expect it to happen by the end of the year. And I think more importantly or as importantly, we do intend to still finish the year with roughly 230,000 students. I just wanted to reiterate those data points.

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

And we do at some point expect to grow the University of Phoenix enrollment and we hope at that point that they'll be retained at a much greater level.

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

I think the interesting thing, though, is to get to the 230,000 just based on arithmetic, you'd obviously need to see some combination of start improvement and retention improvement, and I think the implication is you would have to see then in the fourth quarter, if not the third, fairly dramatic improvement in the start performance, unless I've got my arithmetic wrong here somehow.

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

It is a combination, Peter, of retention, which is much more powerful than any one quarter of starts in our case, at our volume levels, and improvement in -- some natural improvement in the starts.

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

Okay. Greg, can you talk about the roadmap to profitability in the Global business, how should we think about that evolving over the next year, would be profitable in 2015, how does that progress?

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

I'll let Brian talk to that.

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**Brian Swartz** - Apollo Education Group Inc - SVP and CFO

Yes, Peter, first of all, as I mentioned in some of my remarks, the existing businesses that we have are performing really well and Greg gave you some data points on Mexico, ULA, and great things are happening at BPP as well. And then obviously we have the impact of Open Colleges this year.

So we do expect those businesses, existing businesses to move to profitability. We actually expect BPP to be profitable by itself this year, which would be the first time in a few years, given their strong performance. Obviously when we buy schools, we go through purchase accounting, which I know you and all the investors understand very well. We take -- we obviously have -- could have dilutive impact to GAAP-based earnings given my comments on Open Colleges.

So I think it will be a function of a lot of things. It will be a function of how quickly we do further acquisitions, what the purchase price allocation looks like on all of those items if you're focused on operating income, which obviously is an important metric, we focus on that. We focus even more so on cash flows, whether it's cash flows from existing businesses or future businesses.

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

But Peter, I want to make one thing clear. We're not -- we don't have the patience to wait years and years for Global to break even. So it's on a path. It's actually on the time line that we are expecting, if not a little bit better, and within the next couple years we should be profitable on Apollo Global.

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

Fair enough. Thank you.

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

All right, thank you very much.

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**Operator**

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

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

Thank you. Can you just give a bit more detail on what you're cutting with marketing spend? I think you're describing it generically as non-core areas, but is it non-core channels, non-core academic programs? Just I don't know what areas means precisely.

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

Jeff, it's competitive for us. I'm not going to go into a lot of detail. I'll just tell you that we're not doing lead buys for random people that we have no idea who they are and not enough information about them.

There are certain areas of search that we don't think were a good value for us. We're trying to get back to building a reputation, having student inquiries come in through that channel, having them come in through our B2B business. They can come in through Lightspeed, different areas. And we're just -- we're channeling our investment differently, and at the appropriate time we'll give a little bit more information on it. But you

certainly can see in the financials that we are pulling back on the investment in some areas that frankly I don't feel we were getting the ROI that we needed on them.

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

But it's about channel shift, it's not about de-emphasizing certain academic programs or something like that?

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

No, no, no, not at all. Not at all. It's different areas of the channel and also just believing we don't -- if we get better and better and more professional overall in these areas, we should have to do less of it and get a better yield.

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

Okay. And then --

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

I think that the money that we've taken from that, we've only invested it and reinvested it back into academics, and you can see some of the areas that we're doing this in. As I mentioned on the call, with our platforms and areas of Global, and certainly places like adaptive technologies and learning.

We're also beginning to actually be able to leverage some of the things from Global, Apollo Global in areas where we literally are now using a new collaborative tool in the US that they built in Mexico. So I expect to get some leverage off of that too.

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

Okay. And then when you say you have 3,000 corporate partnerships, how is that defined in terms of what's an employer partner? Is this people that are helping you for development or is it people that are hiring employees directly or what is that?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

It's a signed agreement with an employer, a corporation, a company that has agreed with us to do business with Apollo Education Group, and in many cases the University of Phoenix.

Now, as I said before, I think they're -- that is sort of phase one is to build those relationships so that they trust you enough to build some kind of a relationship and partnership and agreement. What I don't want that to be is just an agreement because of a discount, right, to send students to the University of Phoenix. There is so, so much more we can do to solve their human capital growth needs. That's what we want to do.

We want to be their partner to solve those issues for them. We are slowly making progress in that area. But you have to build those relationships the right way. The higher up in the organization the better. We're just going along every quarter, trying to hit our goals and our KPIs in that area.

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

How are expenses related to the corporate partnerships reported?

**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Well, maybe let me try to answer that question. Hopefully I'll answer. There's a group, we call it internally workforce solutions that supports those accounts. Those costs for those individuals show up in the marketing line item on the external financial statements. And then obviously a cost of providing the transaction or having the partnerships as Greg mentioned is we do provide a discount, which is one of the reasons if you look back over the last several years, our overall discounts have trended up, it's because we have more corporate partnerships with more students utilizing that discount.

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

Those students will also be retained at a higher level.

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

Great. And then just one final one, a follow-up on Paul's question. It sounds like when you're saying Bachelors are up, that may be driven by students that otherwise in the past would have registered as Associates that are now registering as Bachelors, or is there underlying improvement adjusting for that potential shift?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

It's very hard to adjust specifically, right. We have a lot of students that enroll every quarter, 30,000-plus, so we don't ask all of them had there been a price difference would you have gone into Associates? It's hard to isolate it.

I would tell you we believe that the principal reason for the mix shift, more Bachelors than Associates, is because of the parity in pricing, but there are obviously other factors that impact it as well in any given quarter.

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

Got it. Thanks, guys.

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

You're welcome, thank you.

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**Operator**

The next question comes from Jeff Volshteyn with JPMorgan. Your line is open.

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**Jeff Volshteyn** - *JPMorgan - Analyst*

Thank you for taking my question. I wanted to follow up on retention. And I appreciate your focus on this metric. I think in the past you mentioned that you may offer a metric for us to be able to monitor it every quarter. Where are you with that determination, whether there's a separate metric that you'll be able to share with us?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Yes, Jeff, we are continuing to study it. I don't want to make any promises as I haven't in the past. But the principal retention metrics that we look at internally, I know I've shared that information with you just generally speaking, is really what I refer to as cohort completion. A cohort of students that start on any given day, week, or month, or quarter at the University or any of our universities for that matter, not just the University of Phoenix, what percentage of those are finishing their first, second, third, fourth course and so on.

So those are the key metrics we're looking at internally. We haven't made a decision when and if we might give some of those out. But we're happy to continue to dialogue about it. But those are the metrics we look at internally.

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

Just try to be clear, Jeff, about it. The other thing that does impact -- I know Peter asked about total enrollment number and how we might achieve that, is re-entries as well.

There are a very significant number of students where life gets in the way for some that love going to school at the University of Phoenix, and that have decided to re-enter and that number's been strong for us. So whether they've stopped out for a certain period of time or not and can make it work again, that's an important area to us as well, and I'm pleased with our team's progress there. That's really a form of retention.

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

And just to be clear, I know this is all in our footnotes, but when Greg refers to re-entries, he's referring to students that come back to the University, University of Phoenix, that were in attendance sometime in the last year, if they've been out of attendance for more than one year then we would count them as a new enrollment. All that is in the footnotes, and I know not everyone understands our metrics real clearly, but I did want to point that out.

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**Jeff Volshteyn** - *JPMorgan - Analyst*

That's helpful. Could you share with us the number of graduates in the quarter and perhaps how would the number of graduates in 2014 compare to the last year's, I think it was about 80,000 graduates?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Yes, I will tell you that the graduates in 2014 will be lower than '13. We don't give the exact number. I believe at least overall we've exceeded almost 850,000 graduates at the University of Phoenix since its founding, which is pretty remarkable this quarter. But with respect to the amount this year, Jeff, it will be lower than it was last year.

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**Jeff Volshteyn** - *JPMorgan - Analyst*

And for the quarter? This reported quarter?

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

I don't have exact data in front of me. We generally don't give out the number, the exact number by quarter.



**Jeff Volshteyn** - JPMorgan - Analyst

Okay, last question from me. Is there any updates to the on-notice status from your accreditor?

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

We don't have a current update for you. Everybody is very hard at work at the University of Phoenix and I'm pleased with their progress.

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**Jeff Volshteyn** - JPMorgan - Analyst

Okay. Thank you very much.

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

Thank you. That goes for West as well. I'm sorry.

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**Operator**

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

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**Jeff Silber** - BMO Capital Markets - Analyst

Thanks so much. I notice in the quarter that you accelerated your share repurchase. Was there a specific thought process that went in mind in terms of doing that, and how should we think about that going forward?

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

We saw a good opportunity to put our capital to use and we were able to do it. It worked out for us, actually the past couple quarters, and I continue to believe and so does Brian and our Management team that we'll be making investments in different areas with our capital but that is certainly one of them that we've believed in strongly in the past.

There's been some times as you know where we haven't been as successful with share repurchases, but we have an authorized program in place and had an opportunity to take advantage of it.

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**Jeff Silber** - BMO Capital Markets - Analyst

Great. And then just switching back to the OIG investigation, and I'm sorry about this, but this looks like a new group or at least a group that you haven't dealt with in the past, and I'm just curious, do you think we're going to be seeing something like this from some of the other regional accreditors where you may have some operations?

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

Jeff, I have no way of knowing that. I know that we have a incredible group of professionals in place that are handling this. They will do it appropriately, professionally. They'll be represented at our Investor Day coming up.



And you just if -- my perspective on this is that if you want to operate in the higher education arena today in this marketplace, you better be extremely professional. You better be very ethical. You better have very high quality people in your compliance departments, because you're going to have to answer questions from time to time. And we're determined to do that going forward.

I don't have any more information on this particular situation. I just know that we've disclosed what we disclosed and our teams will work appropriately to ensure professional process on our side.

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**Jeff Silber** - *BMO Capital Markets - Analyst*

Appreciate the color. Thanks.

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

Thank you.

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**Operator**

The next question comes from Trace Urdan with Wells Fargo Securities. Your line is open.

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

Hey, thanks very much. Just a couple of clean-ups here. The realignment, can you describe sort of the arc that that's taking within the Organization? Is it sort of completely settled? Is it still going on?

I know that it's impacted enrollment in terms of the way the enrollment counselors face prospective students. But can you describe what other parts of the business it might be disrupting that we would notice in terms of tracking your performance?

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

Yes. Thanks, Trace. I use the word disruption with some caution. There is a tremendous amount of change that's occurred. People's jobs have changed, there are new people in some jobs. There's been a realignment as I said by college. There are Deans and Executive Deans that some are in place already and some are being put in place. Obviously there's a new President coming in.

So you can imagine that there's a lot going on, but this as I said, Bill Pepicello, the current President of University of Phoenix and his staff have been -- this isn't an overnight. They've been building this and planning it for a long period of time and working to align with employers and so on and so forth. So yes it is disruptive and I am absolutely certain it's having some impact on the enrollment side.

As far as other areas that it's impacting, it's hard to pinpoint exactly how to answer that question, because it is a very comprehensive realignment throughout the University. I think frankly there's a lot of good things coming out of it already, but people have to settle in to the new structure. And even how you recruit students, we have experts now who are working in their fields. There's no longer going to be generalists that are broadly answering questions about any kind of programs, certificate, degree program. If you want to enroll someone in nursing or in criminal justice or in IT, you're going to be a specialist in that area.

So I really like what I'm seeing. I think they're doing an excellent job. But I think they understand and we understand, it will take some time to settle in and get everything running smoothly. I'm excited about it.



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

Okay. The student facing, the prospective student-facing employees, when did that changeover take place? Like when was day one when all of a sudden the person that you're speaking to on the other end of the phone is an expert versus the way it worked before?

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

It's in process. It's been happening over the last quarter or two. And now it's going to take some more time to get all the people in place that I think the University and their Board thinks needs to be in place. That's not something Brian and I are doing, but very supportive and very supportive of the capital that needs to go into it and the initiatives.

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**Brian Swartz** - Apollo Education Group Inc - SVP and CFO

Trace, just to be clear on the timing. The team, the University of Phoenix Management team has been planning this as Greg mentioned for a long time. All the changes, the actual announcements took place on our call, around the mid-October time frame. Obviously it took some time internally for the operating teams to kind of realign everyone.

So it's really just been a couple few months here since things have started to settle out, it's not perfect still, still a lot of training and communication and all that stuff to occur with a lot of our team members. And the impact --

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

I'm not trying to be difficult. I'm just trying to understand. So in the fiscal second quarter, that change that I describe where the person calling in is now all of a sudden speaking to a nursing expert versus a generalist, that kind of took place gradually over the course of the second quarter? Is it still going on?

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

Let me be clear. Some of it has taken place. Some of it is in progress right now.

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

Great. That's what I was going for, thank you.

And this is really a mundane question, but Brian, your guidance on bad debt expense for the year has stayed at 2%, and you guys have beaten that for first couple of quarters. Is that just you being conservative or is there something structural in the second half of the year that might cause that bad debt number to rise as a percentage of revenue to get to your 2% average for the year?

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**Brian Swartz** - Apollo Education Group Inc - SVP and CFO

Yes, it's just a rough number that we expect. One thing to keep in mind is we do expect the rate of improvement on new enrollments, obviously it dropped down nicely in the second quarter versus the first quarter year over year, Trace. As that improves, that has an impact on bad debts as well. So that has an impact as well. So we just think that's where the full year will come out at this point in time.

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

Okay. Thanks.

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

Thank you, Trace.

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**Operator**

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

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**Tim Connor** - *William Blair & Company - Analyst*

Thank you. I'll keep it to one question. The changes to the orientation program that you've made, do you feel like you have those in a good place? And then any kind of specifics on that would be helpful.

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

Yes, yes, we are -- I'm really happy with the innovation again that I'm seeing there. I think as we said a couple years ago, we were going to learn from orientation and get better and better at it.

Let me answer that the most direct way I can. Students -- so on the front end, we want to have world-class visibility for our students in terms of what the program costs, what the program can lead to, total transparency. When I say our own gainful employment, we help students understand through using Bureau of Labor statistics data what programs are paying for people coming out of school and getting a job in this area, so that you can even understand what percentage of your paycheck has to come out of that area.

And orientation is a part of understanding what you're going to have to do, the commitment you're going to have to make, right? And the work you're going to have to put into it, along with what everything costs to be successful. So they have continued to make adjustments.

I think at the end of the day, we really feel like it's the students who come in without any experience or not a lot of experience that need it the most, that have to understand. Maybe they've been out of school for 10 years, that really need it the most. And there is a risk-free period that we put in place, basically, for three weeks. And that's what orientation is moving into as well.

We also expect orientation going forward to help with a number of things. Our cohort default rates are coming down. Our bad debt has come down very significantly over the past few years. And it has a -- it does a whole host of things for us, but none more important than if we're going to start a student at the University of Phoenix, they are going to know what they're getting into and what it takes to have success.

So it continues to evolve. I think it's getting better and we'll continue to report on it.

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**Tim Connor** - *William Blair & Company - Analyst*

All right. Thank you.

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

Thanks, Tim.

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**Operator**

The next question comes from Phil Stiller with Citi. Your line is open.

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**Phil Stiller - Citigroup - Analyst**

Hello, guys, thanks for taking my question. Just wanted to ask about the revenue per student. You expect it to be down about 4% this year. How much of that is attributable to the harmonization of the price between Associate and Bachelor degrees?

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**Brian Swartz - Apollo Education Group Inc - SVP and CFO**

It does impact it. What impacts it more is the scholarship program that we also rolled out last fall which allows students as I assume you know, Phil, I know we talked about it before, but it will basically allow students to earn a discount on their tuition; after their first year they get some, in their second year, if they stay through their second year, they get some their third year. It's pretty substantial.

Total cost of degree if you start with zero transfer credits it's upwards of the high teens, about 20%, a little less than 20% reduction in the total cost of the degree. So the accruals for that scholarship program are impacting revenue per student, or per discounts are impacting revenue per student as we grow that channel as well.

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**Phil Stiller - Citigroup - Analyst**

Okay. So it sounds like the Bachelor Associate harmonization is a minority of what's going on right now.

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**Brian Swartz - Apollo Education Group Inc - SVP and CFO**

It's impacting it but not the primary reason why it's being impacted.

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**Phil Stiller - Citigroup - Analyst**

Okay. And then just lastly on the gainful employment proposals, just wondering what kind of visibility you guys feel you have into the programmatic proposals, and how you guys are planning for potential implementation next year.

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

Yes, Phil, as I'm sure you know it's in the notice and comment period right now, so we certainly will see where it comes out. But under the 2011 rule that had been proposed, we had seen, we commented on a few programs impacted under the new draft rule then that could have failed, and obviously would have worked hard to do what we needed to do to ensure all our programs were in compliance.

We're in the same position now. One of the things that's new is there is a warning zone for debt to income and debt to discretionary income that has a number of additional programs that could potentially be impacted. That doesn't mean you lose ability to enroll students in those programs.

But as it relates to the programmatic cohort default rates we've seen a significant year-over-year reduction in our overall cohort default rates as I said before, and if that -- we'll look and see what's part of the final rule and how it comes out. But our efforts and our students' efforts regarding the responsible borrowing have also made an impact. We hope that the department and their final rule will more closely reflect the rule that it previously adopted regarding gainful employment, but we're a part of the process, we're in good dialogue I think in a number of different areas, and we'd like to see a good rule being put in place that applies to not only us but to all schools.



There have been a number of studies that have come out recently that have showed very, very significant issues with both traditional schools as well, in terms of being able to recoup your investment from the program. So what we wanted to do over the past year is not wait for a rule that comes out at some point in time. We're certainly in dialogue and part of that process. That's why we wanted to build in our own system already.

And frankly it has an impact. It sort of allows the market to work, where when we ensure students have the visibility upfront and the opportunity to see, they might be very interested in moving into a certain area and a certain program, but they're able to look at how much of their paycheck is going to come out to pay for student loans. And it might alter their behavior in our case to look at another degree-granting program that might be their second choice, but it's going to pay more.

So we're already doing it. I like our system a lot. Certainly whatever rule comes out as a final from the department, we will be in compliance with.

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**Phil Stiller** - *Citigroup - Analyst*

Okay. Great. Appreciate it. Thanks.

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**Brian Swartz** - *Apollo Education Group Inc - SVP and CFO*

Phil, it's Brian. I just wanted to correct what I said earlier. Your question on how much of the RPS is impacted by the price and the discounts. I was confused. Just to clarify, the price is actually impacting the RPS slightly more than half, so it is more significant than the discount's impact this year.

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

Phil, I'm not sure if you got cut off or not, but hopefully you heard Brian's answer. Operator?

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**Operator**

There are no additional questions in queue.

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

Well, I want to thank everybody for joining us today. We are hard at work, trying to execute on our strategy to differentiate our universities and our programs, to diversify the Apollo Group, and to become an efficient Organization with operational excellence employed at all levels. We look forward to updating those that are coming to the Investor Day next week and talking to you all soon. Thank you so much. Take care.

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**Operator**

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

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