THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

APOL - Q4 2015 Apollo Education Group Inc Earnings Call

EVENT DATE/TIME: OCTOBER 22, 2015 / 12:30PM GMT

OVERVIEW:

APOL reported FY15 net revenue of $2.57b, income from continuing operations of $53m, and EPS from continuing operations of $0.49. 4Q15 net revenue was $600m, net loss from continuing operations attributable to APOL was $10m, and net loss per share from continuing operations attributable to APOL was $0.09. Expects FY16 net revenue to be $2.18-2.23b.

THOMSON REUTERS

CORPORATE PARTICIPANTS

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

Greg Cappelli *Apollo Education Group, Inc. - Chief Executive Officer*

Joe D'Amico *Apollo Education Group, Inc. - Interim CFO*

Greg Iverson *Apollo Education Group - Upcoming CFO*

CONFERENCE CALL PARTICIPANTS

Corey Greendale *First Analysis Securities - Analyst*

Denny Galindo *Morgan Stanley - Analyst*

Sara Gubins *BofA Merrill Lynch - Analyst*

Jeff Silber *BMO Capital Markets - Analyst*

Peter Appert *Piper Jaffray & Co. - Analyst*

PRESENTATION

Operator

Good morning, my name is Amy, and I will be your conference operator today. At this time, I would like to welcome everyone to the Apollo FY15 fourth-quarter and year-end earnings calls.

(Operator Instructions)

At this time, I will turn the call over to Beth Coronelli, VP of Investor Relations. Ms. Coronelli, go ahead please.

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

Thank you for joining us. Participating on the call are Greg Cappelli, Chief Executive Officer at Apollo Education Group and Joe D'Amico, our Interim CFO at Apollo. And, also joining is Greg Iverson our soon-to-be CFO.

As we discuss our results today, unless noted otherwise, we will be comparing fourth quarter and full year 2015 to fourth quarter and full year FY14. I'd also like to remind you that the 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 result expressed or implied by such forward-looking statements. These include, factors are discussed in our quarterly reports and are also our form 10-K 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, contains the financial and other quantitative information to be discussed today. As well as reconciliation of GAAP to non-GAAP measures. I'll now turn the call over to Greg.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

All right. Thank you, Beth. Good morning, everyone. Thanks for taking the time to participate in our conference call. I'd like to start by making a few comments. And then, I'll turn the call over to Joe, our Interim CFO to review our fourth-quarter and year-end financial results.

On our last call, I discussed the dramatic steps University of Phoenix is taking to improve student outcomes. And today, I'll update you on the key areas around the execution of the plan. We also continue to make substantial progress at Apollo Global. And, I'll provide some additional data on that, as well as our efforts to diversify our business and expand our B-to-B network. And then, I'll close with a review of our outlook for 2016.

I do want to acknowledge, before I turn it over to Joe, that we are obviously operating in a challenging environment. Since our last call, we disclosed requests for information from the FTC and the California Attorneys General. The University of Phoenix also received notice that it's being placed on probationary status with respect to participation in the Department of Defense tuition assistance program for active duty military students. We're cooperating fully. We've taken appropriate action to correct any area where there is even the slightest indication or perception that we're not appropriately serving our students or complying with the requirements.

In a moment, I'll elaborate on the actions we've taken to support our commitment to put students first. Now, let me turn it over to Joe, and then I'll come back to you.

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

Thank you, Greg, and good morning, everyone. To recap our consolidated results, revenue in the fourth quarter decreased 14% year over year to $600 million. Net revenue for FY15 was $2.57 billion, down from $3 billion in FY14.

Note that, 2015 and prior years reflect Carnegie Learning as a discontinued operation, as we are actively marketing it and expect it will be sold during FY16. Carnegie Learning represented approximately $25 million in net revenue for 2015, and is excluded from the net revenue amounts reported. Including Carnegie Learning revenue, we were slightly below the bottom end of our revenue outlook of $2.6 billion.

Our operating loss for the fourth quarter was $5 million. But, excluding special items, operating income was a positive $26 million. Net loss from continuing operations attributable to Apollo in the fourth quarter was $10 million, or, $0.09 per share. But again, excluding special items, income from continuing operations was $19 million, or, $0.17 per share. The operating income for FY15 was $115 million. And, excluding special items, was $203 million. And, if you include the Carnegie loss of $8 million, we were within our outlook of $190 million to $200 million. Income from continuing operations for the full year was $53 million, or, $0.49 per share. And, excluding special items, was $120.5 million.

Focusing first on the University of Phoenix, revenue in the fourth quarter was $507 million. With operating income of $41 million and, excluding special items, $57 million. For the full year, revenue was $2.15 billion and operating income was $257 million. Excluding special items, operating income for the full year was $308 million, down 45% from 2014.

We enrolled 26,500 new degree enrollments in the fourth quarter, down 31%. With total degree enrollments of 190,700, a decrease of 18% year over year. Our fourth quarter new degree enrollments were adversely affected by a combination of factors. Including, the broader environment, a significant work force reduction at the beginning of the quarter which impacted productivity, as well as the implementation of the new diagnostics pilot and course frequencies. Fourth-quarter revenue per student, or RPS, was up 1% year over year. Slightly above our expectations. This reflects the impact of our price adjustments earlier in the year, which was largely offset by discounts. While there'll be some quarterly fluctuations, we anticipate RPS will be slightly down in 2016.

Discounts in the fourth quarter were 13% of revenue. Driven primarily by an increase in students accepting scholarships that reward progression toward graduation. For the full year, discounts were 12.3% of revenue, in line with our expectations. We expect discounts to be approximately 13% of revenue for 2016. In the fourth quarter, the University of Phoenix operating margin was 8%, or 11%, excluding special items. For the full year operating margin was 12%, or 14%, excluding special items. Compared to 19% and 21% respectively for FY14.

Moving on to Apollo Global, which continues to perform well. Fourth-quarter revenue was $85 million, with a reported operating loss of $23 million. Adjusting for depreciation and amortization and special items, Global's loss was $13 million in the fourth quarter. Compared to $20 million in the prior year. For FY15, revenue was $391 million, an increase of 23% on a constant currency basis. And, 20%, excluding currency and the acquisition of FAEL. Which closed in December of 2014.

The operating loss for 2015 was $50 million. Compared to a loss of $74 million in 2014. Adjusting for depreciation and amortization and special items, the operating loss for 2015 was $8 million. Compared to a loss of $22 million in 2014. Apollo Global was operating cash flow break even, as we anticipated.

Turning now to our operating expenses. In the fourth quarter, total operating expenses, and excluding special items, decreased approximately $63 million, or, 10% year over year. Primarily, as a result of lower enrollments, as well as the continued reduction of our cost base. Based on our actions to date, we've decreased our operating expense, when compared to 2014, by over $170 million. Our effective tax rate, excluding special items for 2015, was 41%. Excluding special items, and assuming the expected release of uncertain tax positions, we anticipate that our effective tax rate to be about 47% for the full year 2016.

Our effective tax rate continues to be impacted by the decline in pretax income of our domestic businesses and foreign tax losses. Which do not have an associated tax benefit. We expect this trend to reverse as Global becomes profitable.

With respect to the consolidated balance sheet and cash flows. At quarter end, our current cash and short-term marketable securities were approximately $698 million and our outstanding debt was $46 million.

Our liquidity, which includes our cash and marketable securities, and available borrowings on our $625 million credit facility was $1.38 billion. Free cash flow for the quarter was $21 million and $71 million for the year. With that, I'll turn it back to Greg.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

All right. Thank you, Joe. The first thing I want to do is thank Joe for returning to lead our financial operations this summer and fall. Joe's done an excellent, excellent job, excellent work. And, we're really grateful for his many contributions during our search process.

It's really also a pleasure to welcome Greg Iverson as our new CFO. He's going to start on October 26th. For the past eight years, Greg has served as a leader in our finance function and is a highly capable and experienced member of the team. Greg's here today. And, he's going to be actually presenting on our next call.

Let me just provide some additional perspectives around our strategic plan. Which we are in the process of executing on. There's three things we're very focused on. Transforming University of Phoenix to a smaller but better performing university, growing our international operations, and expanding our non-degree initiatives through certificates and boot camps.

Up first, University of Phoenix continues to take it's significant action to improve student outcomes. Our current graduation rates for bachelors and masters are about 41% and about 54% respectively. They have improved and we can do better. That's our number one priority.

We're focused on ensuring that the important improvements we're making support our vision to become the most trusted provider of career-relevant higher education for working adults. And, we have been, and continue to be, committed to enrolling students who are better prepared to succeed in and graduate from our programs and to be successful in their professional career goals.

To support this, we're focused on five concrete actions. I'll take you through those. First, incorporating pre-enrollment diagnostics and admissions criteria and creating student pathways into the university. Second, realigning program and course offerings and retiring many associate degree programs that have lower retention. Third, further refining our campus strategy to focus on the best performing major metro markets. Fourth, dramatically simplifying our course calendar by eliminating weekly starts. Which supports student satisfaction and increases operational efficiency. Fifth, realigning how we engage with students. Including, not using third-party affiliate channels and building direct connections with prospective and existing students.

Now, here's where we stand in each of these areas. First, about incorporating diagnostics in student pathways. We're attuning an admissions process to student needs and ensuring we identify which prospective students are academically prepared for the rigors of undertaking a college degree at our university. As well as identifying those who require additional support.

We're also working with partners to implement pathway programs to provide additional academic support for students. We began to test new diagnostics this past summerstarting with all incoming students in two of our colleges. From this pilot, we plan to begin including admission guidelines and a phased approach throughout the fiscal year.

Second, the realignment of our programs. We do remain committed to continuously improving our programs to ensure they deliver the skills students need to succeed in today's high demand careers. And, we're retiring programs, revising existing offerings, and developing new programs with outcomes aligned to industry needs. In FY15, we refreshed over 20 programs. We rolled out 18 new degree programs and 14 certificates. Including, an advanced cyber security certificate and two business programs designed around curriculum guidelines of the Society of Human Resource Management.

This September, the university retired eight associate programs and is offering more career-aligned programs that offer both certificates and bachelor degrees in key career growth areas. In 2016, plans are in place -- in place to launch 14 new certificates and 13 degree programs. Including offerings in public administration, IT, security, and healthcare.

These programs are in growing markets and will provide the university the opportunity to attract new students. We were also pleased to announce in September, Time Warner Cable and IBM are realigning security-related job positions to the University of Phoenix and ASIS Foundation Enterprise Security Competency Model. The US Department of Labor has endorsed this model.

Now third, our campus strategy. We're in process of making our locations vibrant destinations that link students, community partners, employers, alumni, and faculty to enrich all aspects of our classroom and campus activities. Our strategy centers on a process of realigning to fewer markets where we can continue to have a strong regional presence while keeping a national, but more refined, network throughout the country. We're actively focusing on 26 markets in 17 states. For a total of 67 locations.

Fourth point, moving away from weekly student starts. We've begun to reduce the frequency of program starts for new students. That improves student satisfaction and reduces operational complexity. Establishing a more consistent academic calendar improves the student experience and academic engagement. As we make the transition, we anticipate an impact in the near term. With a one-time effect on new enrollments and revenue relating to adjustments in existing student schedules to align to the new cadence. In the long-term, the changes will result in better student retention and satisfaction. With more optimized class sizes and fewer course cancellations.

Fifth, changing how we engage with prospective and existing students. As of early October, the university no longer uses third-party affiliates. For us, this has been a high cost, low conversion channel. So, shifting away from affiliates reduces complexity and compliance risk. The change has been well received in conversations with key regulators and policymakers as well. Although the action will clearly have a negative impact on new enrollments in FY16, we believe the ROI will be positive due to net cost savings overall.

We're going to reinvest into other higher converting channels that directly connect to students and drive more traffic to Phoenix.edu, which is being redesigned to deliver more useful content and improve navigation for students on all devices. In addition to moving away from the affiliate channel, we're creating a balanced mix between marketing the overall university and a college-specific approach to our messaging.

This includes promoting the quality of our education, while demonstrating our deep understanding of students' and employers' needs by college, by industry, and by region. We're increasing our focus on developing the skills and experiences our existing students will need for their careers. While also working with employers so they better understand our capabilities and the uniqueness and value of our well-prepared diverse graduates.

Finally, as we discussed last quarter, we continue to build self-service capabilities for many of our student service applications. And, we're making progress in moving away from more costly, proprietary, and legacy IT systems. That will greatly improve costs and efficiency. We're still on track to begin to roll out the new learning management system for incoming students in partnership with a leading provider using their newly designed state-of-the-art LMS by the end of FY16.

Together, these initiatives will yield a stronger university that we believe will support higher completion rates and improve student satisfaction. Again, these changes will not be without challenges. Specifically, an impact to enrollment. Which I'll address in our outlook.

But, we know these changes are the right thing to do for our students and for the long-term health of the university. Let me provide a concrete example of the success that can be achieved when our college and campus strategies and employer and partner engagement come together. The College of Health Professions partnered with three hospital systems in one market in California and successfully launched seven nursing cohorts in September. This collaboration supported new enrollments well in excess of the budget in the campus and program.

The College of Nursing is also running an RN/BSN concurrent enrollment program with an increased number of community colleges. We're dedicated to providing programs in growth markets connected to careers and specifically tailored to their region. We can apply this targeted approach to serving our students and building employer and partner relationships across our network.

Now, I'll briefly share an update on Apollo Global. We're building a strong value proposition at Global. And, as we're increasing our Global presence with locations in seven countries. Including, the addition of FAEL in Brazil in FY15.

The Global institutions currently serve over 150,000 learners worldwide, including students in degree and non-degree programs. Our efforts to expand our Global reach allow us to continue to diversify our overall revenue mix. In FY15 Apollo Global experienced significant expansion and is expected to grow top line organically. As Joe said, at a compound annual growth rate of about 20%, constant currency, over the next five years. Every country we operate in is growing. We expect our 2016 revenues to be about $435 million, based on current exchange rates. But, it would have been about $460 million on a constant currency basis.

We anticipate Global will be GAAP breakeven in FY17. With EBITDA of about $40 million at that time. And, ramping up to $200 million by 2020, and higher with any future acquisitions. If they occur. Our commitment to growth at Global has and will continue to deliver real results.

We signed an agreement this week to acquire CPG. That's a leading provider of private higher education in Germany. CPG is a premium and highly respected higher education platform in Germany. Including some of the most respected brands in management, hospitality, and tourism.

This acquisition increases the value of our Apollo Global operations. With the contribution of about $8 million of EBITDA annualized for 2016. Our BPP management team and CPG will immediately be able to share best practices. We continue to identify and pursue growth opportunities connected to our professional development business. We're leveraging our corporate relationships, accreditation, and learning expertise.

Just quickly on The Iron Yard. We continue to see excellent growth in the IT boot camp market. We actually recently launched a program in London and we foresee opportunities to collaborate between The Iron Yard team and Apollo Global. We also see opportunity to drive new programs in technical and non-technical fields that benefit from the immersive delivery format. I'm also pleased to report Western International, albeit small, is now experiencing growth. As the new model is really resonating with employers.

Before I close, I'd like to briefly comment on the current regulatory environment. As I mentioned, we're dealing with a number of recent issues. Over the past five years, we've redoubled our commitment to ethics, compliance, and student protections. Our organization is guided by strong core values with one unifying principle: students first. No institution is completely insulated from mistakes. But, when we identify or are alerted to them, we fix them. There's no benefit in recruiting students, either here or abroad, if it's not a good fit.

Here are some of the actions we've taken to put the student first. First, we've increased transparency around the cost of college. Promoting affordability with University of Phoenix tuition and fees. That are now reported below the national average for private schools.

We were an early leader with tools and counseling for responsible borrowing. Which we believe has contributed to the dramatic decline in student cohort default rates at University of Phoenix to 13.5%. We are now closing in on the national average of 11.8%. Despite, educating many first in family students, as well as working adults with jobs and families. And, we're helping our students understand the rigors of our programs by offering a risk-free period before freshmen actually take on any debt.

We're successful when our students are successful. We're committed to engaging students through outstanding service and effective counseling. To that end, we've implemented sophisticated monitoring systems to ensure the quality of calls between our employees and students, which is an integral part of our compliance process. We were pleased to be recognized for the prestigious Ethisphere recognition in 2015 for leading in compliance.

Finally, as I've already said, delivering meaningful outcomes is our top priority, and I want to provide you with a new critical data point. Many of you know that the White House has been working on an important initiative called the College Scorecard. The Scorecard is loaded with data for colleges and universities across the nation. It was designed to help future students sift through data about institutions across the US, so they can more easily understand what colleges are offering and determine the best fit.

We think it's an important new tool, and we're very pleased to see that the University of Phoenix ranked a prestigious number six in the Scorecard for alumni salaries for private universities over 15,000 students. Even more, we placed 24th for all public and private universities in the database with over 15,000 students.

University of Phoenix alumni median salaries are well above the national average and within the top 15% of schools. To anyone questioning the value of a University of Phoenix degree, you can now turn to the White House Scorecard to help answer that question. These results speak for themselves. This is why working adults choose University of Phoenix and have in the past.

It's an institution that provides real value for our students. An institution that makes a meaningful difference in their lives. We're standing up and providing a voice to our over 1 million students and alumni. We've been fighting on behalf of working adults who seek access to quality higher education for 40 years. 25 years of that, serving the men and women of the armed forces. With over 80,000 military graduates.

The success of our students and their significant accomplishments working through rigorous programs cannot be ignored. These are learners who have faced adversity, but have shown the grit and determination to change their lives through education. University of Phoenix is fulfilling an essential need for these students.

I'd like to share some thoughts on our broader outlook now. The actions that I updated you on today, as well as external factors, will put pressure on new student enrollment, revenue and operating margin, in FY16. We firmly believe that as we execute our plans we will begin to see additional improvement in retention and graduation rates, a better student experience, and ultimately, a stronger university. It should also result in a better economic model for our shareholders over time.

Our 2016 outlook, based on our current view, includes net revenue of $2.18 to $2.23 billion and operating profit of $115 million to $140 million. We continue to anticipate ending FY16 with about 150,000 students at University of Phoenix and beginning to stabilize in 2017. As we committed last quarter, to offset this decline in enrollment, we are in the process of taking appropriate cost actions to better align our costs with expected revenue until retention begins to improve and enrollment stabilizes.

Over the next three to five years, we are targeting a consolidated operating margin of 15% to 20%. While we are working to ensure we have the ability to continue to serve active duty military students, our new outlook range does include some impact from the recent Department of Defense action. As we can't be certain as to the timing of reinstatement.

As for retention, we're building in some retention improvement in FY16, that we're seeing now. We do expect to see retention improve modestly throughout the year with more meaningful improvements starting next fiscal year and beyond. Our current operating profit range includes FY16 cost reductions of about $300 million on a gross basis. That's compared to 2015.

Now, our own internal operating income target, remains $150 million. However, that's going to require additional savings to close the gap to our current outlook range. And frankly, the timing of that is not as certain for FY16 and could bleed into FY17. As I said, we are aggressively working to identify those savings and we'll provide an update on our next call.

None of us at Apollo are satisfied with where we are right now. We want better for all of our stakeholders. Despite the enormous political distractions along the way, we are committed to delivering long-term value for our students, alumni, employees, and shareholders.

With that, I'll turn the call over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Corey Greendale, First Analysis.

Corey Greendale - *First Analysis Securities - Analyst*

First question I had is, Greg, as you talked through the assumptions going into your FY16 guidance. I think you said that you still expect to end the year at about 150,000 students? Which I think is what you said last quarter. So, can you just give us some sense of what is driving the reduced operating income assumption for this year if the enrollment number has not changed?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Yes, obviously we're making a lot of assumptions. That's a great question. We're making a lot of questions around the number of significant initiatives that I pointed out in the summer that we're executing on now. Some sooner. We started some of them a bit sooner than even in the first quarter. So, some of it is timing.

Some of it is related to the fact that there is some cushion, or, was some cushion, in the number for the students enrollment number. And, that's a bit tighter right now. But, that is still the aim. To get to that number.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. And then, you talked through the five actions. Can you just help a little bit? Directionally, I think you talked about those things before.

But, I'm not sure I fully understand how those have evolved, relative to last quarter and the timing? So, maybe just a couple specifics to the changes in the pre-enrollment diagnostics and admissions criteria. Has that changed relative to what you talked about last quarter? And, but, when does that go into effect?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Yes, we obviously had not -- I don't believe started it on the last call. So, yes, there. That's a fairly significant sample size that is now being piloted, tested within the university. And, they're really doing a great job looking at a number of different ways to do that. But, they are having success. They're seeing improvements in first quarter's completion in those pilots.

Now, we want to get all the way through the fourth course completion. Because that's when we're fairly certain that the outcomes are much higher at that point. So, I can just tell you that they are using a lot of data. Very sophisticated tools that are aligned properly. And, I think that they will end up completing that pilot as we move throughout the year. And then, locking in a methodology for all the colleges.

But, it is having the impact they had hoped. And again, they're building out pathways as well for students. The idea is to make sure that we have enough data about students so that we can place them correctly in the programs. And, if it's not appropriate to start at University of Phoenix right away. Not only are they having more time now as we're stretching out the start dates, but we can also provide them a better pathway if it's not at the University of Phoenix. So, eventually they can make their way back.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. Can you just give an example of the kind of outside UOP pathway programs that you're referring to?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Yes, it could be directing them to a community college. It could be directing them to an outside provider that we select and have an agreement with to help them. Do the work that they need to do to get prepared. Either to go to another college or back into the University of Phoenix.

Corey Greendale - *First Analysis Securities - Analyst*

I see. And then, on the campus strategy, has the number of physical locations changed relative to what you thought last quarter? And, what's the time -- and are there additional closures to come and what's the timing on that?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

No, nothing's changed from what we talked about last quarter. They're on target. They've done a beautiful job modernizing and refreshing. A number of key locations are ready. It's a super collaborative environment in the new design.

And importantly, we're listening to employers and what they're asking for to get the best outcomes so students are really prepared to move into the world of employment and succeed. What I believe employers don't want is for a student to come out of a college environment and then they have to be retrained in key areas. And, that includes working collaboratively together.

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

I'll just add on the campus closures. That's a process. We go through a teach out. We make sure every student who started with the university can complete with the university. And so, that's in process.

That'll take a few years to get through. But, it's all underway. Plus, we have to get approvals from different states and the like. That's what we're going through right now.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. I'll ask just two more quick ones and then I'll turn it over. And jump through again.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Sure.

Corey Greendale - *First Analysis Securities - Analyst*

So, the simplifying the course calendar. You'd talked about that last quarter. I don't recall if you specifically said five weeks. Or, if you said, just re -- generally, reducing the number of starts.

Is that new? What's the timing of that? And, when you said a one-time effect, do you mean there's going to be effect until that anniversaries? Or, just in the quarter that that's implemented, do you expect an effect?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Yes, just in the quarter. I mean, if you think about it, we were starting students every week for a long period of time. And, as we change the model and we drive the college operating model what the University of Phoenix wants to do is ensure that students, right, have the time to select the right course, right courses.

And, that they're having nice full vibrant cohorts that start. So yes, there is a one-time impact in the quarter and then it should normalize after that. And, I gave those dates, Corey. If you need them again I can get them. But, in terms of the number of -- that we're going to be changing to, instead of weekly, for both our bachelors and masters.

Corey Greendale - *First Analysis Securities - Analyst*

And then, how about -- when does the change happen?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

The change is beginning to roll out -- began to roll out in Q4. We did that with a couple of different curriculum. Health Sciences, or, Education and Criminal Justice are two that started.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. And, this is the last one. I promise. The -- I saw it in the release there. Is a -- there was a charge related to open colleges valuation allowance. Can you just -- but, was that a -- an earn-out or is that a bad debt thing? Or, what is that?

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

So Corey, that relates to income tax. And specifically, it relates to recording a valuation allowance against open colleges deferred tax asset.

Corey Greendale - *First Analysis Securities - Analyst*

Got it. All right. Thank you.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Thanks, Corey.

Operator

Denny Galindo, Morgan Stanley.

Denny Galindo - *Morgan Stanley - Analyst*

Hi. Good morning. Thanks for taking my call.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Morning, Denny.

Denny Galindo - *Morgan Stanley - Analyst*

Some of the revenue in our model, the revenue shortfall in our model, came from higher-than-expected discounting. And, it sounds like this is really a result of the mix of students, moving more towards students who are further along in their degree. And, as we have starts that are declining every year and more students of your mix are farther along in their degree.

Do you expect this discounting percentage of revenue to increase? It's gone from, what, 9% a couple years ago to 12% and now you're saying 13%. Is there any idea of where this might peak? And, when it might peak?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

I -- what I would -- yes, good question. I -- we don't expect there around, but, we can control that number. I mean, the whole key to that discounting methodology is, right, as people get further along in their programs. As you pointed out, right, that they're taking advantage of that.

So, I think that's something that we can control. And, I don't expect that number to rocket higher. Now, I will say this, under the college operating model, every executive dean at the University of Phoenix studies their markets by program. And, the more important piece, aside from discounting, that they're looking at is to make sure that they're competitive in every market. So, there's not one pricing strategy for the whole organization at University of Phoenix.

They're actually looking program by program at every market to make sure that they're competitive. And, they continue to do that. But, I think that the discounts is something that can be controlled. And, we don't see that going significantly higher from here at this point. We'll certainly update you on that quarter to quarter.

Denny Galindo - *Morgan Stanley - Analyst*

Okay. That's helpful. And then, just thinking about discounting and marketing. They're kind of two sides of the same coin; different ways to get students in. You're doing a lot with the shift away from third-party marketing. But, do you have a sense of, if you think about these as one expense, together, the discounts and the marketing? What a normal level will be for you guys once you get to that 15% to 20% operating margin you talked about?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Just so I understand the question. Are you asking, what level we expect to spend?

THOMSON REUTERS

Denny Galindo - *Morgan Stanley - Analyst*

Right, exactly. Like as a percent of revenue. Like, it seems like you're shifting away from marketing more towards discounting. Is that -- are you consciously doing that?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

No, I wouldn't say that at all. I mean, we're making strategic decisions in marketing. There's area of marketing -- areas of marketing that five years ago were very different and very important. But that -- the world's changed and the industry's changed and we're being more strategic about how we spend marketing dollars.

Let me summarize it this way. So, we are being more strategic about how we spend every dollar, right, looking at ROI. In terms of, we only want to spend dollars to attract students that we think can have success at the University of Phoenix. Now, we're going to put them through diagnostics. They're going to get a risk-free period, right? We don't want to bring in students that can't have success, right? We're proud of those graduation rates. We want them to go higher. As I've stated many times.

But, it starts back in the fact that we want to know a lot about -- a lot more about the people that we are recruiting. Number one. We want them to spend time with us on our website with a lot of rich content so they can explore. When -- we want to make sure that the start dates are timed for them to enroll appropriately, right? And then, we'll take it from there. But that does go back to how the marketing is done, the campaigns, how they're aimed, and the strategic dollars that are spent. I -- we're absolutely not saying that that third-party affiliate channel isn't right for certain people in the industry. I'm sure it is.

For us, we've looked at it and said we want to spend our dollars strategically in other ways to get a better, higher ROI for us. So, I wouldn't make the assumption that there's a certain permanent level of dollars that are going to be spent. We looked at mar -- we look at marginal returns and lifetime value, right? So, what it costs to acquire a student and how that plays out throughout the lifetime value of the student. That obviously changes if you're recruiting students that are staying longer and completing at higher rates. Does that make sense?

Denny Galindo - *Morgan Stanley - Analyst*

Yes, that's helpful.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Okay.

Denny Galindo - *Morgan Stanley - Analyst*

Switching gears over to gainful employment. Just wanted to get an update there. It looks like in the 10-K you mentioned that you're teaching now about 10% of the students in programs that were impacted by gainful employment. Which I think is, maybe, the first time you quantified that? But, maybe you could give us a little bit more color of what programs were in that 10%? And, is this higher or lower than what you would have thought, maybe, six months or 12 months ago?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

No, I would say, the number -- well, first of all, I want to be clear. The number one reason that the University of Phoenix is moving away from the number of associate degree programs is to get back to closer to our roots, right?

Of bachelor's and masters and higher, right? Because those are areas that we want to focus on and we believe that we can have success in. Number two, we're looking at programs and how they're aligned to careers. That's the most important piece. If it's not well aligned to a career, then we are unlikely to offer that program.

So, they did a very intense strategic review of all of our programs. The associate - program world is something that the University of Phoenix got into relatively late in its history, right? Over its 40-plus year history. And, something that we are continuing to scale back as I've talked about. As far as a gainful employment, I feel good about our position in that right now. And that, certainly, is part of the equation and the regulatory environment that we'll -- we intend to comply with going forward.

Denny Galindo - *Morgan Stanley - Analyst*

And then, along those lines. I've heard anecdotally that the Department of Education is taking longer than expected to approve new programs. And, a lot of firms are adjusting their programmatic mix to deal with gainful employment. Is that something you're seeing that has impacted you in any way? That it's hard -- you have the idea to put a new program in, but, it actually takes longer to get it approved and get it up and running?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

I haven't heard that. I can -- we can certainly recheck that data. But, that is not something that I've heard is an issue right now.

Denny Galindo - *Morgan Stanley - Analyst*

Okay. And then, the last one, just housekeeping. You mentioned nursing programs. I wonder if you could give us an update on what percent of your starts, or, in your enrollments are in these kind of nursing programs at this time?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

It's a small percentage. But, I'm really pleased with what the university did in a couple locations where they partnered really nicely. Again, it's a listening to the employers, whether they're in healthcare or other areas. And, they did that nicely.

They made sure they understood where the demand was. They created the right kind of program and certification. And, as an example, that's growing really nicely. And, I think we believe that's something that we can replicate and copy as an example around the country. So, no. It's not a big part right now. But, it certainly, we think, can be much bigger.

Denny Galindo - *Morgan Stanley - Analyst*

All right. That's it for me. Thanks, guys.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

All right. Thanks, Denny.

Operator

Sara Gubins, Bank of America and Merrill Lynch.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Hi. Thanks. Good morning.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Morning, Sara.

Sara Gubins - *BofA Merrill Lynch - Analyst*

So, one of the biggest questions that I've been getting is how you get to the target of about 150,000 students for University of Phoenix being the right target? And, why it couldn't be higher than that or lower than that? Could you help us think about, or, understand better your thinking about why that's the right number?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Sara, it could be. It could be higher. It could be lower. I mean, this is an environment that is unprecedented, in that we're in right now.

And, we are dealing with a lot of things in the environment right now. And, we're trying to deal with them as professionally as we can. And, we're committed to getting through this period, right? For our million graduates. So that they're very proud and they have a very solid and sound foundation in the University of Phoenix moving forward. We're absolutely committed to that.

So, that number could move around. That's our best guess. There's a lot of work that goes into that. That is a college by college buildup by executive dean. By looking at market, market share, competitive sets, the program rollouts, the number of schools. You load on to that the number of initiatives that are in place. All, again, to put the student first and to get better outcomes.

Pre-enrollment diagnostics, admission criteria, realigning program and cost offerings, refining the campus strategy and the footprint, simplifying the course calendar, how we're engaging with students including the third-party affiliates. There's a tremendous amount of analysis that's going into that. So, is that to say that number's perfect? No, but it's our best estimate at this point.

And we're just going to keep you updated where we are quarter to quarter. Until we get through this to a more stable pattern where we can predict it a little bit better and our outcomes are going the right direction. Which we saw the first hint of this quarter.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. Great. Several on enrollment. I know that there's been a huge focus on trying to reinvigorate corporate relationships and to expand them. Could you give us any ballpark sense of what portion of your revenue or enrollment is coming through some type of corporate relationship?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

I'd say it's less than 20% at this point. But, again, we're building. And, again, that has to be categorized, right? In degree and non-degree. It's more when you include everything. So, it's a real opportunity for us.

What we've been doing is listening to the most respected employers in the country. And, we've learned so much over the past couple years in terms of how we can help improve the ROI on their workforce development. It is absolutely the number one thing that I hear every single time. Corporations are trying to better identify the right people, make sure they're trained the right way so they don't have to retrain them. And then, make sure they don't leave before they get the ROI off that whole process. And, that is a real problem.

What I've heard, this is my analysis and data, is it's about 50% of the time they don't. So, instead of building a bunch of stuff and then saying, you absolutely need this and we know you what's best for you, we've listened. And, we're building to that now. I do expect those percentages to go higher over the course of the next year or two. And, we are building some great relationships and you will hear more about those this year.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. Great, and then a couple of cost questions. First, where should the cost cuts that we see this year be concentrated? In what line items?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

They're across the entire organization.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay.

Greg Iverson - *Apollo Education Group - Upcoming CFO*

Yes, we have cost reductions across all the categories. I'd say one where you'll see -- you can expect to see a disproportionate decrease is in the admissions advisory area based on some of our actions there.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

And then, Sara, think about it. We're not looking -- everything we look at there is not just go get costs out. It's looking at the structure of the organization, right? The reengineering of everything from how do we do it better, how do we use more self-service? Which we know our students really, really like.

How do we not be the only customer of our technology systems and finding the best partners to make sure that they're getting it done right for us? And, all of that is coming together in 2016 for us. Whether it's financial aid processing, or -- there's so many areas that we're addressing that were legacy for many, many decades here. So, that is all stuff that's being worked on and there's costs associated with it.

Sara Gubins - *BofA Merrill Lynch - Analyst*

And, in the past, you've given a rule of thumb about the impact, the variable costs declines as enrollments decline versus fixed costs coming out. Has anything changed about that variable rule of thumb?

Greg Iverson - *Apollo Education Group - Upcoming CFO*

There's been no change structurally in our cost base.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. And then, just last question. There are a lot of moving pieces and a lot's going to depend on the timing of when the various initiatives get rolled out. But, as we build quarterly models for FY16, is there anything that's just worth noting we should try to take into account from a quarterly perspective?

Greg Iverson - *Apollo Education Group - Upcoming CFO*

I think the biggest thing to take into account from a modeling standpoint in terms of the initiatives that Greg spoke to is the timing of the course frequency change is front end loaded in Q1 and Q2.

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

It puts in Q1.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. Thank you.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Thanks, Sara.

Operator

Jeff Silber, BMO Capital Markets.

Jeff Silber - *BMO Capital Markets - Analyst*

Thanks so much.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Hello, Jeff.

Jeff Silber - *BMO Capital Markets - Analyst*

Hi, how' re you doing?

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

Hi, Jeff.

Jeff Silber - *BMO Capital Markets - Analyst*

Just a follow up on those last line of questions. What impact, or, where do you think starts declines can go because of some of these impacts? And, where will we see it ramp up to get to that 150,000 soft target by the end of the year?

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

So, I think you'll find that the next few quarters will be difficult quarters for us from a new degree enrollment perspective with more recovery late in the year.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Hello, Jeff, I'd look for a similar pattern that we had this quarter in terms of percentages and then improving throughout the year as Joe said. So -- and again, our hope is that offset the retention is going to continue to improve and offset that we haven't built a huge bond into it. But, I -- certainly for next quarter, I would look for a percentage range that's similar or within this range. Maybe, a little bit more, even, because of the number of initiatives and the timing of those, right? And then, some more normalization towards the back half of the year. Certainly the comp gets a lot easier in the fourth quarter.

Jeff Silber - *BMO Capital Markets - Analyst*

Yes, no, that's fair. So, let's assume that's the case and you do end the year at about 150,000 students. Given the steep decline in starts this year, would it make sense that total enrollment would continue to decline next year since you're starting with a lower freshman class, per se?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Yes, it's possible it could go lower than 150 next year. We don't know exactly how much. Some of that's going to depend how big the retention gains are. But, it is possible you could be looking at 140 to 150. I mean, what -- we're going to keep you updated as we know that information and data. And, some of it will depend on where the starts obviously come out. As we look to some of these initiatives kicking in towards the back half of the year that we're putting in place now in terms of growth initiatives.

Jeff Silber - *BMO Capital Markets - Analyst*

All right. That's helpful. I'm going to ask you a question that investors ask me and hopefully you can answer this.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Sure.

Jeff Silber - *BMO Capital Markets - Analyst*

I've had a lot of questions as to why the Company uses its cash to continue to make acquisitions outside the core business before the core business is even close to being stabilized?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Well, it's a good question. It's a fair question. We've used a lot of capital in the past on the core business. We're funding it to the needs of what they need. You can see that they're continuing to make investments in certain areas in the core business. Look, we set out and were very clear a number of years ago, that part of the strategic plan approved by the board of directors was to diversify revenue, right?

In some part away from just the US domestic for profit, higher education, degree granting business. I think you can see what happens when all of your eggs are in that basket. It is something that this organization has been doing and focusing on in terms of executing on that plan to move some of that, right? Outside the US and abroad. And frankly, Apollo Global, right, is delivering. It's growing. It's on its plan.

We believe it can have very significant EBITDA. And, every quarter we should be able to show that and demonstrate that there's real value creation there. And, as I gave some of those numbers out, you can look at the size potential with Apollo Global, right? The institutions that we're adding, the quality of those institutions, the branding, the network effect, right? That should even rub off here in the US, in the University of Phoenix.

So, we understand the question. We respect the question. We haven't been using very, very significant amount of the capital over the last couple years. We have $1.4 billion in liquidity. And, we'll use that appropriately.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay. Great. Just one more. I know when you had disclosed the issue with the Department of Defense you gave us some color quantifying the -- I think it was the percentage of University of Phoenix students that get tuition assistance.

I've had some questions if you've heard anything from the Department of Veterans Affairs on similar issues? And, if you can also quantify the impact of money coming from that department? Either, through the GI bill, or something else, on the total Company? Thanks.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Sure. We have not quantified our specific divisions. Whether it's any of the colleges or military. Obviously, the Veterans Affairs -- Veterans is a bigger position. And, I think we've been clear about that in terms of our enrollments.

And, with respect, Jeff, to any regulatory concerns or the veterans which we've been proud to serve for decades, we want to make sure that we're doing everything correctly and in compliance. And, if there's questions, we will address them. We will answer them. And, we will ensure that if there's something that needs to be changed, it's changed.

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

Yes, and the VA has come out and said, basically, the VA program is available to veterans and continues to be. So, that was after the DOD issued the -- put us on probation, so.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

If there's any update there or something that we believe has changed, we're going to update you.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay. Appreciate that.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

And, we do expect, whether it's Department of Vet-- any of the military, any of our regulatory bodies, to regularly, right, have audits. To regularly have reviews, program reviews, our accrediting body. We're very appr -- proud to be affiliated with. That's in a really, really important part of the structure and the industry. So, when those things occur, we're going to do whatever we need to do to make sure that we're listening, doing the right things. We have the right compliance in place. And, we're executing on that. That is part of being in this industry.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay. Appreciate the color. Thanks so much.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Thank you, Jeff.

Operator

Peter Appert, Piper Jaffray.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Hi, Peter.

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

Thanks. Hello, Greg. So, how big -- can you quantify how big the third-party affiliates are in terms of a portion of starts? And, I'm asking this in the context of understand -- I'm trying to understand if this might be particularly disruptive here on the near-term basis?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Well, it's a large part of our spend. Still, all things considered. And, it's a -- it -- what we are finding is that when you look at the margin of returns, when you look at the ROI on that spend, it's not consistent with where we think it needs to be for us. It might be for others. They might do a great job for others.

For us, it's not. And, it's not consistent with what we're trying to accomplish in terms of making sure that our students are informed the right way. And again, I go back to the ROI lifetime value analysis. That starts with how we spend our dollars to attract students to the university. So, it's not insignificant. It's built into the disruption, and yes, it is absolutely disruptive on a starts front this year. Because we are pretty abruptly and quickly moving away from it, but, we think it's the right thing to do.

We'll be reinvesting dollars into other channels where our marketing team believes there's opportunities for us. And, we'll be doing it the right way. But, I absolutely agree with you that it is disrupted this year. No doubt about it.

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

Right. I think granularity, Greg, in terms of the performance within the global businesses. In terms of, just some color on --

---

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Well, I guess I would say that -- and we'll look at data and perhaps, maybe, put some more data out again next quarter. I'm giving more and more data on Global. As an example, BPP went from unprofitable to significantly profitable for us over the course of the last year. They are clicking on all cylinders. I think they're up to 50 of the top law firms that are exclusively enrolling students at BPP's law school.

THOMSON REUTERS

Their PQ business, right, in finance and accounting is they have transformed the way that industry works from an offline to an online world. From a technology standpoint. And now, they're sharing that information to other Global entities. They're recruiting internationally now. So, I would say that every country is different. They all have different opportunities.

I'd -- probably our fastest growth is coming out of Brazil, even despite what the country's going through there. I know they're very, very excited about that part of the world. South Africa is doing a beautiful job taking learnings and best practices from other entities that we have. And, they're just really excited. Not everything goes perfectly in every country. There's always going to be a challenge.

But again, no one country is going to cause, that I see, the amount of disruption that we've seen in the US here, right, to the Global network. Because they're pretty well diverse around the world. And, continue you add piece of it. Looked at the German economy. It's one of the largest countries in the world and it's tied into some exceptional B-to-B partners. That we are very, very interested in having relationships with. And, I think we can do a good job with.

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

Apart from the D and A charge, which of the units now is holding you back from a profitability standpoint?

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Yes, it may -- let me -- so, obviously they're investing in growth, right? I mean, in Mexico they're opening up a lot of new locations, right? In Brazil they're investing, into -- I mean, their enrollment there is doubling, right? I mean, they're investing in really all of their key markets. And, they have an infrastructure that they're just crossing over to, right? From a profitability standpoint, they're cash flow positive this year. Their -- frankly, their EBITDA ramps up really nicely.

You're going to see this now in 2016 and 2017, unless something changes, right, in the businesses. Which we don't see at this point. Again, things aren't perfect across the board. There's always an issue in some country that they deal with. But, the scalability of the model, I really believe works, and I think the margins can be at least what they are here, and, or, have been at scale in the US.

Greg Iverson - *Apollo Education Group - Upcoming CFO*

And, one thing I'll add to that, Peter, is we've talked about this in the past related to open colleges. Australia, specifically. But, we recognize revenue, as we've said before, over a fairly lengthy period. A couple of years. Whereas, a lot of the cash is received upfront. And so, you'll continue to see that deferred revenue building. And so, that's part of why you see a disconnect between the cash flow for Apollo Global versus the GAAP earnings.

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

Got it.

Joe D'Amico - *Apollo Education Group, Inc. - Interim CFO*

We are in the stages of planning an analyst day so that investors and analysts in 2000 -- in calendar 2016 can get a better look at the universities and training associated with Apollo Global. And, can start to understand our individual markets and their contributions going forward.

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

That would be great, thanks. And, the last thing, do you have an estimate of what the restructuring charges could look like in FY16?

Greg Iverson - *Apollo Education Group - Upcoming CFO*

Yes, so based on the restructuring actions that we have planned to date. So, related to our campus, the campus realignment as well as some of the employee actions that we've identified, that amount is less than where we -- where we were for this past fiscal year. That said, as Greg mentioned earlier today, we have some additional cost actions that we are contemplating. And so, I think a reasonable assump -- planning assumption is a level that's fairly comparable to what you saw in 2015.

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

Got it. Great. Thank you.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

Thank you very much.

Operator

This concludes our question-and-answer session. I would now like to turn the call back over to Greg Cappelli for closing remarks.

Greg Cappelli - *Apollo Education Group, Inc. - Chief Executive Officer*

I want to thank everybody for taking the time this morning and for your thoughtful questions. We will continue to keep you updated. We appreciate your support and we look forward to talking again soon. Thanks so much.

Operator

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