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APOL - Q3 2014 Apollo Education Group Inc Earnings Call

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OVERVIEW:

Co. reported 3Q14 reported revenues of \$800m and net income attributable to APOL of \$66m or \$0.59 per share. Expects 2014 net revenues to be \$3.04-3.06b.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning and welcome to the third quarter 2014 earnings release conference call.

(Operator Instructions)

This conference call is being recorded today, June 25, 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 July 2 beginning approximately two hours after we conclude today. I would now like to turn the call over to Beth Coronelli, Vice President of Investor Relations. Mrs. Coronelli, go ahead please.

Beth Coronelli - Apollo Education Group, Inc. - VP of IR

Thank you for joining us. On our call today will be Greg Cappelli, Chief Executive Officer of Apollo Education Group, and Brian Swartz, Senior Vice President, Chief Financial Officer. As we discuss our results today, unless noted otherwise, we will be comparing the third quarter of FY14 to the third quarter of FY13.

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 to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in our quarterly reports and Form 10K filed with the SEC which is available on our website. The Company disclaims any obligation to update any forward-looking statements made during the call.



Additionally, we may refer to non-GAAP measures which are intended to supplement but not substitute for the most directly comparable GAAP measures.

Our Press Release, available on our website as well, contains the financial and other quantitative information to be discussed today, as well as the reconciliation of the GAAP to non-GAAP measures. And with that, I will turn the call over to Greg.

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

All right. Thank you, Beth, and good morning, everyone. I apologize up front for my voice. I'm enjoying a wonderful summer cold so hopefully it will hold up because I'm excited to talk to you a bit about Apollo Education Group here. Let me just provide a brief update on the progress we're making with respect to our strategic plan and then Brian is going to provide some additional color around our 3Q financials and outlook.

Our long-term strategic plan is centered around three important areas: first, to differentiate the University of Phoenix; second to diversify Apollo; and then third to drive operational excellence throughout our organization.

We're building Apollo to deliver high quality education and training that's relevant to students who are looking for fast growing and rewarding careers. We'll do this by delivering an experience that's innovative, flexible, efficient, and of course, aligned with employers' needs.

Although degree-granting programs continue to be a very important part of our offering, we're in the process of developing new programs to address the large and growing skills gap, both domestically and internationally. These include programs with stackable certificates, professional development offerings, boot camps, and other innovative approaches to connect education to careers. Our long term strategic plan is designed to significantly expand the number of students and employers we serve globally over the next five years, and I'm confident with proper execution, we can get it done.

Now let me briefly update you on the three legs of our strategy. First, differentiating the University of Phoenix. After a long and comprehensive search, I'm really pleased to have our new President, Tim Slottow, on board who joined us this week after a long and successful career at the University of Michigan. Tim brings significant experience along with a passion for innovation and high quality student outcomes which is very well aligned with our mission at University of Phoenix.

Additionally, the University of Phoenix recently completed a major realignment by college including the hiring of new executive deans, all now in place to help lead the respective operating strategies across the University. This team is focused on helping the University to be significantly more competitive in all areas across the board. To support this, we're working closely with companies, listening and adapting our content and approach to ensure that our programs more directly address the skills necessary to help students connect their education to a career of choice.

We're also expanding the breadth and depth of our product offerings. Curriculum development has been completed to refresh more than 400 offerings this year. A significant amount of our program development is in the most promising areas of employment including subsets of business, education, IT, and healthcare.

Again, Phoenix is also building professional education offerings and is on track to roll out a total of more than 45 new certificate programs in FY14. This provides the flexibility for students to earn important credentials that can stand alone, or transition into a degree program.

Retention remains a top priority and the hard work in this area has recently been paying off the past several quarters. We're creating an ecosystem that supports students from their very first contact with the University through completion. There are many factors driving retention including heavier use of full time faculty and first year courses, but we know that this is a long term initiative, there's likely to be some fits and starts, and we're determined to stay the course.

We're also pleased to report that nearly all students in the University are now being served by our new learning platform, which has been greatly enhanced and provides a more efficient and user friendly experience. We remain very committed to compliance, transparency, and providing leading edge student protections.



We're focused on educating students on what to expect as they enter college, including our orientation program, financial planning tools to understand the underlying costs, and return on college education. We have a life resource center where students can receive financial counseling and a personal finance course incorporated in the first year sequence.

Finally, we're very proud of the results of our recent ethics and compliance employee survey. Close to 90% of our employees believe we have an ethical and compliant culture. This compares with 58% of all employees with companies in a comparative major national survey.

Now let's talk about diversification. There's a significant opportunity in global higher education, which is currently estimated to be a market size of \$2 trillion and is expected to grow about 10% over the next several years.

We entered two new continents in FY14: Australia in the first quarter, and this quarter, we entered Africa. We're now on six of the seven continents. In Australia, the online education training market is growing nearly 20% annually. Our newly acquired Open Colleges is performing well above the market and we expect to see continued rapid growth over next few years.

This quarter, we were pleased to add Milpark Education. They are a premier South African education provider with a tremendous management team. Moving into South Africa supports efforts to explore opportunities in other areas of Africa, which hosts 7 of the 10 fastest growing economies in the world. Both of these new institutions fit well with our strategy to operate highly capital efficient business models within the higher education industry and to do it globally.

Our other core institutions within Apollo Global are all expected to perform in line or better than planned. This important division of our Company has completely transformed its operations over the past couple years, has an annual revenue run rate of close to \$400 million US, and we expect steady growth to continue both organically and through strategic acquisitions over the next several years. We also expect our global operations to be operating cash flow positive in the next 12 to 18 months.

An additional focus of our diversification strategy is providing offerings outside the traditional degree space, developing relevant, career-connected, high quality education and professional development offerings. There's demand for flexible programs directed to the personal needs of the student, while addressing employer education and professional requirements.

Here is just a few examples we're pursuing today. In 2014, we launched Balloon, the foundation for a multi-industry skills-job marketplace connecting learners, course providers, industry experts, and employers. Balloon has integrated the power of SkilledUp, a site connecting learners to courses and now provides access to over 120,000 courses and jobs and 350 courseware partners, including 30 of the largest partners in global IT and technology.

We're also piloting an exciting new IT boot camp, and based on the positive response so far, we plan to roll it out into other cities, better leveraging our ground locations around the country. With the rigorous selection process, the boot camp delivers skills that students need to be job ready and what's so interesting about this new model is its efficiency. It is very intense. It requires a total commitment over a few months and when you come out of the program, you're highly qualified in attractive career areas that generally pay very well right out of the box for these students.

Finally let me touch on operational excellence. We've been building a stronger Apollo Education Group. We are reshaping the organization with ongoing focus on increasing efficiency, improving how we operate, and providing a world class student experience.

Just a few highlights so far. We substantially completed our ground campus realignment this year. We successfully transitioned the online classroom platform to an industry leading, private cloud infrastructure offering and enhanced scalability, reliability, and performance. This allows us to increase our advanced data analytics capabilities to support how we serve students. We've also gained efficiencies in our marketing spend, the marketing performance, and realigned to focus on managing and operating the eight distinct colleges at University of Phoenix, or individually to address the specific needs of the students in markets they serve.

Overall, we're confident in our strategy to differentiate, diversify, and build a stronger Apollo Education Group with focus on operational excellence, which again, is the center piece of our long term strategic plan. So with that, I'll turn the call over to Brian and then we'll take some questions.

Brian Swartz - Apollo Education Group, Inc. - SVP & CFO

Thank you, Greg, and good morning, everyone. I'll quickly review the third quarter financial results and then share with you our updated business outlook for 2014. We ended the third quarter with new degreed enrollments of 33,900 and total enrollment of 241,900 at the University of Phoenix.

As you know, we are moving through a transition to realign the University by individual college. As a result, and in part, during the third quarter, we reported revenue of \$800 million, down 16% year over year which was generally in line with our expectations.

Although obviously smaller in scope at this point, our global operations have experienced increases in student volumes during 2014. Third quarter revenue per student at the University of Phoenix was down 4.1%, primarily related to the University's pricing initiatives that we have previously discussed. We expect 2014 revenue per student to decline about 4%. Discounts, as a percentage of revenue, were approximately 9% and we expect it to remain at about that level for 2014.

Third quarter operating income was \$113 million, compared to \$132 million for the same period in the prior year. Excluding special items, operating income was \$137 million and operating margin was 17.1%, compared to \$195 million and 20.6% in the prior year. For the third quarter, net income attributable to Apollo was \$66 million or \$0.59 per share, and excluding special items it was \$85 million or \$0.76 per share.

Turning to operating expenses. In the third quarter as expected, we experienced year-over-year declines in all expense line items. In the fourth quarter, we anticipate costs that are more fixed in nature to increase slightly on a sequential basis, primarily due to seasonality and in particular in the marketing area. We also anticipate expenses in the second half of 2014 to be higher than the first half, primarily due to the addition of Open Colleges and Milpark, as well as investments in the University of Phoenix college realignment and our student retention efforts.

With respect to income taxes, our third quarter effective tax rate was 41.6% and 38% excluding special items. For the fourth quarter, we expect our tax rate to be approximately 41%. Additionally, to provide clarity, we estimate that for the fourth quarter, our after-tax loss attributable to non-controlling interests to be approximately \$1 million, which would represent income to us. We also expect other income and expense, net to be roughly \$2 million of expense, and our share count, excluding the impact of further share repurchases, to be about 111 million shares.

As Greg said, we remain committed to driving operational excellence throughout all of Apollo. Since 2012, we have lowered our cost base by roughly \$900 million, with approximately 80% of that coming from costs that are more fixed in nature. It is never easy to realign the cost base of a company as large as Apollo, but we believe that we have positioned the organization to be leaner, more efficient, and have the opportunity to be more competitive on many levels going forward. For 2015 and beyond, we will work to ensure our cost structure is aligned with the expected size of the business.

Turning to the balance sheet and cash flows. We continue to maintain a well-capitalized balance sheet and generate healthy cash flows. At quarter end, our cash and marketable securities were approximately \$808 million.

Our free cash flow for the third quarter was \$73 million, compared to \$44 million in the prior year. Our free cash flow increase principally due to lower capital expenditures and cash received from the successful resolution of a foreign indirect tax matter.

Our 2014 adjusted free cash flow is expected to be impacted by approximately \$90 million of cash outflows from restructuring activities or about 30 million more than the prior year. It is important to note that we believe our business model will continue to be highly capital efficient with the ability to generate healthy free cash flow going forward.

Now I'd like to spend a minute on our outlook and provide a long-term view of our business. With respect to new enrollments at the University of Phoenix, the year-over-year rate of decline has improved throughout the first three quarters of 2014. The fourth quarter is a little more difficult to predict given the back end nature of the enrollments, as August is seasonally one of our largest months of the year for the University. But with the information we have now, we expect the rate of decline to be about the same as the third quarter with the potential to see some improvement.



Over the course of the next year, we expect the transformative changes that have been made to the operating structure at the University of Phoenix to drive continued improvements in new enrollments and most importantly student retention, which improved again this quarter. After a great deal of analysis, strategic planning, and work, we believe the University of Phoenix is well positioned for long term sustainable growth.

In terms of our immediate outlook, based on our current view, our updated 2014 financial outlook is as follows. Net revenue of \$3.04 billion to \$3.06 billion and operating income excluding special items of \$420 million to \$435 million. Shifting to a high level view of the next three to five years, you can expect us to work hard to substantially increase our revenue while diversifying the revenue sources of Apollo Education Group. At the same time, we will continue our focus on operational efficiency, both of which are important to operating margin expansion and operating profit growth over the long term.

As we report our year-end results and provide our outlook for 2015, we plan to share more specific details on our long-term view, including supplemental financial information to help you more clearly value and understand the trajectory of the Apollo Global business. With that, let me turn the call over to the operator to open the line for your questions.

QUESTIONS AND ANSWERS

Operator

Your first question comes from the line of Jeff Silber. Your line is open.

Jeff Silber - BMO Capital Markets - Analyst

Thanks so much. In terms of narrowing the range of guidance for the current year, can you explain what was behind that thought process?

Brian Swartz - Apollo Education Group, Inc. - SVP & CFO

Yes, hi, Jeff. Well, we have more information today than obviously we had last quarter or the quarter before. With that information, we have obviously used that and provided an update for the next quarter's financial performance. The range that we've provided allows ample opportunity for us to ensure we're making investments in Q4 to benefit Q4 and 2015. So, we have more information today and feel good about that range.

Jeff Silber - BMO Capital Markets - Analyst

But there was no specific line items where your assumptions changed dramatically?

Brian Swartz - Apollo Education Group, Inc. - SVP & CFO

No.

Jeff Silber - BMO Capital Markets - Analyst

Okay, great. And then, you mentioned the sizeable amount of cost cutting that the Company has done over the past few years. Should we be expecting any more restructuring charges or are those pretty much behind us as well?



Brian Swartz - *Apollo Education Group, Inc. - SVP & CFO*

Yes, it actually disclosed in the 10-Q. We do expect about \$25 million more in one-time restructuring charges. Most of that we expect to happen in the next couple of quarters, and then the balance will happen into 2015 and beyond.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, great. And then, just one more quick one: On prior calls, you've given us a little bit more information on your enrollment side between dealing with the corporate alliances or your business partners, and I guess the traditional public. Can you give us a little bit more color on how those two channels are doing?

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

Yes, Jeff. The corporate area is coming along well. We've spent a lot of time with both senior management teams of corporations, all the way down into the Organization. I think we've previously disclosed that we have thousands of relationships with employers; now we're trying to go deeper, and certainly have them organized into certain tiers. So, you're going to hear more from us over the coming year on this really important area for us.

As I said, I think we're getting more efficient with our marketing spend -- more targeted. It's really going to be, as both Brian and I said during our remarks, you know, the transformative things that we're doing at the University of Phoenix that we think can turn enrollment growth around. And we've said that for the past year, that we're doing these things to provide a better experience, to differentiate the University to be totally aligned with the employer and the jobs that they're looking to fill, and that's coming along. It was never going to be an overnight process, but we've made a lot of progress so far this year.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay. Thanks so much.

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

Thank you.

Operator

Your next question comes from Sara Gubins. Your line is open.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Thanks, good morning. Do you think there was any disruption in the quarter from the shift that you've made to operate by college? And if yes, where did you see it?

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

Yes, there was some disruption, Sara. Any time you go through a transformation the size of what we've done at the University, there's going to be some dislocation. There's many people that have been repositioned, we think, into areas that they can have more success. There have been new additional folks that have been added to the team.

So, just through that repositioning process, and the restructuring of how the University operates through the colleges, yes, there has been disruption. But we don't expect that to last for too much longer. And, in fact, we expect that, over the next quarter or two, for things to stabilize from that perspective of an employee perspective at the University of Phoenix.

Sara Gubins - BofA Merrill Lynch - Analyst

And your retention continued to be up year over year, but not as much as it was in the last two quarters. I know you've talked about that being choppy, but I'm wondering if that may have been because of the reorganization, and if you think that we should see greater retention improvements in the fourth quarter and beyond?

Brian Swartz - Apollo Education Group, Inc. - SVP & CFO

Yes, Sara, the retention did improve in the quarter, consistent with kind of what we've seen in the first couple of quarters of this year. I think the persistence calculation, perhaps the way you're calculating it, was up a little bit less on a reported basis. If you exclude the impact of grads, it was actually more than what the pure calculation is that you calculated. So, again, as we've always said, this will have fits and starts; it will go up and down. It's not going to be up and to the right perfectly linear, but we're pleased with the results that we've seen thus far, and will continue to drive it as it's our number-one priority.

Sara Gubins - BofA Merrill Lynch - Analyst

Okay. And then just last question on share repurchase: You have been making share repurchases this year, although not a huge amount. I'm wondering: Now that you've made two recent acquisitions, do you expect the acquisition pipeline to slow a little bit, and you might ramp repurchase more significantly over the next couple of quarters?

Greg Cappelli - Apollo Education Group, Inc. - CEO

Sara, I think repurchases are a healthy part of the conversation, under our capital deployment. You can kind of see what we've done strategically with acquisitions and the size that they are. We do have other opportunities to continue to build out the network around the world, which is, frankly, something we think will help our domestic operations as well, as they collaborate more together, which we're seeing now. But share repurchases are going to continue to be a part of the conversation as we look at capital deployment going forward. We totally believe in our Apollo Education Group overall, including our domestic businesses and their potential for future growth as we get through this transition.

Sara Gubins - BofA Merrill Lynch - Analyst

Thank you.

Greg Cappelli - Apollo Education Group, Inc. - CEO

Thank you.

Operator

Your next question comes from Peter Appert. Your line is open.



Peter Appert - Piper Jaffray & Co. - Analyst

Thanks. Greg, I was wondering if you could provide any additional granularity in terms of the drivers of enrollment performance? Can you give anything directionally, even in terms of enrollment numbers by college, by degree level -- something to help us better understand what's driving the overall performance? And then, I'm not sure if I missed this, but are you still looking for 230,000 enrollments at year end?

Greg Cappelli - Apollo Education Group, Inc. - CEO

Yes, we are. And second, your question around drivers and trends -- and there's a number of things driving the trends. We continue to see a much greater shift towards Bachelors' degrees in the University at this point.

Now, they are adding a healthy number of new programs and refreshing programs that was necessary in the transformation. The executive Deans are working hard already with our new President, Tim Slottow, and I'm sure they will be looking at the most relevant and important areas where employers are telling us that they need highly qualified people to fill jobs. So, you're going to see that evolve over the course of the next year, and we expect that.

To this point, we have seen a greater number of people coming in the Bachelors' channels, and we're using a greater number of full-time faculty early on, with folks up front that's probably driving some of the retention improvement as well. I think what you'll continue to see from us going forward is a greater emphasis on help that people badly need early on, not only in the recruitment process but into the early parts of their program around career counseling and how to help them best to get to where they need to go, so we can build a better road map for them going forward.

Peter Appert - Piper Jaffray & Co. - Analyst

Anything on inquiry levels or conversion rates that would be interesting?

Greg Cappelli - Apollo Education Group, Inc. - CEO

You know, the inquiry levels remain healthy. I've been very pleased with what I've seen on the front end, led by our marketing and data analysis team in that area. So, I would say the front end of the funnel is very healthy right now, and I don't see any changes to that right now.

Obviously, there's an entire process of the student inquiry process into leads into the University, and then starting and staying at the University. And that's just something we're really, really focused on getting right, and that comes with total transparency to the student up front so that they understand what they're getting into, what it's going to cost, how much work it's going to take, what they need to do to be successful, and what they really need to do to get the job that they're looking for. So, we truly believe that as we refine that process, and get better and better at it, that our front end will get even healthier than it is now.

Peter Appert - Piper Jaffray & Co. - Analyst

Great. Thanks, Greg.

Greg Cappelli - Apollo Education Group, Inc. - CEO

Thank you, Peter.

Operator

Your next question comes from the line of Jeff Volshteyn. Your line is open.



Jeff Volshteyn - JPMorgan - Analyst

Thank you for taking my question. Brian, could you help us understand your comments on 2015 costs? I think you said they will be more aligned with [the instruction.] Does it mean -- are there still sizeable opportunities in specific areas of cost management?

Brian Swartz - Apollo Education Group, Inc. - SVP & CFO

The answer is yes. And my comment -- as you know, Jeff, as most companies, during our fourth quarter, we go through our annual budgeting process. That's why we provide our annual financial outlook for the next year on the year-end call and not on this call.

But I think the key message is: We are absolutely committed to ensuring that our costs are aligned with the expected size of the Business. So, we'll certainly provide more commentary if we do need to take out more costs; there are opportunities to do that. And as we go through our budgeting process this summer, we'll provide more commentary on that on the October call.

Jeff Volshteyn - JPMorgan - Analyst

Okay. And is there an update to regulatory [and accreditation] matters?

Greg Cappelli - Apollo Education Group, Inc. - CEO

On the regulatory front, we don't have an update to provide you with right now. Obviously, on the HLC front, we are very focused on completing the work that needs to be done. We expect to have that done on time, to be delivered in the fall, and we expect to have a review in the spring for the focus visit that we've talked about in the past.

Jeff Volshteyn - JPMorgan - Analyst

Okay, thank you.

Greg Cappelli - Apollo Education Group, Inc. - CEO

Thank you, Jeff.

Operator

Your next question comes from the line of Corey Greendale. Your line is open.

Corey Greendale - First Analysis Securities - Analyst

Thanks, good morning.

Greg Cappelli - Apollo Education Group, Inc. - CEO

Good morning, Corey.



Corey Greendale - *First Analysis Securities - Analyst*

Greg, so, now that you're in six continents, can you comment on your plans for Antarctica?

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

(laughter) Well, it can't be any colder than Chicago.

Corey Greendale - *First Analysis Securities - Analyst*

That's for sure.

So, a few questions: Brian, I heard your comments on marketing spend. Should we expect similar seasonality in marketing this year as we saw last year in Q4?

Brian Swartz - *Apollo Education Group, Inc. - SVP & CFO*

Yes.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. And without asking for specific numbers for FY15, can you just conceptually help us think through what the impact of -- what discounts and scholarships should do to that discount line if nothing changes? Should it keep creeping up in 2015?

Brian Swartz - *Apollo Education Group, Inc. - SVP & CFO*

So, let me try to provide a little bit of commentary on that on top. Again, we are not going to say too much about FY15 just because, as you know, as I mentioned we're going through our budget process now. But in the current year of FY14 with RPS for the full year projected to be down about 4% in discounts, about 9% of revenue -- because of the pricing changes we made last fall, the majority of that decrease is related to those changes.

There is -- going into next year, we will have the Phoenix Scholarship Reward Program -- the \$10,000 scholarship program. That will impact for another year, but our expectation is that our continued retention improvements will help offset some of that. So, without being more quantitative than that -- and again, we'll certainly talk more in October -- hopefully that helps you a little bit.

Corey Greendale - *First Analysis Securities - Analyst*

Yes, that's fine.

And, Greg, when you said that there's a shift toward Bachelor, how much of that do you think is driven by the moderation in the price point for the first two years, and how students responded to those initiatives?

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

I think it's a good portion of that when we realigned the pricing, so it would more naturally work with Bachelors and obviously Associates program, to answer your question.



Corey Greendale - *First Analysis Securities - Analyst*

Okay. And then just quickly -- I realize some of these newer initiatives are very small right now, but just to help in terms of how you're thinking about the Business, I'm curious: The certificate programs that you rolled out this year, I know it's early but what's the student uptake been on those?

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

It's been good. I mean, there's a lot of excitement around that. What I'm really pleased to see, Corey, is the level of interaction with employers and what they're looking for. I just launched a new white paper this past week, and have been talking about it publicly, but when you go coast to coast and you talk to CEOs and employers, and I know many of you are doing that on this call as well, you'll get a pretty clear picture of the enormous demand that they need in terms of high-quality human capital, which is going to be the main source of powering their growth.

There's plenty of access to financial capital at low costs in the world right now. But they need -- they do need, certainly, high-quality, degree-granting programs to educate their students at certain levels. When you look at the 4 million jobs that aren't being filled as of March, many of those are in middle-skilled areas, and we can help in those areas much more dramatically and more quickly. A lot of those jobs you can train within three months to a year to help fill those positions. So, we're listening and we're working to try to help solve a problem and fill a gap in that area to go along with our degree-granting program areas.

Corey Greendale - *First Analysis Securities - Analyst*

And on the boot camps -- so, first of all, are you branding those as UOP, and those are on the site of the UOP campuses? And I'm curious of your view, Greg, on whether that sort of thing expands the market or whether people attend those who would have otherwise maybe pursued a Bachelor degree?

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

No, not at all. It's a totally different value proposition. We're branding it as RockIT, and there may be some other brands as well that come into play. But, again, that's just something where we've listened to employers, and literally in a few months.

Now, you have to be willing to make a very sincere commitment, which everyone has done in our pilot to this point. We've lost very few people out of the pilot. But once you make that commitment and get through it -- these are people that are extremely committed and are doing very well throughout the course; and coming out of it, have really good job prospects.

In fact, I know that our own IT department is excited to go after some of them as well, because of what we're seeing in terms of the competency coming out of it. So, look: It's early. I don't think it's going to steal at all from degree-granting programs because it's a very different value proposition, and it's really for people who have been in the market but now realize they need a specific skill and they're trying to get it quickly and they're willing to put everything into it for a few months to get it and just get employed to where they want to be.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. I will turn it over. Thank you.

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

Thank you very much.

Operator

Your next question comes from the line of Paul Ginocchio. Your line is open.

Paul Ginocchio - *Deutsche Bank - Analyst*

Thanks. Brian, I know you just commented that you want to position the Company for long-term growth. I missed some of the comments about when you were going to provide us the update. When do you think you'll be ready to give the street a sort of timeline to returning to new enrollment growth?

Brian Swartz - *Apollo Education Group, Inc. - SVP & CFO*

Yes, we're not prepared to do that at this point. What I can tell you is: We've gone through transformative change, as you all know, at University of Phoenix. We think all of those changes -- the process changes, the structure changes at the University by college, lots of people changes, and lots of system changes are the foundation. And with those changes, as those take place and we gain traction, we'll have a competitive value proposition in the marketplace, and we're confident we'll get back to growth at some point in the future.

Paul Ginocchio - *Deutsche Bank - Analyst*

But at this point in time, is there even a -- would it be on the next quarter call that you think you'll give us that, or is it still farther off than that?

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

Paul, we're always going to provide as much data as we possibly can with the information we have about where we are and where we think we're going to be. We're looking for healthy growth over the next three to five years. It's going to be a more diversified Company. There's going to be stability within the University here domestically; and as we go along, you'll get as much information as we can provide you.

We expect to see continued improvement throughout FY15 on the domestic front. Where it ultimately lands specifically, we don't know yet, but we're putting the Company in a position to grow.

Paul Ginocchio - *Deutsche Bank - Analyst*

Great. And just a question on Starbucks: Did you guys have a look at that? Were you contacted or is that -- I guess that's the question: Did you even get a chance to look at that? Thanks.

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

You know what? We're involved in a lot of different situations with employers and corporations, so I won't comment specifically on any one brand. I will say that I think it's just excellent that corporations like Starbucks are allowing students and willing to pay for students to go back to school. We have many different situations where we're building up relationships like that.

I expect to also see employers target different areas of, as I said, the skills gap as we move forward here into FY15 that you'll hear more about that, both from us and others. So, the good news is: There's a lot of movement in that front, and it shows that employers are really seeing the value of investing directly in their employees.

Paul Ginocchio - *Deutsche Bank - Analyst*

Great. And if I could just ask one more: Any update on Western International?

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

Yes. Western International is close to relaunching their value proposition with a -- obviously, a significantly lower price than our other University -- University of Phoenix. They've been working very hard on the entire experience for the student. They have been tweaking things and they've been -- they want to make sure that they get it totally right, so when they go out into the market here, we feel they're ready to win. So, they are excited about it. I think you'll hear much more about that process this fall, and we'll certainly be ready to comment more on it on our fall conference call.

Paul Ginocchio - *Deutsche Bank - Analyst*

Thanks very much.

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

Thank you.

Operator

Your next question comes from the line of Suzi Stein. Your line is open.

Denny Galindo - *Morgan Stanley - Analyst*

This is Denny on for Suzi. We actually have no questions at this time.

Operator

Your next question comes from the line of Jerry Herman. Your line is open.

Jerry Herman - *Stifel Nicolaus - Analyst*

Thanks, good morning, everybody.

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

Good morning, Jerry.

Brian Swartz - *Apollo Education Group, Inc. - SVP & CFO*

Hi, Jerry.



Jerry Herman - *Stifel Nicolaus - Analyst*

Greg, I wanted to ask a little bit about global, and I appreciate your comments about its cash flow characteristics. Can you maybe give us some baseline in terms of what the cash flow dilution, let's say, is for this year? And maybe help with us -- or help give some color about the dilution associated with Open Colleges in the quarter and this year?

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

Yes, sure. I'll ask Brian to comment.

Brian Swartz - *Apollo Education Group, Inc. - SVP & CFO*

Yes, Jerry. You know, in terms of the dilution, Open Colleges -- well, all of Apollo Global and Open Colleges is dilutive to the GAAP-based earnings. Under Open Colleges, revenue recognition processes, they actually -- we recognize revenue over two years, which is generally the contractual period of the services they provide to their students. Much of the learning actually takes place much faster than that, so there's a little bit of a mismatch between when we can recognize the revenue and when we incur much of the cost to teach the students.

Having said that, it doesn't impact cash flows. It just has a buildup in the deferred revenue account on the balance sheet. So, it does negatively impact the near-term GAAP-based earnings of both Apollo Global and, obviously, of all of Apollo Education Group. I think, as we look towards the October call, as I mentioned, we'll try -- our plan is to provide more transparency into the Apollo Global financial results, including what the impacts of those deferred revenue -- longer-term -- revenue recognition time tables are for Open Colleges.

So, in terms of answering your first question, which is: What are the cash flow characteristics currently? They are smaller than the GAAP-based earnings losses. There obviously is CapEx; there are some cash tax benefits, and there is benefits on the working capital side. So, I can't quantify it exactly for you, Jerry, but hopefully it will give you a little bit of context in terms of the performance of that business, prior to the October call.

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

And to this point, they've beat every single expectation we've had for them since the acquisition.

Jerry Herman - *Stifel Nicolaus - Analyst*

Okay, great. And then, let me flip it over to your other category, if I can, because there too are substantial losses associated with those businesses. Greg, maybe can you comment on your thoughts of trajectory or reduced losses in those businesses, understanding that there is a corporate piece as well there?

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

Yes, for sure. I do expect those losses to improve. Obviously, we're planting the seeds and investing in things like Balloon for future growth, but we do expect those losses to be controlled and to moderate, and to not continue losing money for years into the future. And Mitch Bowling, our COO, is working very, very hard with these groups to ensure that there's operating excellence and efficiencies in place -- that they are getting the capital they need to plant the seeds for future growth, but that we do it in an efficient manner. So, it's a balancing act, but I can tell you that we're very focused on ensuring that the financial and margin performance and profitability performance for Apollo Group is there, without wild swings going forward.



Jerry Herman - *Stifel Nicolaus - Analyst*

Great, thanks. I'll turn it over.

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

Thank you.

Operator

Your next question comes from Nick Nikitas. Your line is open.

Nick Nikitas - *Robert W. Baird & Co. - Analyst*

Yes, thanks, just looking at longer term, it sounds like you have a little more confidence maybe in the University of Phoenix long-term growth. At the Analyst Day, it was more about sustainable growth at Apollo overall. It just sounds like more recently there's greater conviction at the University of Phoenix. Has anything maybe changed recently that gives you greater confidence?

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

I think you're hearing us right. We do have a good deal of confidence in the University of Phoenix. They've been through a rough patch. There's been a complete transformation, but we've been talking about it for 18 months.

We are preparing them to go on the offense, but for very good reason, because employers are telling us they need a healthy University of Phoenix. We need a University of Phoenix to grow -- to close the skills gap in a number of different areas. And this has been not an easy transition, but one that we think, now, they have the ability to start to focus on going on offense.

You've got to have a great product. You've got to have great service. You have to ensure that you're being completely transparent with your students and potential students on the front end, and you've got to connect their education to careers. It's not only important to the government, and they're right about that, but it's very important to the employers and to us as well, the educators.

So, I have to say: Two years ago, we didn't have that complete package in place. We're getting there, and I feel like, in the course of the next year, they can really be well positioned to get back to growth.

Nick Nikitas - *Robert W. Baird & Co. - Analyst*

Okay, that's good to hear. You mentioned the global strength, but specifically, could you talk about trends at BPP and what you're seeing there, and if you still expect that to be breakeven by the end of the year?

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

Yes, good trends all around. As I said, Curt Uehlein and the management team at Apollo Global has completely transformed the operations of that organization over the last 18 months to two years. BPP is operating in a market that still, in some areas, is in decline.

We believe they've taken market share; they are growing in the market in just about all of their categories. They're starting to enroll international students in it. I'm really, really proud of the BPP team. And they're doing it while winning awards and also increasing the stature of their accreditation and University status as well; so, good things on that front.



Nick Nikitas - *Robert W. Baird & Co. - Analyst*

Great. And then just one last one for me: Looking at marketing spend in Q4, it sounds like we should expect a slight uptick and maybe a narrowing of the year-over-year decline, but still down somewhat substantially from 2013?

Brian Swartz - *Apollo Education Group, Inc. - SVP & CFO*

Yes, we do expect it to be down year over year for the quarter, but not as much as the first three quarters' year-over-year declines.

Nick Nikitas - *Robert W. Baird & Co. - Analyst*

Okay. Great. That's it for me, thank you.

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

Thank you.

Operator

Your next question comes from the line of Tim Connor. Your line is open.

Tim Connor - *William Blair & Company - Analyst*

Thank you. Would you say you've moved out of the restructuring phase for Phoenix?

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

I'd say we're moving out of that phase.

Tim Connor - *William Blair & Company - Analyst*

Okay. And in Apollo Global, some of the lower ASPs in some of the geographies you're entering -- how does that match the cost structure there? And do you feel like you have that business scaled to a level where you feel like you can broaden your search a bit, look at some new geographies, and particularly lower-ASP geographies? And how does that fit longer term?

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

I think the answer to that is yes on all fronts. And the way it fits longer term is that these are not universities or institutions that we're either starting like we have with our partner, HT Media in India, or we're acquiring and then growing organically like we've done with our partners in Australia or in South Africa.

This is, from the beginning, meant to be a global knowledge network that needs to be on six continents -- that works with each other, doesn't compete with each other, that is helping each other build certain kinds of tools and competencies, that is in the midst of starting to share those findings and winnings where they've had them, with our domestic operations. So, it's been built from the beginning, although we think it can scale



and get a lot bigger than it is today, to work as a global network with the domestic operations being part of it. That's the last piece here that we haven't talked about, but you'll hear a lot more going forward about how Phoenix fits into that network, along with West.

Tim Connor - *William Blair & Company - Analyst*

And then, as you talked a little bit about the boot camps, in general, are you seeing any opportunities to speed time to completion for your more traditional degree programs, whether it's through West or new models at Phoenix or otherwise?

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

Well, what we're seeing is opportunities to provide value along the way. So, to provide value by stacking certificates along the way, and that is a process where you can speed value to the consumer and the student, and also to the employer.

Tim Connor - *William Blair & Company - Analyst*

Okay, thank you very much.

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

Thank you.

Operator

Your last question comes from the line of Jeff Lee. Your line is open.

Jeff Lee - *Wells Fargo Securities - Analyst*

Hi, thank you. What are your thoughts on the macro [environment], and has there been any change in the demand for post-secondary education?

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

I think the macro trends are stable at this point. It's a competitive industry, as you all know, but it's also a big industry -- over \$500 billion of spending. And actually, if you look at some key areas, it's important to understand that in key areas of employment going forward, there's growth within the sectors, and there's certainly growth in certain areas like online as well, not only domestically but certainly internationally as well.

Jeff Lee - *Wells Fargo Securities - Analyst*

Okay. And last question: Can you give us any color on how leads, conversion rates, and share rates have trended recently?

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

I would say all stable to positive.



Jeff Lee - Wells Fargo Securities - Analyst

Okay, great, thanks.

Greg Cappelli - Apollo Education Group, Inc. - CEO

Thank you very much.

Operator

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

Greg Cappelli - Apollo Education Group, Inc. - CEO

All right. Listen, thank you very much to everybody who took the time to participate in the call this morning. We're looking forward to updating you this fall. We'll be certainly hard at work to continue building the Apollo Education Group, and look forward to talking to as many of you as we can along the way. Take care.

Operator

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

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