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APOL - Q1 2016 Apollo Education Group Inc Earnings Call

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OVERVIEW:

Co. reported 1Q16 revenue of $586m and net loss from continuing operations attributable to APOL of $58m or $0.53 per share. Expects 2016 net revenue to be $2.14-2.18b.

CORPORATE PARTICIPANTS

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

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Denny Galindo *Morgan Stanley - Analyst*

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Trace Urdan *Credit Suisse - Analyst*

Jeff Mueller *- Analyst*

PRESENTATION

Operator

Good morning. My name is Shannon and I will be your conference operator today. I would like to welcome everyone to the first-quarter FY16 conference call.

(Operator Instructions)

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

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

Thank you for joining us. Participating on the call with us today are Greg Cappelli, Chief Executive Officer of Apollo Education Group, and Greg Iverson; Chief Financial Officer. As we discuss our results today, unless noted otherwise, we will be comparing the first quarter of FY16 to the first quarter of FY15.

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 10-K filed with the SEC, and also on the 10-Q that was just filed this morning, both of which are 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 the reconciliation of the GAAP to non-GAAP measures.

And with that I'd like to turn the call over to Greg Cappelli.

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

Thank you, Beth. Good morning, everyone from Phoenix. Thank you for taking the time to participate in our conference call. Today I'd like to speak to three areas of focus that are primary drivers as we work to increase shareholder value for the long term.

First is the execution of our transformation plan at the University of Phoenix. We'll update you there. Second is the diversification and growth through Apollo Global. And, third, efforts to further adjust our cost base and simplify our operations. I'm then going to turn the call over to Greg Iverson, our Chief Financial Officer, to review our first-quarter results.

Earlier this morning, we also released a statement that the Board of Directors has made a determination to pursue strategic alternatives. We won't be able to make any further comments at this time. As a consequence of that we will not be addressing the topic in our formal remarks.

Let me start with the University of Phoenix where we are taking dramatic steps in making meaningful progress to further enhance student outcomes and to provide outstanding career-relevant higher education for working adults. Given the magnitude and scope of the changes being made, there's been a negative impact on enrollment and revenue so far in FY16, but the actions the University is taking, we believe, will lead to better outcomes including increased retention, which we're seeing early signs of. Adapting quickly to this rapidly involving environment is best for our students and key to our long-term success.

I'll just share a brief update on a number of the concrete actions that we're taking at University of Phoenix to implement the transformation plan.

First, diagnostics and pathways -- in piloting a more rigorous diagnostic we're assessing the cognitive and academic foundation of our incoming students, and we're learning that students who take the diagnostics enroll and pass their first course at a higher rate.

Information gathered in the pilot is driving changes in the curriculum, course work, course sequencing, and resources to address skills gaps for our incoming students in an effort to increase their academic success and engagement. We still plan to implement our pre-enrollment diagnostic and admissions criteria this year across the entire University to help ensure we're enrolling students academically prepared for the rigors of a college degree program at the University of Phoenix.

Second, our programs -- the goal here is to reduce operational complexity and offer programs that are better aligned to direct job pathways. Our portfolio of associates programs has been reviewed to ensure they are aligned with existing industry credentials, as we adjust offerings and content to reflect feedback from employers. Nine associate degree programs were eliminated, and over 350 courses were refreshed during the first quarter.

We continue to review our offerings to spotlight existing quality programs, develop new certificate and degree programs, and eliminate others, as appropriate. We've added significant expertise within each college as it pertains to ensuring we better understand employers' needs across the industry specialties and align our programs accordingly.

Third, reducing course starts -- our objective is to improve student retention and generate cost savings through thoughtfully reducing the number of program starts and course frequency. This will have an impact on enrollments and revenue relating to adjustments in existing student schedules to align to the new cadence. We believe this change will result in better student retention and satisfaction with more optimal class sizes and fewer course cancellations. Early indications suggest these changes will improve first course pass rates and lower withdrawal rates.

Finally, related to marketing, we're taking a renewed approach, including the elimination of the use of the affiliate channel, in the first quarter. And we're focused on student fit, college-specific messaging, increasing employer awareness of our programs, and the redesign of our Phoenix.edu website. We're working to rebuild our reputation with meaningful options step by step. You'll see the implementation of our new marketing campaign later this quarter.

We believe these initiatives, along with our campus realignment and other actions we've taken previously, will form the foundation for a stronger University with higher completion rates and improved student satisfaction, and will support our goal to transform University of Phoenix to a more trusted, focused, higher retaining and lower complexity institution.

We continue to operate in a challenging regulatory environment. We've been responding to the Department of Defense's actions to put the University on probation for the department's tuition assistance program. We're working closely with the Department of Defense to be a good partner in the higher education of active duty military members and their families.

Let me be clear, Apollo and University of Phoenix have taken very strong actions over the past five years to dramatically improve student protections. The list is long, including the elimination of recruiter comp based on enrollment levels, one of the first to institute a student tuition and debt calculator, mandatory three weeks of student orientation for college newcomers -- that's prior to taking on student debt -- a risk-free period, eliminating third-party marketing affiliates. And that's just to name a few.

Our student loan default rates are significantly lower than just several years ago and now closing in on the national average. This organization has won the prestigious Ethisphere Compliance Verification Award to recognize our considerable ethics and compliance initiatives. And we remain committed to working with our regulators in order to drive the best compliance results possible while playing a very important role in the education and training for working learners throughout the country.

Next, let me quickly touch on Apollo Global which continues to expand into new geographies while growing organically, as well. We continue to build a worldwide presence for Apollo Global and I'm pleased to report every institution in Global is growing. We expect organic revenue to grow close to 20% for FY16 on a constant currency basis, and in excess of 20%, including our newest acquisition.

However, unlike prior years, Apollo Global is now cash flow positive. And as we further leverage our infrastructure we expect to deliver a minimum of $40 million of EBITDA in FY17. We're gaining economies of scale at global and are successfully collaborating across the institutions.

In December, we closed on the acquisition of Career Partner in Germany, a premium higher education platform which includes some of the most respected brands in businessman management, hospitality and tourism. The addition of CPG to Apollo Global allows us to expand our global network and is an opportunity to share best practices and build upon highly respected brands.

Now I'd like to discuss our commitment to operating excellence and efficiency throughout Apollo. Given the speed and scope of the transformation we're making at University of Phoenix, we think that it's prudent and necessary to ensure we continue to match our cost base with near-term revenue declines. There's no doubt that some of the initiatives we're taking are putting significant pressure on near-term enrollments, as I said before.

But, as I also said last quarter, we're willing to sacrifice near-term revenue for long-term success. Therefore, I asked our organization to collaborate and to work together to find additional efficiencies where it makes sense that will allow us the runway to get through the transformation at University of Phoenix while maintaining the financial health of Apollo. This is a very significant initiative and I'm pleased with our progress so far.

We are all committed and working together to the ongoing financial health of the organization going forward. As an side, we've hired a third-party firm with deep education industry expertise to both validate the plan and help ensure the cost structure is consistent with achieving the transformation plan and the University's vision and objectives.

Before I close I just want to quickly update you on an exciting development related to our B2B efforts. We're pleased to announce a new partnership with Genesis Rehabilitation Services, one of the nation's largest providers of rehabilitation services and a division of Genesis HealthCare, to develop scalable rehabilitation therapy training programs in China.

There's a strong need to meet China's growing therapy needs, as the second largest healthcare market in the world, and we're honored to support Genesis in their efforts to meet this need and prepare aspiring healthcare professionals. We'll have more information as this contract unfolds.

I'll now turn the call over to Greg Iverson.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Thanks, Greg. And good morning, everyone. To recap our consolidated results, revenue in the first quarter decreased 18% year over year to $586 million. We reported an operating loss for the first quarter of $45 million, which include goodwill impairment charges of $73 million, primarily representing the goodwill balance related to the University of Phoenix. This charge was not deductible for income tax purposes.

Excluding special items, operating income was $54 million. Net loss from continuing operations attributable to Apollo in the first quarter was $58 million or $0.53 per share. Excluding special items, income from continuing operations was $31 million or $0.29 per share.

Focusing first on the University of Phoenix revenue in the first quarter was $463 million with an operating loss of $18 million. Excluding special items, operating income was $73 million.

University of Phoenix enrolled 24,500 new students in the first quarter, down 38%. Total degreed enrollments was 176,900, a decrease of 22% year over year. Our first-quarter new degreed enrollments were adversely affected by the transition to our reduced number of course starts per month, which we believe will improve the classroom experience and optimize class size.

First-quarter revenue per student was flat year over year. This reflects the impact of our price adjustments last year, which was offset by an increase in student scholarship awards and the impact of the reduced number of class starts. Class starts during this transition period reduced the average weeks students attend class and therefore the revenue recognized in the quarter.

Discounts in the first quarter were 13% of revenue driven primarily by an increase in students receiving scholarships that reward progression toward graduation. We continue to expect discounts to be approximately 13% of revenue in 2016.

Moving on to Apollo Global, first-quarter revenue was $115 million with a reported operating loss of $2 million. Adjusting for depreciation and amortization and special items, Apollo Global's income was $8 million in the first quarter compared to $7 million in the prior year.

On a constant currency basis Apollo Global grew double digits in Q1 and we expect Global to grow in the mid 20's, including the impact of the acquisition of Career Partner. Excluding the impact of Career Partner, organic growth at Apollo Global is expected to be in the high teens, close to the 20% long-term growth rate expectation for Apollo Global. As stated in our last call, we expect the Career Partner acquisition to contribute approximately $8 million of EBITDA annualized for 2016.

Turning now to our operating expenses, in the first quarter, total operating expenses excluding special items decreased approximately $96 million or 15% year over year, primarily as a result of lower enrollments as well as continued reduction of our cost base. Our effective tax rate excluding special items for the first quarter was 43%. Excluding special items, and assuming the expected release of uncertain tax positions, we anticipate our effective tax rate to be about 47% for the full year.

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

With respect to the consolidated balance sheet and cash flows at quarter end, our cash and marketable securities were approximately $756 million and our outstanding debt was $43 million. Our liquidity, which includes our cash and marketable securities and available borrowings on our $625 million credit facility, was $1.32 billion. Free cash flow for the quarter was an outflow of $33 million or $11 million excluding restructuring payments.

Now I'd like to update you on our financial targets for 2016. Based on our current view we are targeting net revenue in the range of $2.14 billion to $2.18 billion. This range includes approximately $30 million of revenue for FY16 associated with the acquisition of Career Partner.

Finally, we are targeting $115 million of operating income for 2016 excluding special items. This will require additional cost savings and we are increasing our gross cost savings commitment for 2016 to $400 million.

Thank you. We will now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from the line of Peter Appert from Piper Jaffrey.

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

Thanks, good morning. Greg, I know you can't talk about the strategic review but I'm wondering just how you can help us understand the regulatory complexities of what you might have to think about in the context of the strategic review, and particularly the change of control rules and regulations.

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

Peter, I understand your question and your focus. We've said as much as we can say on the topic. I just can't comment further on that press release. And when we have additional comments we're going to make them. So, I appreciate that but we just can't comment further.

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

Okay. How about, is 150,000 still the number you're thinking about in terms of the year-end enrollment target?

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

Yes, I'll let Greg address that because we've been doing a lot of work on derisking the back half of the year and our targets and that to insure that we take out the appropriate amount of cost to align our cost base with potential revenue. So, Greg why don't you talk about that.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Peter, as Greg mentioned, we have derisked our revenue forecast for the remainder of the fiscal year. The revenue targets that we provided equate more closely with a ending enrollment in the 140,000 student range.

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

If you think of the number of initiatives that we're taking, fairly quickly, all in the fourth quarter of 2015, first quarter of 2016, we think they are extremely important, whether it's the diagnostics, the change in the start dates, the assessment on the front end, and many others, the taking out of the associate programs, the affiliate channels, all in the light of improving outcomes. And we believe those are going to want to work and we want to give them room to work, even though it's a lot to do all at once, so we can come out the other side as quickly as possible. We've looked at the whole year including going into next year and done what we thought we need to do so that we can get our cost basis in order, in order to prepare for that, to preserve our financial health.

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

Understood. And then, Greg, related to that, the DoD financial responsibility score, how big a risk is it that's something that could come to bite you in the context of some of these charges you're going to have to take?

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

Yes, it's a good question. I'll let Greg address that.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Historically we've had a very strong composite score ratio for the last several years. This year, with the goodwill impairment charge that we recorded related to University of Phoenix, it will reduce our composite score when reported at year end relative to where we've been at the past. But based on the financial projections that we outlined we still continue to believe that we have a reasonable level of cushion relative to the 1.5 threshold.

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

And if we needed to take further action there we would.

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

Got it. And just one last thing -- any programs you would call out, Greg, in terms of positives or negatives from an enrollment trend perspective?

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

I don't have that list of programs in front of me but there actually are. There's a number of areas within the University and the colleges that are seeing, particularly in areas of healthcare in certain areas of the country, and in IT, where we're seeing some good results. There's signs of retention, as I said, in first course and second course completion rates. So, there are some good green shoots here and we want to make sure that we see that through for the entire fiscal year.

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

Got it, great. Thank you.

Operator

Your next question comes from the line of Jeff Silber from BMO Capital Markets.

Jeff Silber - *BMO Capital Markets - Analyst*

Thank you so much. I'm apologizing in advance but I'm also going to ask a strategic alternatives question. I've had folks ask me, if you can't comment then why did you have to issue a press release? Was it something that your attorneys pushed you to do?

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

Jeff, what I can tell you is that the Company put out the statement it's going to put out. We've just said as much as we can say on the topics at this time. And, again, we'll have additional comments when we make them but this is what we can say at the time. I apologize.

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Jeff Silber - *BMO Capital Markets - Analyst*

Okay, I understand. Just moving back to fundamentals, you mentioned the reduction in class starts. Can you just talk about the order of magnitude what it was beforehand and what it is now?

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

Yes, sure. Greg do you want to take that?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

The biggest impacts from a financial perspective from the change in course starts we experienced in the first fiscal quarter, both from a new degreed enrollment standpoint as well as for our continuing students who adjusted from our previous weekly starts to the less frequent new course start cadence. So, we believe the majority of the financial impact was reflected in our Q1 results.

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

And, Jeff, think about the strategy behind that. Weekly starts are something that when you're dealing with hundreds and hundreds of thousands of people coming through, that were more appropriate for several years ago. But as the leadership of the University looks at the preparation of students that they want to have in working with them before they actually start the class, having a very healthy cohort, it makes everything less difficult and complex, and the preparation levels are higher. And we expect, and we're already seeing students doing better that are starting in those cohorts.

The whole premise of everything that we're doing taking this near-term pain is quickly as possible come out the other end. And this is something that the University leadership feels strongly will be a part of helping that.

Jeff Silber - *BMO Capital Markets - Analyst*

I understand that. My question was, I know you were doing weekly starts beforehand. Can you just remind us how often the starts are right now?

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

Sure. In most cases it's monthly; in some cases it's twice a month.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay. I just wanted to confirm that. Thanks so much. And then on the expense line items, I know you had alluded to the fact that there's potential for more cost cutting, but from a modeling perspective for the rest of the year is the first quarter the run rate we should use? Obviously I understand the seasonality in the business but beyond that, is that a good base for modeling the rest of the year?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

I think if you look at our Q1 expenses relative to the prior year, you'll note there's a disproportionate decrease in both our marketing expense and our admissions advisory expense. Those are reflective of some of the actions that we took in the fiscal year, most notably the exit of the affiliate channel. We will be experiencing reductions, I'd say, across the board in each of the different expense line items, but those are the two that were impacted on a disproportionate basis.

Jeff Silber - *BMO Capital Markets - Analyst*

Okay, great. That's very helpful. Thanks so much.

Operator

Your next question comes from the line of Denny Galindo from Morgan Stanley.

Denny Galindo - *Morgan Stanley - Analyst*

Hi, there. Just to comment on starts trends, your starts are down 38% this quarter. Is this the bottom or could it potentially get worse? What are your thoughts on what starts are looking like for the next quarter and maybe for the whole year?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Sure, Denny. Based on our current projections, based on a percentage decrease year over year, we are projecting that this current quarter is a tough period for enrollments, and we're expecting some moderating of that trend on a go-forward basis, with the exception of the second fiscal quarter which should be relatively in line with the first quarter.

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

And part of the thing that will be unfolding is a new pattern here, where you can imagine if you have less starts in certain periods over the last, call it, the holidays and December, how those classes build and form in January, February, and March with those new start patterns. We'll be providing an update on that on the next call.

Denny Galindo - *Morgan Stanley - Analyst*

Okay. And then the cash flow from operations was negative this quarter, which doesn't typically happen for you guys. Can you give us any thoughts on how the cash flow should develop over the next year, as well? I imagine you had some unusual expenses this particular quarter.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

We continue to project to have positive free cash flow for the full year. That's cash flow from operating activities minus capital expenditures. In the first quarter, as you noted, our free cash flow was negative, and that was principally the result of some uses of cash from working capital, principally in the accounts receivable, accrued liabilities, and restricted cash areas.

Denny Galindo - *Morgan Stanley - Analyst*

And then one other question just about Apollo Global, you have Germany now, you have BPP, Brazil, Mexico. Maybe you could talk about how much some of these assets use shared services in Apollo Global and how much are standalone managed at a country level.

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

They are sharing services and particularly in technology where they've built a really good capability there to help generate economies of scale. And they're sharing best practices in terms of what they're learning with new programs across the board. I would say that Apollo Global is not operating as standalone institutions, that one of the major keys for any institution that we identify there is a good fit in.

And any country that we think is a good fit, is to make sure that there are ways to share best practices, and that, as a whole, the network can scale better and generate more value than just being a number of standalone institutions. It was never designed that way when we designed it from the beginning, and that's the way we continue to run the organization.

Denny Galindo - *Morgan Stanley - Analyst*

That's it for me. Thanks, guys.

Operator

Your next question comes from the line of Paul Ginocchio from Deutsche Bank.

Paul Ginocchio - *Deutsche Bank - Analyst*

Greg, I don't think you're going to answer my question but I was just going to ask you about the timing of this announcement. It just seems odd that you're announcing it when your new enrollment declines are at their worst. Why wouldn't you have just waited until, if some of these initiatives you've just implemented in the last two quarters start to pay off, you'd be in a better position in a few quarters? It just seems a bit odd, the timing.

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

I understand your question and I've said what I can say about it. There's some language in the press release that's out this morning about the announcement, but I just can't say anything else about it. I do understand your question but I apologize.

Paul Ginocchio - *Deutsche Bank - Analyst*

Great. And then you talked about positive free cash flow. I think you said there was roughly, I think, $22 million of restructuring charges in the first quarter. Can you just talk about how much of the announced or planned restructuring for FY16 plus the stuff you've done in the past, what are the restructuring charges that run through FY16? And then what's the run-off into 2017, also?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Our current projections for restructuring charges, excluding the goodwill impairment for FY16, is in the neighborhood of $100 million.

Paul Ginocchio - *Deutsche Bank - Analyst*

I'm talking about cash through the cash flow statement.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Yes, our restructuring liability payments for FY16, we're modeling at the same level. That's going to be both a combination of cash payments on restructuring charges that we incurred in prior years along with cash payments associated with any 2016 actions.

Paul Ginocchio - *Deutsche Bank - Analyst*

And does that drop off significantly in FY17 or is it broadly similar?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

We're not providing outlook on FY17 at this time.

Paul Ginocchio - *Deutsche Bank - Analyst*

I was just trying to ask about stuff that's already been done, how the run-off. But, okay, thank you.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

I can tell you this information is generally in our 10-K, as well. The run-off cash payments associated with actions that we've announced to date in FY17 is quite a bit lower than that FY16 number I mentioned.

Paul Ginocchio - *Deutsche Bank - Analyst*

Thank you.

Operator

Your next question comes from the line of Sara Gubins from Bank of America.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Hi, good morning. First, on the enrollment expectation of ending the year at about 140,000 versus 150,000 previously, could you talk to us about what's different than what you expected last quarter, just to try to understand it in the context of whether or not there might be factors that could cause it to move down further over the course of the year?

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

We tried to account for that the best we could with the number of initiatives that are going on. But clearly looking at those initiatives and the rollout and the timing accounted for the change in the enrollment projection for the year. I'll let Greg comment, as well.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

As Greg mentioned, what we've tried to do is really derisk our plan for the back half of the year. Also, as Greg mentioned, there's so many things that are going on within the University, including the rollout of a new marketing campaign. So, if you look at the financial factors that bridge between the past outlook and what I mentioned earlier in terms of enrollment in the 140,000 range, it's a combination of lower new degreed enrollment assumptions, especially at the very end of FY16, as well as the remaining effects of the course frequency change.

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

And we're using these numbers, again, to set our cost basis for the remainder of the year and going into 2017, and if they outperform those enrollment levels then we'll all be happy.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay, great. And then the persistence trends, that improvement that you saw this past quarter, do you think we should continue to see improving trends? And could we see positive year-over-year movement in persistence? Presumably at some point, but when would you expect to see it?

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

We would be disappointed if we didn't see those trends continue. That's the basis for taking all of these significant initiatives. We realize that it takes time for that to play through. And some of the things, some of these initiatives students are just getting through their first couple courses. So, as we see three-course and fourth-course completions we'll have a much better data of the magnitude of the follow through. That will be very helpful into the spring to provide you more data on that. But it is the whole reason that we're taking these steps.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Any way to help us think about the magnitude that you've incorporated into your revenue expectations?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Yes, we have assumed some improvements in calculated persistence, really student retention, through the back half of the year as a result of all the actions that the University is undertaking. Going back to a previous question around our outlook, I think we've risk-adjusted those assumptions somewhat. But it's our plan and our belief that we will see some positive trends in our persistence rates going forward.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. The $400 million of cost cutting, that's the active cost cutting and then presumably there's more given the variable nature of student base coming down? Or is that $400 million the total?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

$400 million is the total. That's all-in including fixed and variable.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Okay. And then, last, could you talk a bit more about what's driving the strong organic growth at Global? And I'm sure it varies quite a bit by school and market but I'm wondering if it's more marketing initiatives, new programs, new campus openings, particular markets that are performing better or worse than others.

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

It's a combination of things, Sara. We've acquired really good institutions who have only improved their ability to offer new programs and their accreditation standards and their most trusted status. They've gotten out ahead of the ball with certain changes, moving to online in certain programs, like in BPP where the whole industry changed in the PQ business and they were ahead of that.

A lot of the institutions that they're working with have gotten out ahead of the B2B trends, as well. So, if you think about the University of Phoenix it was built really B2C, with some business relationships as well, a lot of people already working. Some of the institutions in Global are very actively working on business relationships and B2B relationships, knowing that the consumer will follow as they build as they build this.

I'll just give you an example. BPP in the law school, they have over 50 exclusive agreements with the top law firms in the country. They have just excellent relationships with businesses. They continue to build those. They're networking together. And it's working, it's driving organic growth.

Is everything perfect in every country? No, it's never going to be there. We are always going to be dealing with opportunities to improve and excel in certain countries. But as a whole, the management is doing an excellent job of working with each other across the board, building scale and improving institutions, while sharing best practices. We like what we're seeing right now.

Sara Gubins - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Your next question comes from the line of Corey Greendale from First Analysis.

Corey Greendale - *First Analysis Securities - Analyst*

Hi, good morning. Just a couple quick ones. First, again, sorry to go back to the thing you're not commenting on, but I just had a factual question I was hoping you could answer. I believe that a change in control could happen just with a purchase of the Class B shares without anything happening to the Class A. Is that correct?

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

I just can't comment on it. I'm sorry about that. There was a separate release put out on it from the Board and I apologize that I don't have that information to comment on it.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. And then on the fundamentals, a flip side question of what Sara asked, Global is doing well but I think it did slow somewhat the growth from last quarter on a constant currency basis. Can you just comment on that and whether there's anything specific going on there and whether you expect that should reverse the next quarter?

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

Yes, that's a great question and, yes, there are some timing issues. Greg, why don't you talk about that.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

The two things I'd call out, one is, if you look at Apollo Global's results on the first quarter on a year-over-year basis, there was pretty significant revenue impacts from foreign currency. I think if you look at the delta caused by foreign currency it's in the ballpark of $13 million.

And the other thing that we experienced in the first fiscal quarter relates to BPP. Part of BPP's business is in the accountancy training space. There's two key credentials there, ACCA and CMA. Both of the bodies that oversee those exams have moved from two exam sittings per year to between four and six exam sittings per year.

Historically BPP has had a lot of this exam prep revenue in the first fiscal quarter, and highly seasonal, as you can imagine, with just two exam sittings a year. Beginning this year and on a go-forward basis we would expect to see less seasonality in the BPP business across those two line items.

Corey Greendale - *First Analysis Securities - Analyst*

Okay. And then just one other quick one -- it sounds like moving to mostly monthly starts has been largely, by and large, positive. Have you seen any negative impact on the show rate that was the one potential negative I saw about change?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

No. From an operational standpoint, I think it's been a smooth rollout and we've seen some nice positive benefits.

Corey Greendale - *First Analysis Securities - Analyst*

Okay, great. That's all I had. Thanks.

Operator

Your next question comes from the line of Trace Urdan from Credit Suisse.

Trace Urdan - *Credit Suisse - Analyst*

Hi, good morning. I wanted to go back one more time, if I could, and maybe press Greg Iverson a little bit on the impact of the change in starts. Is there any way that you can help quantify a little bit more than you have? I know that you stated you thought the majority of the impact was contained in Q1 but either in terms of the percentage of the impact on the year that's contained in Q1, or maybe even just something more granular like how many starts you feel were impacted relative to the prior year, just to help us frame how much of what we're looking at is what's happening in the market and how much of it is the result of these changes that you're making to your business.

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

Yes, we'll do our best here.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Sure. The impact in the first quarter was meaningful. So, all of the new students coming into the University who would have potentially started on a weekly basis now were delayed, delayed their enrollment. So, that had an impact. And then also, as we mentioned, for the existing students it certainly had an impact on them, as well. Our estimates around the new degreed enrollment in the first fiscal quarter as a result of the rollout is about 1,700 students.

Trace Urdan - *Credit Suisse - Analyst*

Okay, that's very helpful. And then a comparable question related to the Department of Defense probation, I know it's not going to be nearly as material but can you help us think about that as well?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Sure. What we discussed in the past call and I think also in public releases is that the students who were impacted by the DoD probation status, we would expect to have an impact on our revenue of less than 1%.

Trace Urdan - *Credit Suisse - Analyst*

Yes, I was more concerned about just the actual numbers of enrollments. Can you comment on that? The reason I ask is because the impact on a percentage basis, you have guys throwing out that 38% decline number. A relatively small number of students can impact that percentage number more than the relatively minimal impact on your revenue. So, that's the point of my asking. I want to understand how many percentage points, if any, is it worth in terms of that.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

Yes, it's a good question. And, as you probably know, those students who are part of the Department of Defense tuition assistance program pay a significantly lower tuition rate. It's a 250 credit level. So, you're absolutely right that less than 1% of revenue does equate to a disproportionately large number of students just based on the much lower tuition rate.

Trace Urdan - *Credit Suisse - Analyst*

Okay, I'll let you off the hook for that. And then the other question I had was, you guys report, in your release you talked to us about the operating income of the business units. Obviously there's some one-time expenses that are attached to the University of Phoenix and I was wondering if it was possible to quantify that. It looks like, if you add back 100% to the University of Phoenix, that we actually saw UOP margins expand year over year in the first quarter, and I'm wondering if I'm off base in thinking that or whether you can comment on that.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

If you look back in the earnings release toward the end, we do have segment EBITDA for the different business units, including University of Phoenix. Hopefully that's helpful to see that level of detail excluding the restructuring charges.

Trace Urdan - *Credit Suisse - Analyst*

Okay. I was looking at the operating income but I'll take another look. Sorry about that. And then the final question, a little bit more esoteric, but, Greg Cappelli, when you guys have this pathway recommendation that's leading people to better outcomes, at least that you're seeing initially, how many different options are we talking about? How much complexity is involved in recasting the course progression that the students are taking that are having this impact? Are we just really talking about one or two or three different changes that you recommend that they make relative to what you might have seen otherwise?

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

The University and management is doing everything they can to make the institution less complex. It was very complex. It had gotten very big, many programs. And so the pathways -- and, again, it's been brought up, the negative 38%, yes, a lot of that is from the very significant steps that we're taking to try to get through this as quickly as possible. But to your point, Trace, one of the things that we're trying to do is make it less complex along the way.

The way I would answer that is management of Phoenix is looking at that and just trying to get a clear idea of where you should be. So, if you should be starting in a certain cohort at a certain level, with certain types of students at the University of Phoenix, they're going to put you in that. They have so much more information about you.

It's not easy, always, taking the assessment in these pilots, but they're gathering the information. It's just a few different options but it's to give you the best chance. Some of those students will come back to the University after they've done the preparation that they need. We know that.

It's to provide the person with the best opportunity and the most honest assessment for their well-being. And we feel that if we do that they're going to end up in a great place or back at the University when it's appropriate.

Trace Urdan - *Credit Suisse - Analyst*

Okay. Last call I think Jeff asked you and you answered it and it was very helpful, you talked about maybe sending somebody to a community college, for example, and recommending they take some courses and come back. I think as an alternative pathway to better prepare them, that makes a lot of sense.

My question was more to do -- you seem to be implying that -- and maybe I got this wrong -- but you seem to be implying that for the students that are starting, you're making recommendations to them about different things that they could be doing. Is that not the case? Are we just talking about screening better at the front?

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

I'm talking about after the assessment but before starting, is the recommendation of where they should be, and cohorting students better so they have a better experience with the level of student that they're with in the classroom. Those are things that they're working on. So, I'm sorry, Trace, it's pre actually starting.

Trace Urdan - *Credit Suisse - Analyst*

No, I was just trying to get a little bit more of a feel for exactly what we're talking about and making it a little bit less abstract. So, you're saying that basically some of the students might, for example, require more remedial preparation in math, so they would be put together with other students that have that same need and they would be in that cohort. Is that what you're talking about? I'm just trying to get a feel for what we're describing here.

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

Sure. The admissions and the pathways have not been completely implemented. That's what these pilots are for. They are determining the cut scores for the products. There's really three paths. There's advanced, there's standard and there's something like go to a community college? So, it's not meant to be very complex. It's supposed to be straightforward, less complex, but very clear to the individual. And they're really doing some great work there with the data that they're getting back.

Trace Urdan - *Credit Suisse - Analyst*

And, sorry, last question -- when can we expect that this process will be fully worked out and implemented? It sounds like you're still figuring things out.

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

And these have been big pilots, with a lot of impact, so I don't want to imply that they haven't. We've given out some data on that in the past. In some cases where it's affected 20% of the starts or more, that has a bigger impact than if you think about dealing with the funnel of students coming in, because some are choosing not to take the diagnostic at all, which tells you something about the student's commitment there, as well.

But there's going to be major work done throughout this fiscal year. I think going into 2017 we'll be in a great place where things will be humming along more complete. But they want to get it really right. And to their credit at the University of Phoenix, they are piloting making changes, piloting getting data, making adjustments. And it's just getting better and better, so a lot of credit goes. The team is putting in a lot of work and they want to do it the right way.

If this were about trying to make sure that we're at a certain enrollment level every quarter, then it would be a different story, but we're not doing that. We want the best outcomes and we want the transformation to go as soon as possible despite the near-term consequences. And that's why we have to manage our costs. We have to give ourselves that runway so we can get through this.

Trace Urdan - *Credit Suisse - Analyst*

Okay, thanks, Greg.

Operator

Your last question comes from the line of Jeff Mueller.

Jeff Mueller - - *Analyst*

Yes, thank you. Can you just give us a refresher on the ownership of the voting shares? I think there was a Form 4 about a collateral call on some shares to fulfill a loan, but I don't recall if those are voting shares or not. So, any refresher you could give us on the voting stock ownership.

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

Jeff, I'm sorry, I don't have that information in front of me. I do recall obviously the filing there. I just don't have any further data. I think those were A shares, but I don't have that. I'm pretty sure they were, actually. But I can research that a little bit for you. But that was all disclosed in a prior filing. I'm sure those were A shares.

Jeff Mueller - - *Analyst*

Okay. And then the $40 million minimum EBITDA target for Global in 2017, is that inclusive or exclusive of the contribution from the German acquisition?

Greg Iverson - *Apollo Education Group, Inc. - CFO*

That is inclusive. So, now that we've included the partial year results for Career Partner, we're expecting EBITDA for 2016 to be in excess of $40 million now for FY16.

Jeff Mueller - *- Analyst*

Okay. And then can you give us a sense of the breadth of profitability in Global? You've done a few acquisitions of Germany and open colleges that have been profitable, and then you're improving BPP. So, just any way you can frame up the breadth of the profitability. Is it concentrated in just a few institutions or is it pretty broad?

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

It's a great question. Profitability matters a lot to us in Global. There are some things, when we look at valuing the organization and creating long-term value, where local accounting revenue rack and things like that are different than we convert to in the US. So, we will follow that very clearly in the US. But that's why we look at EBITDA and cash, because that to us is the ultimate barometer for creating value. And I'll let Greg speak to that a little bit more.

Greg Iverson - *Apollo Education Group, Inc. - CFO*

First I want to just correct something I said to answer your last question. That $40 million of EBITDA obviously refers to FY17, not to FY16.

But with regard to the composition of Apollo Global, as we've said in the past, BPP is more than half of the revenue of Apollo Global, so it's clearly the largest institution. It's one of the institutions we've owned for the longest period of time. We are seeing some very significant -- or starting to see some revenue growth there and also, importantly, some better leveraging of our fixed cost base.

We are seeing, as Greg mentioned, revenue gains in each of the different business units. But, to your point, just given BPP's size relative to the whole Apollo Global portfolio, we definitely see a disproportionate amount of our EBITDA, both this year and next year.

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

They've been through the transformation. The management has done an incredible job going through a very tough market there, 2009, 2010, 2011, taking the necessary steps, transforming, doing what they need to do, in a similar way to what's going on here to get improved relationships, outcomes, status. And it's working so their profitability has moved up nicely. They addressed the costs early on, which wasn't easy.

I will say this too, Jeff, that when you look at certain institutions around the globe, some are making some meaningful investments. If we're opening up a number of new locations in Mexico, that's going to have an impact. Or if we're investing in Brazil or in open colleges, that's going to have an impact.

But we look at all that closely, we look at returns and incremental invested capital. We care very much about measuring the near-term results but also the long-term value that can be created. That's how we assess the level of investment and the offset to profitability near term. Does that help?

Jeff Mueller - *- Analyst*

It does. And then just one more for me. On Global, I just want to make sure I have it right. I think that it was 20% organic constant currency growth last year. That's also the five-year long-term target. But you're saying dipping down maybe to the high teens this year. I know it's not a big change but the only factors I heard were BPP timing and FX. Is there anything worth calling out that's potentially driving a bit of deceleration in Global organic constant currency this year?

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

Not really. There's nothing that stands out. Whether it's high teens or 20% it's going to be -- call it 15% to 20% -- it's going to be in a range, depending upon the timing and level of investments. But I don't see anything as I look across the organization to point to, other than the timing of things that Greg mentioned like the change in the number of times you can take exams and tests and things like that at BPP. If there is something that's more meaningful we'll call it out going forward.

Jeff Mueller - - *Analyst*

Fair enough. Thank you, guys.

Operator

As there are no further questions on the phone lines at this time, I would now turn the call back to Greg Cappelli.

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

Thank you so much, everybody for listening this morning and for your understanding. And we'll look forward to following up and talking to you again soon. Take care.

Operator

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